THE TAX INSTITUTE
AT H&R BLOCK

THE AFFORDABLE CARE ACT:

2014 Tax Filing Impacts

February 2015

© 2015 The Tax Institute at H&R Block

ABOUT THE TAX INSTITUTE AT H&R BLOCK

The Tax Institute (TTI) is H&R Block's expert tax research and analysis group. TTI is staffed by tax experts, including CPAs, enrolled agents, and tax attorneys, with a broad range of expertise. TTI specializes in objective research, analysis and interpretation of federal and state tax laws affecting individual and small business taxpayers. TTI regularly conducts tax research and analysis to provide insights to tax practitioners, tax policy experts, media, and industry. These insights focus on consumer and tax-administration impacts rather than the merits of or rationale for a given tax policy.

STAFF ACKNOWLEDGEMENTS

The following staff made key contributions to this report: Jackie Perlman, Lindsey Buchholz and Jayme White.

CONTACT INFORMATION

mediadesk@hrblock.com
(816) 854-4287
@HRBlockNews

www.newsroom.hrblock.com

I. Introduction

The Patient Protection and Affordable Care Act (ACA) contains not only the most significant reforms the American health care system has seen in decades, but also some of the largest changes to the tax code. It requires all taxpayers to obtain health insurance or face a tax penalty. Beginning with 2014 tax returns (filed in 2015), all tax filers will experience this new intersection between health insurance and taxes through new filing requirements.

Many experts who study ACA tend to see households in black-and-white terms: either fully covered or uninsured. However, H&R Block conducted a survey in August 2014 that revealed a much more complex reality: Almost half of affected households had much more complicated and inconsistent coverage situations.

In fact, the survey found that only half of households were covered under the same health plan, with many experiencing coverage changes throughout the year. That means many households will face multiple tax return impacts.

The survey also exposed widespread consumer confusion about the law. Many are overwhelmed by the abundance of information – and sometimes misinformation – in the media. In addition, many taxpayers who enrolled in coverage through the health insurance Marketplace and received advance tax credit payments did not understand they had received government assistance.

Virtually everyone surveyed was confused about the tax credit reconciliation process, and many taxpayers without minimum essential coverage didn't understand penalty calculations, the exemption process or tax form filing requirements.

This paper summarizes how ACA tax law changes are being implemented through tax forms and illustrates these changes using real-world scenarios.

II. Summary of Form Changes & New Forms for 2014 Tax Returns

The following is an overview of form changes, additions, and new requirements for 2014 returns.

Form 1040 series

On 2014 returns, all filers – insured and uninsured – are asked about their insurance coverage status on the Form 1040 series of returns. Form 1040 and Form 1040-A now require taxpayers to report:

- Insurance coverage status for 2014, and
- Tax penalty and exemption information, if uninsured, or
- Premium tax credit information, if advance payments of the premium tax credit were received, or
- Some combination of the above.

Filers will report insurance coverage status by checking a box for "Full-year coverage" on line 61 of Form 1040, line 38 of Form 1040-A, and Line 11 of Form 1040-EZ.

These same lines are used to report the tax penalty for being uninsured, although the actual penalty calculation is done on a worksheet provided in the instructions to Form 8965 (see below).

Form 1040-EZ cannot be used to report premium tax credit information. Taxpayers claiming or reconciling this credit must file a Form 1040 or 1040-A and attach Form 8962 (see below).

Note: Taxpayers whose income is below the filing threshold are not required to file a return just to claim an exemption. However, filers who received advance tax credits through the Marketplace in 2014 must file a 2014 tax return, even if they do not otherwise have a filing requirement.

Form 1095-A, *Health Insurance Marketplace Statement*

Beginning with the 2015 tax season, all individuals who enrolled in a qualified health plan through the Marketplace will receive a critical new information statement, Form 1095-A. This form provides coverage information for each member of the taxpayer's household, and information about any advance premium tax credits paid directly to an insurance company.

Form 8962, *Premium Tax Credit*

Taxpayers who enrolled in a federal or state Marketplace plan and received advance payments of the premium tax credit must file a Form 8962.

On this form, taxpayers:

- List monthly (or annual, in some cases) payment amounts sent to their insurance company as reported on Form 1095-A, and
- Reconcile the total amount of premium tax credit they were eligible to receive for the year.

Note: Taxpayers who qualify for the premium tax credit but did not receive it in advance will also use this form to claim the credit.

