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THE EFFECTS OF THE AFFORDABLE CARE ACT

How Obama Care will Force Small Businesses to Make Big Decisions

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PlusSigns™

Welcome to the first edition of Addicus PlusSigns, a quarterly series of whitepapers published by the principals of Addicus to give you a new perspective on life, wealth and the world of economics. Our top analysts have filtered the vast amount of information and data constantly poured into the marketplace to provide you the essential facts needed to make well-informed decisions and maximize your personal and professional success.

As a VIP of the Addicus rolodex, you are invited to become a **Plus**Signs member and continue receiving these insightful papers with no further obligation to you. Upon registration, we'll immediately send you the second edition followed by our latest volumes published each quarter. In the meantime, get daily updates and breaking news by following us on twitter @addicustweets and connecting with us on LinkedIn. At any time you feel ready to find new strategies and approaches to building and protecting your wealth, visit us at www.weareaddicus.com or contact us directly to learn how we can help.

Addicus is a full service firm driven by economics, not finance. Our global perspective and approach often challenges conventional wisdom with amazing results. We specialize in providing services usually reserved for family offices of the world's top earners providing our clients a boutique style approach with a personal touch. Addicus architects the solutions, deploys the strategies and manages the tactics first-hand to make owners of closely-held businesses more successful. Our model is similar to the way an NFL football franchise is operated. You are the team owner and Addicus serves as the head coach. We coordinate the advice and expertise of your existing coaching staff and team (attorneys, CPA's, bankers, financial advisors, etc.) or find the essential members necessary for optimum impact and success.

Our Private Wealth Development services start with a discovery phase where we piece together a full and thorough profile of your personal and business finances. Leading with your mission statement, a playbook is designed and uniquely crafted to accomplish your goals and initiatives. We then train the team and execute the plays (strategies) similarly to the way a quarterback and coach drives winning teams to success. Addicus also serves as your statistician; providing ongoing management and analysis to assure your team and playbook are producing the right results. All the while, you observe overall performance from the owner's box, providing you the ideal vantage point to clearly deliver vision and innovation to keep your team on top. Contact Addicus today and get started with a playbook of your own.

By Stephen D. Miles, Managing Director Addicus
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The Effects of the Affordable Care Act

How Obama Care will Force Small Businesses to Make Big Decisions

The Affordable Care Act (ACA), now embraced by the president himself as "Obama Care," is one of the single most far-reaching pieces of legislation in American History and also one of the most divisive. However, while the Affordable Care Act is at odds with general economic philosophy of Addicus as a company, the purpose of this paper is not to fan the flames of emotion. It is, instead, to explain in the effects this law will have on small business owners, their employees and the U.S. economy.

If you earn a living as an employee of a business you do not own, you will unfortunately have little control over the changes being made. However, if you are a business owner the economic and psychological burdens are even greater. Not only will you need to make a decision on how to implement employee healthcare under this new law, but you may also need to restructure your business and investment assets in order to remain profitable and especially to remain competitive.

SMALL INCENTIVES

Among the first changes business owners can expect as a result of Obama Care are multiple tax increases. These taxes are listed in detail on the Americans for Tax Reform website. (While this site is openly partisan, it references sections of the law that support the assertions made.)

Governments use taxes not only as a source of revenue, but also to create incentives and deterrents which affect economic and social change. Obama Care is no exception. The Affordable Care Act features a number of taxes created to overtly incentivize certain behavior, as well as other taxes that, although not meant as incentives, will inadvertently cause great changes in the way we go about our daily lives.

Overt examples include tax increases for so-called "Cadillac" healthcare plans, as well as changes to which items may be paid for with a Health Savings Account (HSA). These changes were designed to make these choices less attractive to both employers and employees, and will change the way plans are structured in the future.

