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Healthcare Reform: What Taxpayers and Investors Need to Know Now

Presented by

Bob Pugh, CFA, CFP[®], President, Insight Wealth Management, Inc.

www.insightwealth.com, bob@insightwealth.com

and

William S. Duvall, CPA, CVA, *Duvall Wheeler, LLP*

www.duvallwheeler.com, wduvall@duvallwheeler.com

The AAIL Washington DC Metro Chapter

Saturday, November 20, 2010

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Introduction

- Congress passed and President Obama signed legislation in March 2010 called, The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010, also known as “Obamacare”

Introduction

■ The legislation will

- Require most legal residents of the United States to obtain health insurance (2014)
- Impose an annual health insurance provider fee (2014)
- Create insurance exchanges (2014)
- Provide Federal subsidies for some individuals and families to reduce their cost of purchasing private coverage (2014)
- Expand eligibility for Medicaid;
- Reduce the growth of Medicare's payment rates for most services
- Impose an excise tax on insurance plans with relatively high premiums
- Make various other changes to the federal tax code, Medicare, Medicaid, and other programs.
- NOT create a single-payer, government option

Opportunities and Threats for Investors

- The legislation changes the landscape of the healthcare and insurance industries only minimally in the short-run but potentially significantly in 2014 and after.
- Diligent investors can add value to their portfolios from moving toward sectors and firms that benefit from the legislation and avoiding those potentially at risk

What Does the Market Think of Obamacare So Far?

Fund Symbol (Inception Date)	Actual Return		Average Annual Total Return		
	3 mo.	6 mo.	1 yr.	5 yr.	10 yr
Data as of October 31, 2010					
VGHGX -- (05/23/1984) Vanguard Health Care Inv	8.35	3.93	13.30	4.71	5.43
JAGLX -- (12/31/1998) Janus Global Life Sciences T Fund Performance (without load)	11.11	2.59	14.73	3.22	0.13
PRHSX -- (12/29/1995) T. Rowe Price Health Sciences	11.16	0.50	21.26	7.30	5.01
FBTIX -- (12/27/2000) Fidelity Advisor Biotechnology I	9.02	-4.46	19.65	3.62	N/A
FHCIX -- (09/03/1996) Fidelity Advisor Health Care I	11.03	1.25	20.01	3.28	1.80
SPDR S&P Pharmaceuticals ETF XPH	5.18	N/A	37.16	N/A	N/A
FUSEX -- (02/17/1988) Fidelity Spartan 500 Index Inv	7.93	0.70	16.45	1.69	-0.10

Health Care Spending Growth Continues Under Obamacare

- Spending generates the demand for health care services, and the ability of firms to generate cash flow and earnings.
- According to the Congressional Budget Office:

“Growth in spending on health care programs remains the central fiscal challenge. In CBO’s judgment, the health care legislation enacted earlier this year made a dent in the problem but did not substantially diminish that challenge.”
- To read the full CBO report to the Fiscal Commission on the impact of the health care legislation on health care spending and the long-term budget outlook, read the materials submitted for the June 30, 2010 hearing:

<http://www.fiscalcommission.gov/meetings>



Global Opportunities

- Investors analyzing the healthcare industry should not restrict themselves to the US market.
- Consider US multinationals that derive substantial earnings from global markets.
- For example, GE Healthcare President John Dineen on November 9 raised projections for profit growth in its health-care business to 10% per year, citing increased spending in China and other emerging markets on medical equipment, and efforts aimed at lowering costs and improving quality.