Reconciling advance payments of the premium tax credit

The reconciliation process "settles up" any credit the taxpayer received in advance with the amount the taxpayer was actually eligible to receive for the year. This is necessary because advance payment amounts are based on *projected* income, filing status and family size at the time of enrollment in a Marketplace plan. The actual amount taxpayers are eligible for is calculated based on their actual circumstances at the end of the year.

Reconciliation involves four steps:

1. Determine the total premium tax credit amount the household was entitled to, based on modified adjusted gross income on the tax return.
2. Compare this amount with the advance payments received by the household, which is listed on Form 1095-A.
3. Determine whether full repayment is required for any excess advance premium tax credit received.
4. Adjust the tax refund or taxes due based on any additional credit due or amount that must be repaid.

NOTE: For taxpayers who must repay some or all of the premium tax credit back to the government and whose household income is less than 400 percent of the federal poverty level (FPL), there is a cap on the repayment amount based on the household's filing status. Households whose income is 400 percent or more of the FPL must pay back the entire premium tax credit they received.

This reconciliation process can be more complex for some taxpayers. For instance:

- There are specific allocation methods for spreading the premium tax credit across separate tax filing households, as in the case of couples who divorce during the year.
- There is an alternative calculation process for reducing repayment amounts for taxpayers who got married during the year.
- A special approach is required for filers whose household makeup changed during the year and who didn't notify the Marketplace of the change. For example, this would apply to a taxpayer who expected to claim a dependent, but couldn't, because the dependent was claimed by someone else or didn't qualify as a dependent at all. Additional calculations are necessary; also, information on the Form 1095-A issued to one taxpayer in this type of situation may need to be included on the return of another taxpayer who is not on the Form 1095-A at all.

Taxpayers who received an advance premium tax credit but do not file a Form 8962 may be barred from receiving premium tax credits in future years.

Form 8965, *Health Coverage Exemptions*

Taxpayers who are uninsured must use this form and, in some cases, accompanying worksheets to determine and claim partial or full exemptions from the penalty.

Calculation of the tax penalty

The calculation of the penalty amount is contained in a worksheet included in the instructions to Form 8965. However, unless an exemption is involved for part of the year, as well, the taxpayer would not attach Form 8965 to the return.

There are two methods of penalty calculation: flat fee and percentage of income. While most taxpayers are aware of the $95 flat fee for 2014 returns, the percentage method is less well-known and may end up with a higher penalty amount.

The flat fee is $95 per uninsured adult ($47.50 per uninsured child under 18), capped at $285. The percentage is 1% of household income, less the filing threshold, regardless of how many in the household were uninsured. For example, under the flat-fee calculation, a married couple who was uninsured for all of 2014, with one dependent over 17 and household income of $70,000 would have a flat-fee penalty of $285. However, under the percentage method, the calculated penalty is almost $500 ($70,000 - $20,300 filing threshold x 1%).

The penalty is the higher outcome of the two calculation methods. The maximum penalty is capped at the cost of a national average premium for an applicable bronze level plan. This is currently about $2,448 annually for each individual who is uninsured the whole year.

Claiming an exemption

There are nearly three dozen exemptions, and each one has different qualification requirements. There are two broad exemption categories:

1. **Exemptions that can be claimed directly on the return:** These cover a wide range of circumstances, including unaffordability, short-term coverage gaps, limited health benefits from government programs, U.S. immigration status and certain group affiliations, such as Indian tribes. Also, as explained above, taxpayers with income under the filing threshold for their filing status qualify for an automatic exemption. Individuals in this category do not have to file, but may do so to claim refundable credits such as the EITC.
2. **Exemptions that require a separate Marketplace application:** Generally, households that are members of particular religious sects, or those that experienced one of many financial, family, or personal hardships may qualify for a Marketplace exemption.

Marketplace exemption process

To apply for a Marketplace exemption, taxpayers must fill out a paper application and attach specific documentation, such as eviction notices or medical expenses for certain hardship exemptions. If the Marketplace approves the application, the applying household would then receive a letter containing a specific exemption certificate number (ECN) for each member of the household who needs the exemption. This number then must be recorded on Form 8965 and filed with the tax return for the filer to claim the Marketplace exemption.

Ideally, taxpayers will have completed the Marketplace application process ahead of time, and will be prepared with the ECN at tax time.

However, the reality of the Marketplace exemption application process presents several issues from a consumer standpoint:

- Households that experienced hardships may not be aware of exemption availability and the application process.
- The application is done by paper, and the taxpayer must attach specific documentation.
- Hardship exemptions are not permanent, so taxpayers must reapply for this exemption every year.
- Hardship exemption categories are subject to change each year, so some may no longer be available for future years.

