How the Health Insurance Mandate Penalty Will Work

Beginning in 2014, many consumers who forego health insurance will pay a tax penalty to the IRS.

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Beginning with their 2014 federal taxes, many consumers who can afford health insurance but decide not to buy it will owe penalties to the IRS when they file their taxes in the spring of 2015. There will be constant efforts to overturn this and other provisions of the Affordable Care Act (ACA), also referred to as Obamacare. But the Supreme Court decision to uphold the law's constitutionality has greatly increased the odds that the so-called individual mandate to have health insurance will be implemented over the next two years.

The nonpartisan Congressional Budget Office (CBO) has estimated that roughly four million people will choose to pay a penalty each year instead of purchasing health insurance. This group is expected to be dominated by younger Americans without children who feel they are healthy enough to forego insurance. Those penalties will be small in 2014 and 2015 before rising to their full levels in 2016.

Due to expected confusion in the early years of the program, more people may face penalties. But it's unclear what will happen if they don't pay them. The ACA forbids the IRS from aggressive efforts to collect the penalty from people who don't pay. The biggest stick the agency may have is to withhold tax refunds from those who owe penalties.

Insurers are required to send out notices of health coverage that will, over time, become as routine as a taxpayer's W-2 statement of taxable wages. The 2014 notices are due to consumers and the IRS by Jan. 30, 2015. But this process may experience its own learning curve, and few people are predicting that a flawless reporting system will be in place right away.

The three major parts of the individual mandate rules are 1) understanding the non-financial grounds on which people are excluded from having to get insurance; 2) the income provisions affecting the need to be insured, and 3) the penalties themselves.

Non-Financial Exclusions

The mandate is designed to apply to people who make enough money to buy private health insurance but choose not to be insured either on their employer's plan, in the individual market, or through the insurance exchanges that must be set up in each state under the law. It does not apply to Americans age 65 and up who are covered by Medicare.

There is a long list of people who do not have health insurance but will not face a penalty on non-financial grounds:

• between jobs and without insurance for up to three months

• have religious objections

• are an undocumented immigrant

• are in jail

• are a member of an Indian tribe

Income Provisions

The financial tests to avoid a penalty include having family income that is too low to require filing a federal tax return. Using 2010 rules, this would be less than $9,350 for an individual and $18,700 for a family.

Higher-earning households may also be exempted from penalties for not buying health insurance if their out-of-pocket cost for private health insurance is more than 8 percent of their taxable income. This amount is for any additional cost after subtracting employer healthcare insurance contributions.

It is also after reflecting any health insurance subsidies available as tax credits through the state insurance exchanges being created by the act. A report from the CBO and the staff of the congressional Joint Committee on Taxation last March estimated that consumers who qualify for subsidies using the state exchanges will receive an average benefit of $4,780 in 2014, $5,040 in 2015, and $5,210 in 2016. This benefit is mostly for the tax credits but also includes other support items, according to a Treasury Department spokeswoman.

Those credits are keyed to the nation's financial poverty guidelines. These are set each year by the government and adjusted annually based on changes in the consumer price index. The exchanges will offer a sliding scale of insurance subsidies that extend to incomes as high as four times the poverty guidelines.

The guidelines for 2012 begin at $11,170 for one person and increase by $3,960 for each additional person in the household. For a family of four, the 2012 guideline is $23,050. Tax credits for buying health insurance would be available for four-person households with taxable earnings up to 400 percent of that level, or $92,200. (The size of a household is determined by how many people are included on the head of household's tax return.)

So, to avoid a penalty for not buying insurance, a household would have to determine the annual premiums on one of the lowest-quality plans in a state exchange, figure out how much of a tax credit their income would entitle them to, and then calculate if the resulting out-of-pocket expense was more than 8 percent of their household's modified adjusted gross income. If it was, they would not pay a penalty if they decided not to buy health insurance.

The Kaiser Family Foundation has built a Health Reform Subsidy Calculator that helps simplify this complicated calculation.

The Penalties

The actual individual mandate penalties under the ACA are perhaps the easiest part of the program to understand:

In 2014, the annual penalty will be $95 per adult and $47.50 per child, up to a family maximum of $285 or 1 percent of family income, whichever is greater.

In 2015, the penalty will be $325 per adult and $162.50 per child, up to a family maximum of $975 or 2 percent of family income, whichever is greater.

In 2016, the penalty will be $695 per adult and $347.50 per child, up to a family maximum of $2,085 or 2.5 percent of family income, whichever is greater.

"Most people think of it as an annual penalty," notes Larry Levitt, a senior vice president at Kaiser. "But it is in fact a monthly thing, and you would pay a penalty for any month that you are uncovered." However, a person may be without coverage for up to three months without triggering the penalty.

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