Healthcare Insurance Companies

- No effective cost constraints – AARP, Boeing, 3M and others have already passed on increased health insurance costs to those insured
- Earnings may be squeezed by the requirement to cover children and later others with pre-existing conditions in the short run
- 2014 requirement for nearly everyone to buy healthcare coverage will bring in many profitable new customers



Winners and Losers

- Winners

- Healthcare Services Providers
- Hospital Operators
- Biotechnology Firms
- Medical-Device Manufacturers
- Pharmaceutical Companies

Winners and Losers

- Losers (possibly)

- Healthcare Insurance Providers

- The insurance industry is already lobbying the incoming Congress to:

- Eliminate the roughly \$70 billion tax on insurance companies that takes effect in 2014
- Loosen restrictions on insurance premiums
- Enact medical malpractice protections
- Keep the requirement that most Americans purchase health insurance, and Federal subsidies to help purchase the insurance

Risks

- Enactment of the legislation in March alleviated uncertainty to some degree but mid-term elections raised new questions
- Most of the key provisions don't come into effect until 2014, two years after the next presidential election
- Obamacare is unpopular. Rasmussen reported on November 15 that 58% favor repeal and 37% oppose repeal
- Republicans who won a House majority promise repeal but with a Democratic Senate and President Obama still in office, they can do little beyond deny funding and slow implementation
- 2012 election will be key as to the future of Obamacare

Investing Conclusions

- Because of demographics (aging baby boomers) and global economic growth, especially in emerging markets, continue to allocate part of your portfolio to the healthcare industry. ETFs and mutual funds allow exposure to subsectors or the entire industry.
- Don't under or overweight the sector compared to the pre-Obamacare landscape yet. We just don't know how this legislation will play out, and most major reforms are not scheduled until at least 2014.
- For stock analysts, search for firms that stand to benefit from spending under the new legislation (research intensive). See articles such as the one on entrepreneurial opportunities at:
<http://www.wallerhealthcarereform.com/Entrepreneurial-Opportunities-Abound-in-Healthcare-Reform> - this web site has a wealth of information on Obamacare and its economic implications.
- Watch for changes made by the new Congress, and the 2012 election.

Major Tax Acts Passed in 2010

- Small Business Jobs Act of 2010
- Education, Jobs and Medicaid Assistance Act
- Homebuyer Assistance and Improvement Act of 2010
- Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010
- Health Care and Education Reconciliation Act of 2010
- Patient Protection and Affordable Care Act
- The Hiring Incentives to Restore Employment (HIRE) Act
- Acceleration of Income Tax Benefits for Haiti Relief

Small Business Jobs Act of 2010

- Extends 50% Bonus Depreciation through December 31, 2010
 - Provision is Retroactive to January 1, 2010
- Increases the Maximum Deduction for Code Section 179 Expensing to \$500,000 and the Investment Limit to \$2 Million for Tax Years Beginning in 2010 and 2011
- Extends the Carryback Period for Eligible Small Business Credits to 5 Years
- Raises the Deduction Limit to \$10,000 and Increases the Phaseout Threshold to \$60,000 for 2010 for Start Up Expenses
- Requires Individuals Receiving Income from Real Property to File Form 1099 for Payments to Service Providers of \$600 or More



Education, Jobs and Medicaid Assistance Act

- Eliminates Foreign Tax Credit Splitting
- Reduces Foreign Tax Credits on Stepped-Up Assets
- Restricts Treaty Use to Resource U.S. Income
- Eliminates the Advance Earned Income Credit for Qualified Individuals for Tax Years Beginning After December 31, 2010

Homebuyer Assistance and Improvement Act of 2010

- Extended the Closing Date Deadline for the Homebuyer Tax Credit from June 30, 2010 to September 30, 2010
 - Homebuyers Must Have Signed a Sales Contract Prior to May 1, 2010
 - Credit is up to \$8,000 for First-Time Homebuyers or \$6,500 for Long-Time Homeowners
 - Purchase Price of the Home Cannot Exceed \$800,000
 - Adjusted Gross Income Limits Apply

Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010

- Reverses a 21% Cut in Medicare Physician Reimbursements that Took Effect June 1, 2010
- Provides a 2.2% Update to Physician Payment Rates Through November 30, 2010
- Allows Sponsors of Defined Benefit Plans Additional Time to Amortize Pension Funding Shortfalls
 - However, Funding Relief Provisions Do Not Waive or Alter an Employer's Obligation to Fully Fund Its Pension Plan.