Taxpayers who do not have an ECN when they file their tax return can file their return without one. They would indicate the ECN is “pending,” but must then submit an exemption application to the Marketplace. This process is intended to give taxpayers access to their refunds without having to wait for the Marketplace to process the exemption application.

III. Tax impact scenarios

The following scenarios demonstrate the impacts that taxpayers will face this 2015 filing season. While there are many fact pattern variations and complications that can occur, these scenarios seek to illustrate the typical range of ACA situations that taxpayers are likely to encounter when preparing and filing their 2014 tax returns.

Scenario 1: Employer-sponsored insurance for 2014

Dan and Judy Blue are married with four children and file a Form 1040. Dan was employed at a large business for all of 2014, and his employer provides health insurance for him and his family. During tax prep, the Blues' tax professional asked whether everyone in their tax household had health insurance coverage for 2014. Dan answered yes, but was confused about why his tax professional asked him about insurance coverage.

The Blues asked whether they needed to show the tax professional their insurance policy documents. The tax professional said that they did not, but that next year, they would need to bring Form 1095-C, *Employer-Provided Health Insurance Offer and Coverage*, which will be issued by Dan's employer.

For 2014, because all of the Blues had insurance for all of 2014, Dan and Judy would check the box "Full-year coverage" box on Form 1040, line 61.

Scenario 2: Marketplace insurance with advance payments of the premium tax credit

Mark and Lucy Green filed a Form 1040-EZ for 2013 and received a refund. They enrolled in a health insurance Marketplace plan in March 2014. When the Greens enrolled, Mark was the sole earner in the household, and the couple estimated that their household income was $38,775. Based on the Greens' projected income, the health insurance Marketplace determined that the Greens qualified for an advance premium tax credit of $2,772, which reduced their monthly insurance premiums. The Greens were happy to find a silver-level plan that cost only $261 out of pocket per month.

Because the credit was paid directly to the Greens' health plan provider, the couple didn't realize that they had received a tax credit. In January 2015, the Greens received a Form 1095-A from a health insurance Marketplace that indicated they had received an advance premium tax credit. The Greens were not sure what to make of it.

The Greens sought help from a tax professional, who said that because they received the advance premium tax credit, they would need to reconcile the amount of the advance premium tax credit they received (based on estimated household income) with the actual amount of the premium tax credit they were eligible to receive in 2014 (based on their actual income).

The Greens' year-end household income ended up being higher than estimated, at $46,530, because Lucy got a part-time job in May. With the higher-than-projected household income, the Greens qualified for a premium tax credit of only $1,476. As a result, the Greens owe $1,296 ($2,772-$1,476) to the government, which they may need to pay out of pocket if their expected refund does not cover this amount.

Note: The Greens' household income is 300% of the FPL for a family of two, so any payback amount would be limited to $2,500. Because the excess in this instance is less than that amount, they would have to pay back the entire $1,296.

Because the Greens must file Form 8962 with their tax return to reconcile the tax credit, they can no longer use Form 1040-EZ and must now file Form 1040-A.

Note: Depending on when the Greens enrolled in March 2014, their insurance coverage would not begin until April 1 or May 1. However, they would still qualify for an exemption for the uncovered months because they had insurance by May 1. They must also file Form 8965 to claim this exemption.

Scenario 3: Tax penalty for being uninsured

Clyde Mason is an independent contractor and was uninsured in 2014. His spouse, Vicki, is covered under her employer's plan. Together, the Masons' household income is about $65,000. Even though Clyde had heard about the "individual mandate," he did not believe the government would enforce it, and if it did, he thought he would have to pay only $95.

The Masons filed a Form 1040 in 2013. When the Masons got their 2014 taxes prepared, they learned that because Clyde was uninsured for 2014 and did not qualify for any exemptions, he would have to pay a tax penalty, reported on Form 1040, line 61. Clyde was surprised that he would have to pay, and even more surprised when he learned that the tax penalty would be $447, calculated using the percentage-of-income method, which he had not heard of (($65,000-$20,300) x 1%) versus $95 ($95 x 1). The Masons' tax professional informed them that the tax penalty would be subtracted from the tax refund they were otherwise expecting.

The Masons' tax professional also said that if Clyde continues to be uninsured in 2015, next year, his tax penalty would be $888 (($65,000-20,600) x 2%).