The most significant tax increase, however, will be to the Hospital Insurance (HI) portion of the payroll tax, which will move from 2.9 to 3.8%. This increase will not only apply to payroll tax itself, but also on investment income, (corporate dividends/distributions from s-corps, sales or real estate and other capital gains, interest, etc.) for individuals with adjusted gross income exceeding $200,000 or $250,000 for families.

The additional 3.8% tax on investment income may not seem like a great burden by itself, but once you add 39.6% federal income taxes and state income taxes, your overall tax bill can be as high as 54.4% and will average around 49.6% for "income" exceeding $200,00 for individuals and $250,000 for families.

"Income" is in quotes, because it does not necessarily refer to take-home pay. For example, a business owner who only earns $75,000 in in personal income, but had $200,000 in non-deductible business expenses would have to pay both an extra 3.8% ($8,275) on that $200,000, as well as an extra .9% on the $75,000 dollars of personal income. For this business owner the Affordable Care Act Tax would actually be 11.03% relative to his take-home pay. Repeated thousands of times across the country, this can't help but negatively affect jobs and the overall economy. It is easy to see that while this new tax was meant as a revenue generator for the government, it will have unintended consequences on American businesses. It is also important to note that while the current threshold to pick up the additional Medicare tax is currently $200,000 for an individual and $250,000 for a family, this threshold is not indexed for inflation. This means that as income rise to offset purchasing power decreases in the future that a larger portion of the population will be hit with this tax.

There may be some positive news for smaller businesses that have fewer than 25 FTE's and either currently provide or want to provide healthcare for their employees. Again, it is an all or nothing proposition, meaning that the employer cannot be selective in which employees to provide coverage to and pay premiums. However, if an employer provides health coverage for all employees, and pays at least 50% of the premium (employee earnings have to average less than $50,000 annually), the employer will be eligible for a tax credit of up to 20% of the premium cost. This means that if you pay $50,000 toward employee healthcare expenses and meet the qualifications, this credit could be worth as much as $10,000 annually.

50/50 DECISIONS

While much of the Affordable Care Act has not yet taken effect, one provision is already forcing many small businesses to make some very tough decisions. The provision requires businesses with 50 or more full-time employees to offer those employees health insurance. Well intentioned as this provision may be, it is a nightmare for business owners whose staffs hover around 50 employees. As explained on the National Federation of Business (NFIB) website, the law unintentionally incentivizes employers to keep their number of full-time equivalent employees below the 50-person mark by either cutting hours or letting people go. In a 50-person company this is not an abstract or purely logical choice, as the business owner likely knows each of the employees affected on a personal level.

Some of the decisions that will need to be made immediately will be regarding the full time or Full-Time Equivalent (FTE may add two part time employees together as one full time) of employees if you are hovering around the 50 employee number and do not currently offer care (Link to NFIB article). In brief, if you meet or exceed the 50 FTE threshold, the Affordable Care Act may affect you in one of a few ways. If you currently offer no coverage or limit this coverage to select groups of people in the company you will have to offer and make payment toward coverage for all Full-Time employees. For an employees with 50 full time employees (employee coverage only), the total cost of health insurance would be approximately $280,000 annually. The employer will be mandated to pay at minimum 60% of the employee coverage premium, which would be estimated at almost $170,000. Many small businesses simply cannot afford to have an additional tax of this size and will either have to risk raising prices on their customers and potentially suffer lost sales, or make much tougher decisions.

In addition to the employers 60% of the premium, the employees' individual share cannot exceed 9.5% of their gross Form W-2 wages. Based on the scenario above, the employee W-2 earnings would have to be just under $22,500. If the employee's wage falls below this level, the employer will have to raise what they contribute to the health insurance, raise the employee's salary, or alternatively accept an IRS penalty. Speaking of penalties, the employer can refuse to provide health insurance, but will have to refuse universally, meaning they cannot provide it for certain groups and not others (owners/management vs. all other employees, etc.). If the employer does choose not to provide coverage, there will be a $2,000 per employee penalty. No matter what you choose, many closely-held businesses fit the model of high revenue, low margin, and high number of employees. Businesses such as car dealerships, grocery stores, restaurants that will have extremely tough decisions to make.