Health Care and Education Reconciliation Act of 2010

- Amended the Patient Protection and Affordable Care Act of 2010
- Does Not Mandate Employer-Provided Coverage But Includes “Play or Pay” Language for Employers With 50 or More Full-Time Employees
- Employers with Fewer than 50 Employees are Exempt from any Employer Responsibility
- Provides a Temporary Small Employer Tax Credit to Help Offset the Cost of Employer-Provided Coverage
- Imposes Penalties on Nonexempt Individuals who Fail to Carry Minimum Essential Coverage Starting in 2014
- Provides a Refundable Premium Assistance Tax Credit to Qualified Individuals to Help Make Coverage More Affordable

Health Care and Education Reconciliation Act of 2010

- Imposes an Additional Medicare Tax on Wages and Self-Employment Income of Higher Income Taxpayers Starting in 2013
 - Additional Hospital Insurance Tax Rate of 0.9% is Applied to Earned Income in Excess of \$200,00 for Individuals and \$250,000 for Married Couples Filing Jointly
- Imposes a New Medicare Contribution Tax on Net Investment Income Starting in 2013
 - Additional Medicare Contribution Tax Rate of 3.8% is Imposed on the Lesser of:
 - Net Investment Income
 - Includes Interest, Dividends, Royalties, Rents, Gains from Disposing of Property from Passive Activities and Income Earned From a Trade or Business that is a Passive Activity
 - The Excess of Modified Adjusted Gross Income over \$200,000 for Individuals or \$250,000 for Married Couples Filing Jointly

Health Care and Education Reconciliation Act of 2010

- Imposes a 40% Nondeductible Excise Tax on High-Dollar Insurance Plans Beginning in 2018
 - Applies to Insurance Companies or Plan Administrators for any Health Insurance Plan with an Annual Premium in Excess of \$10,200 for Individuals or \$27,500 for Families (Adjusted for Inflation)
- Requires Employers to Disclose the Value of Employer-Provided Health Insurance to Employees Annually on Form W-2 Starting in 2011
- Modifies the Definitions of Qualified Medical Expenses for Health FSAs, HSAs and HRAs
 - Over-the-Counter Medications will be Excluded Unless Prescribed By a Health Care Professional
- FSA Contributions will be Capped at \$2,500 Annually After 2012

Health Care and Education Reconciliation Act of 2010

- Raises the Threshold for the Itemized Medical Expense Deduction from 7.5% of AGI to 10% of AGI Effective for Tax Years Beginning After December 31, 2012
 - Applies to the Regular Income Tax
 - Allowable Medical Expense Deduction for AMT Purposes Remains at 10%
 - Individuals Age 65 and Older (and Their Spouses) are Temporarily Exempt from the Increase
 - Exemption for Seniors Applies to Tax Years Beginning After December 31, 2012 and Before January 1, 2017



Health Care and Education Reconciliation Act of 2010

- Act Makes the Adoption Credit Refundable
 - Dollar Limitation of the Credit is Increased to \$13,170
 - Credit is Extended Through 2011
- Imposes Reporting Requirements for Businesses that Pay any Amount Greater than \$600 During the Year to Corporate and Non-corporate Providers of Property and Services

The Hiring Incentives to Restore Employment (HIRE) Act

- Provides Payroll Tax Forgiveness for Social Security Taxes for Businesses who Hire Unemployed Individuals
 - A Qualified Employee Must Start Work After February 3, 2010 and Before January 1, 2011 and Must Have Been Unemployed for at Least 60 Days Before His/Her Start Date
 - Provision Exempts Employers from Paying the 6.2% Social Security Tax on Wages
 - Provision Does Not Apply To the Employer's Medicare Tax
 - Employees Related to the Employer or who Directly or Indirectly Own More Than 50% of the Business Are Not Eligible
 - An Employer May Qualify By Rehiring Workers who had Previously Been Laid Off