Scenario 4: Marketplace exemption from the tax penalty for being uninsured

Trisha is an uninsured head-of-household filer who has two children covered by the government's children's health insurance program, or CHIP. In 2014, Trisha experienced financial difficulties, and was repeatedly evicted from her rental apartments. Trisha makes $28,000 a year, but feels she cannot afford health coverage even though she qualifies for the advance premium tax credit.

Trisha's tax professional indicated that because Trisha was uninsured for 2014, she may be subject to a tax penalty of $150 (($28,000 - $13,050) x 1%). Trisha was surprised, because she could not afford health insurance premiums.

The tax professional investigated further to determine whether Trisha qualified for any tax return penalty exemptions, but she did not. After asking more questions about Trisha's situation, her tax professional determined that Trisha may qualify for a Marketplace hardship exemption because of the evictions, but that it would require Trisha to submit an application to the Marketplace to receive the exemption. Trisha's tax professional also reminded her that she would need to attach copies of her eviction notices when she sends in the exemption application form.

Trisha's tax professional will complete Part I of Form 8965, showing "pending" in the exemption certificate number (ECN) area, and file it with her Form 1040-EZ. Trisha should be advised to submit the completed hardship application, along with appropriate documentation, as soon as possible. If the hardship exemption does not apply for the entire year, Trisha may have to pay a penalty for part of the year.

Scenario 5: Tax return exemption from the tax penalty for being uninsured

Michael and Tina Alvarez have a household income of about $23,000. They have two children and live in Texas, which is a non-expansion Medicaid state. Michael and Tina are uninsured. Their two children receive coverage assistance from the government's children's health insurance program, or CHIP.

At tax time, the Alvarez family's tax professional indicated that because the adults in the household were uninsured for 2014, they could face a $190 tax penalty. After some more research, however, their tax professional said that the family qualified to receive a penalty exemption on their tax return. They qualified because they live in a non-expansion state and thus are in the so-called "Medicaid donut hole," meaning that their income is too high for "regular" Medicaid but too low to receive premium tax credits. The Alvarez family would file a Form 1040-EZ, as they have in the past, and attach Form 8965 to claim the exemption.

Scenarios for specific tax return exemptions

Scenario 6A: Exemption for household income below the filing requirement

Arthur and Lily Miller file a joint return and claim their son, Louis, as a dependent. Art and Lily's combined wages are $20,000, and they have no other income. Louis is a high school senior. He earned $3,500 from his after-school job and has no other income. The family did not have health insurance during 2014.

The Millers' tax professional investigated whether the family qualified for an exemption from the tax penalty for being uninsured, based on household income below the filing threshold. For this exemption, household income is defined as the modified adjusted gross income (MAGI) of the taxpayer and the taxpayer's spouse. It also includes the MAGI of dependents claimed on the taxpayer's return – but only if they have a tax return filing requirement. MAGI for this purpose consists of adjusted gross income, plus tax-exempt interest and excluded foreign earned income.

The Millers' tax professional explained that, under the filing rules for dependents, Louis is not required to file a tax return, and so his MAGI is not included in household income.

Because the family's household income is less than the $20,300 filing threshold for joint filers, the Millers qualify for an exemption from the tax penalty.

Because Art and Lily do not have a filing requirement, they do not have to file a tax return just to claim the exemption. They may wish to file to claim the Earned Income Tax Credit, for example. If so, they would claim the exemption on Form 8965 and include the form with their tax return.

Scenario 6B: Exemption for gross income below the filing requirement

In the scenario above, suppose that Louis' earned income was $6,500. Under the filing rules for dependents, Louis would be required to file a tax return and, therefore, his MAGI would be included in household income. In that case, the family's household income of $26,500 ($20,000 + $6,500) would be more than the filing threshold of $20,300, and the family would not qualify for an exemption based on household income below the filing requirement.

However, because Art and Lily's combined *gross income* of $20,000 is under the $20,300 filing threshold, they would qualify for an exemption based on gross income below the filing requirement.

Because Art and Lily do not have a filing requirement, they do not have to file a tax return just to claim the exemption. They may wish to file to claim the Earned Income Tax Credit, for example. If so, they would claim the exemption on Form 8965 and include the form with their tax return.