Larger companies also have an incentive to reduce the number of fulltime employees who qualify for insurance, and are creating strategies to do so. An entire industry is forming to help businesses deal with this complicated issue as explained in this excellent article by the Wall Street Journal. Companies must take into account not just financial considerations, but also any effects on workplace morale, which may result from taking away employees' current healthcare plan and forcing them (as mandated by the government) to purchase their own insurance through a healthcare exchange.

For many companies it will come down to allowing employees to keep a healthcare plan that they are comfortable with or remaining profitable as a company — not an easy decision. It cannot be stressed enough how this one provision of the Affordable Care Act will change the relationship between hourly wage employees and their employers. The business environment will never be the same, and owners of closely-held businesses must begin planning now.

UNINTENDED COSTS

Healthcare is about to get more expensive for everyone. You cannot add an additional 30 million people to the healthcare rolls, tax the health insurance industry to fund the act and mandate that insurance carriers cover certain procedures with no copay or deductible without costs going up. Several major insurance companies as well as at least one of the prime architects of the Affordable Care Act itself estimate that premiums will increase 30-40% by 2016. (For more information read this Forbes editorial.)

Ironically, this means the Affordable Care Act will make goods and services less affordable for many people as rising premiums take money out of consumers' pockets. Wal-Mart is already reporting lowered sales due to the expiration of the payroll-tax holiday on January 1, which resulted in an average loss of $80 per paycheck for its shoppers. Increased healthcare premiums will only make the situation worse.

There are only so many dollars an employer can allocate to each worker. Increased premiums and mandated coverage will mean some employees cost more than the value they bring to their companies. These employees will have to be terminated, and these businesses will be forced to operate with a smaller staffs. This will result in a higher national unemployment rate, which will in turn further stifle growth in an already sluggish economy.

THE RUST BELT AND SILVER LININGS

These are just some of the effects the Affordable Care Act will have on businesses. Many of the other effects are, unfortunately, unpredictable at this point. What is predictable, however, is that there will be unintended consequences. History tells us that much for sure. Take for example increases in regulation and minimum wage, which The United States government enacted to protect workers. These laws, well intentioned as they may be (they always are), had in many ways the opposite effect. They made the American worker too expensive, and as a result there was a mass exodus of manufacturing jobs to countries with a more hospitable business climate, while Detroit and other American manufacturing cities were left to rust away.

However, if there is anything that we at Addicus have faith in, it is the ingenuity and creativity of the American people. Business owners and employees will not sit still while a net is drawn around them. We already see creative ideas such as employee leasing programs and employee sharing being discussed and revamped in order to keep business profitable while also keeping the maximum number of employees onboard. Investors and business owners are also looking at innovative ways to keep their tax burden down, such as using a C-corporation or US protectorates such as Guam or Puerto Rico to find lower tax brackets and entities that are not affected by the 3.8% ACA tax.

The Affordable Care Act will change the business landscape and we feel that with that change will come opportunities to become more competitive in the marketplace than your competitors who are not thinking ahead. Any time there is a major change such as this, business owners who step up and plan properly will be greatly rewarded. Those who do not make the changes that will ultimately have to be made will see their margins eroded and their business suffer. While we at Addicus are not happy that our clients will need to spend their valuable time and resources on making decisions around the ACA, we do see it as an opportunity to plan properly and be one step ahead of the competition.

Right now, thousands of lawyers, financial planners, and CPA's all across the country working on ways to stay within the law while reducing tax and employer coverage mandates. Our advice is to find a competent and creative group of advisors who have a long and impressive track record and work with them to overcome whatever obstacles the Obama Care throws at you. If your current advisors aren't coming up with creative ways to reduce your exposure to taxes and other costs associated with the Affordable Care Act, get new advisors. You can't afford not to.

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