The Hiring Incentives to Restore Employment (HIRE) Act

- Provides Businesses with an Additional Tax Credit for Each Qualified Retained Worker who is Kept on the Payroll for at Least 52 Consecutive Weeks
 - Credit is the Lesser of:
 - \$1,000 for Each Qualified Retained Worker or
 - 6.2% of Wages Paid by the Taxpayer to the Qualified Retained Worker During a 52-Consecutive Week Period
- Requires Individuals with Foreign Financial Assets to Disclose Certain Information if the Aggregate Value of All Foreign Financial Assets Exceeds \$50,000



Acceleration of Income Tax Benefits for Haiti Relief

- Applies to Taxpayers who Made Charitable Cash Contributions for the Relief of Victims of the Earthquake in Haiti
 - Contributions Made After January 11, 2010 and Before March 1, 2010 May Be Treated as a Contribution Made on December 31, 2009

Sunseting Benefits of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Bush Tax Cuts)

- Unless Congress Acts, many Benefits will Sunset After December 31, 2010
 - Sunseting Benefits for Individuals:
 - Individual Marginal Tax Rates will Revert to 15%, 28%, 31%, 36% and 39.6%
 - The 10% Tax Rate Bracket will Disappear
 - The Limitation on Itemized Deductions will be Reinstated
 - The Personal Exemption Phaseout will be Reinstated
 - Lower Standard Deduction for Married Couples Filing a Joint Return
 - Return of the “Marriage Penalty”
 - Reduction of the Phaseout Limits for Purposes of the Earned Income Tax Credit

Sunsetting Benefits of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Bush Tax Cuts)

- Sunsetting Benefits for Individuals (Continued):
 - Child Tax Credit will Decrease to \$500 per Qualifying Child
 - The Maximum Amount of the Dependent Care Credit will Decrease From 35% to 30% of Qualified Employment-Related Expenses
 - AMT Exemption Amounts for 2010 and 2011 will Decrease to \$33,750 for Individuals and \$45,000 for Married Couples Filing a Joint Return
 - Congress May Enact an “AMT Patch” for 2010 to Provide Relief
 - Maximum Tax Rate on Capital Gains will Increase from 15% to 20%
 - The 0% Tax Rate on Capital Gains (For Taxpayers in the Lower Income Brackets) will Disappear and will be Replaced with a 10% Rate
 - Qualified Dividends Previously Taxed at a Maximum 15% Tax Rate will be Taxed at Ordinary Income Tax Rates

Sunsetting Benefits of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Bush Tax Cuts)

- Sunsetting Benefits for Individuals (Continued):
 - Exclusion for Employer-Provided Educational Assistance will Disappear
 - Annual Contribution Limit to a Coverdell ESA Reverts to \$500 and Distributions will No Longer be Allowed to Pay Elementary and Secondary Education Expenses
 - The Increased Modified AGI Phaseout Ranges for the Student Loan Interest Deduction will No Longer Apply
 - The 60-Month Limitation will also be Reinstated.
 - The American Opportunity Tax Credit for Higher Education Expenses will Expire and the Hope Credit Provisions will be Restored

Sunsetting Benefits of the Economic Growth and Tax Relief Reconciliation Act of 2001 (Bush Tax Cuts)

- Sunsetting Benefits for Individuals (Continued):
 - Maximum Federal Estate and Gift Tax Rates Revert to 55%
 - Exclusion Amounts Return to \$1 Million for Estate Tax and Gift Tax Purposes
 - Income Tax Exclusion for the Sale of a Decedent's Principal Residence Sold by the Decedent's Estate will No Longer Apply



Thank You!

- Questions?
- Bob Pugh at Insight Wealth Management and Bill Duval at DuvallWheeler both welcome you to schedule a free, no-obligation initial consultation.