Note: Depending on family make-up and types of income, a taxpayer may qualify for either the household income exemption or the gross income exemption (or both) in scenarios 6A and 6B. Gross income, for this exemption, is not simply the total of the amounts in the income section of Form 1040. In addition to wages, interest and dividends, taxable pension distributions, and other amounts shown on page 1 of the tax return, gross income also includes:

- Capital gains not reduced by capital losses
- Gain from the sale of a residence, whether or not excludable
- Gross income from a sole proprietorship or farm business

Scenario 7: Employer affordability exemption

John and Amanda Smith are married with three young children. All family members were uninsured for all of 2014. The Smiths' 2014 household income is $60,000. The Smiths had several insurance options during the year that they considered too expensive. They sought help from their tax professional to figure out whether they qualified for an exemption based on unaffordable coverage options.

In 2014, John's employer offered self-only coverage for $300 a month, and full family coverage for $1,100 a month. Amanda's employer offered self-only coverage for $380 a month, and self-plus-dependent coverage for $800 a month.

The Smiths' tax professional explained that a family member would be considered to have unaffordable coverage if the lowest-cost employer premium that would cover the family member is more than 8% of household income. In this case, the Smiths' affordability threshold is $4,800 ($60,000 household income × 8%).

First, the tax professional determined whether John's and Amanda's respective employer-provided self-only coverage was unaffordable for each of them:

- John's total annual premium of $3,600 ($300 × 12 months) is less than the $4,800 affordability threshold, so John had affordable self-only coverage.
- Likewise, Amanda's annual premium of $4,560 ($380 × 12 months) is less than the $4,800 threshold, so she had affordable self-only coverage, as well.

Therefore, neither John nor Amanda qualifies for the affordability exemption.

Next, the Smiths' tax professional determined whether the lowest-cost family policy was unaffordable for the Smiths' three children, who would be eligible for coverage under their parents' employer-provided family-coverage plans.

The lowest-cost family policy was Amanda's employer-provided plan that would cover Amanda and her children. The plan cost $800 a month. The annual premium of $9,600 ($800 × 12 months) is more than the $4,800 threshold and, consequently, the employer coverage for the children is unaffordable.

That means that the Smiths' three children qualify for the affordability exemption, but not Amanda or John.

Because John's and Amanda's respective self-only coverage offered through their employers was affordable, and the cost of family coverage was unaffordable, the Smiths' tax professional needed to determine whether the combined premiums for John's and Amanda's self-only coverage were unaffordable.

The combined cost of the two self-only premiums is $8,160 ($4,800 + $4,560), which is above the Smiths' $4,800 affordability threshold. Therefore, John and Amanda qualify for an exemption based on unaffordable aggregate premiums for self-only coverage.

Note: Because every member of this family had employer-sponsored coverage available, the Marketplace affordability exemption would not be tested in this scenario.

Scenario 8: Marketplace affordability exemption

Jessica Taylor lives in New Jersey and was uninsured for all of 2014, with no employer-provided insurance options. Her household income is $45,500. She asked her tax professional for help determining whether she qualifies for an exemption based on unaffordable coverage options.

Because Jessica had no access to employer-provided insurance, her tax professional tested the Marketplace affordability exemption. Jessica's tax professional explained that Marketplace insurance would be considered unaffordable if the lowest cost bronze plan (LCBP) premium available for Jessica – less any premium tax credit (PTC) that she would have been entitled to, had she applied for coverage through the Marketplace – is more than 8% of her household income. To calculate the hypothetical PTC, Jessica's tax professional will also need to know the second lowest cost silver plan (SLCSP) premium available for Jessica.

Using the LCBP and SLCSP look-up tools on healthcare.gov, Jessica's tax professional determined that, with Jessica's household income of $45,500, zip code for the whole year, and her age at the start of the year, her LCBP premium would be $373.69 per month, and the SLCSP premium would be $429.71 per month.

Jessica's tax professional followed the Marketplace affordability worksheet in the Form 8965 instructions to calculate a hypothetical PTC of about $70 per month, a required monthly contribution amount of $304, and an annual contribution amount of $3,650:

> $374 LCBP premium - $70 hypothetical PTC = $304 required monthly contribution amount
> $304 × 12 = annual required contribution amount

Jessica’s affordability threshold is $3,640 ($45,500 × 8%). Because her annual required contribution amount of $3,650 is above the affordability threshold, Jessica qualified for this exemption based on unaffordable Marketplace coverage for the entire year. Jessica would claim the exemption on Form 8965 and include the form with her tax return.

Note: Jessica’s required contribution amount is just slightly over the affordability threshold. This illustrates the importance of calculating household income accurately to determine whether the client is eligible for this exemption. A slight difference in household income could result in the Marketplace option being affordable.