



# Beware the ACA Subsitax

## Or, how to avoid the 121,100% tax bracket

When planning end-of-year tax moves, making a Roth conversion, an IRA withdrawal, tax gain harvesting, or other income adjustments are always worth considering. However, hidden hazards exist for some people. Those receiving a subsidy to purchase an Affordable Care Act (aka Obamacare) health insurance plan, and whose income is below four times the poverty level, as shown in the table below, should be aware of the consequences of the subsidy, especially when considering tax reduction strategies.

Persons in household	4 x 2015 Federal Poverty Level
1	\$47,080
2	\$63,720
3	\$80,360
4	\$97,000
5	\$113,640
6	\$130,280
7	\$146,920

Perhaps because ACA plans can be far more costly than former, equivalent, standard insurance policies, the ACA provides a Premium Tax Credit (PTC), a payment from the government that can be used toward ACA plans. The PTC may not bring the net cost down to previous levels, but it certainly helps.

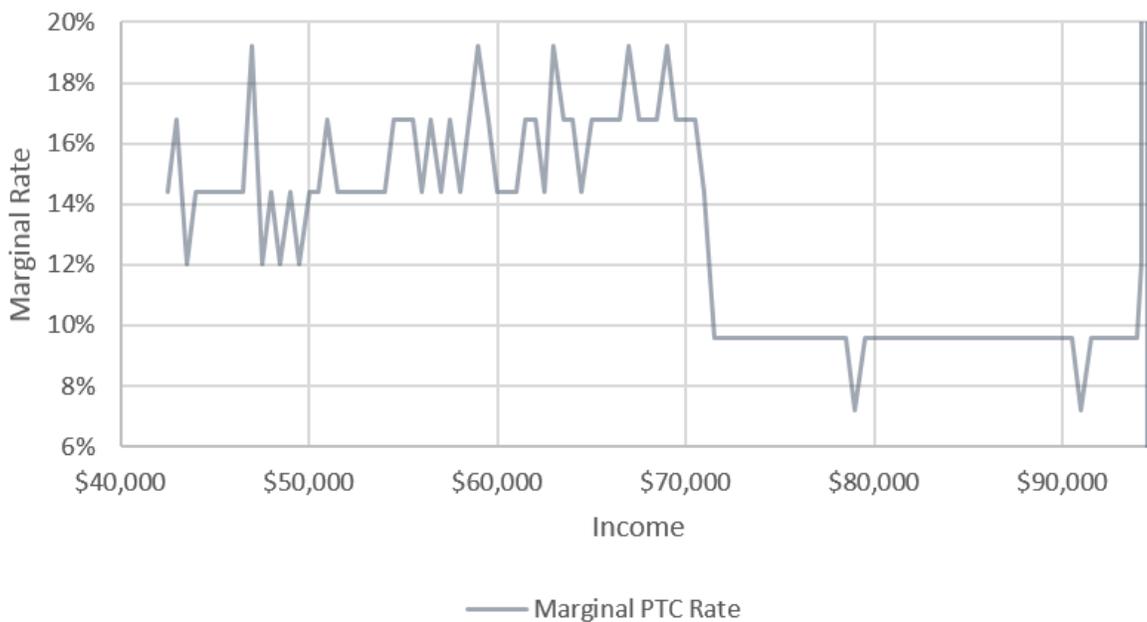
Unfortunately, the PTC is adjusted according to the recipient's income. That means that if the recipient makes more money, the subsidy is reduced. This is mathematically equivalent to an additional tax, or what we call a subsitax. For example, in 2014 a family of four making \$46,500 would have received a \$7,288 subsidy for the year to purchase an ACA insurance plan. However, if their income was \$500 more at \$47,000, the subsidy would have been reduced by \$96 to \$7,192. Even though the \$96 reduction in the subsidy is technically not a tax, it is the equivalent to a tax. It is a subsitax. A \$96 reduction in subsidy on \$500 of income is equivalent to a 19.2% tax rate. This 19.2% tax rate on the next \$500 dollars earned is known as a marginal tax rate. It is not the total tax rate. It is the tax rate on the next few dollars earned.

Knowing the marginal tax rate (or marginal subsitax rate) is critical when using tax reduction strategies. If the

family above is making \$46,500 and is considering whether to take some money out of an inherited IRA, they need to understand that \$500 withdrawn from an IRA will cost them \$96 in subtaxes in addition to income taxes.

Ironically, the subtax is higher for lower income families with incomes between \$42,500 and \$71,000 than it is for higher income families with incomes between \$71,000 and \$94,000, as shown in the figure below. The lower income families pay a marginal subtax rate of about 16%, while the higher income families pay around 10%. It is a bit of a circular firing squad to be subtaxing the lower income folks more than the higher income folks, but this is not uncommon in benefits that only go to lower income families.

The harshest part of this subtax occurs when the income level just reaches four times the upper poverty limit, or \$94,199 in 2014. Increasing the income just \$1 reduces the subsidy by \$1,204. Plus, the income tax goes up \$7 because of a step in the tax table, for a total additional tax of \$1,211 on that one dollar. Ouch! That is a marginal tax rate of 121,100%! One has to wonder how many unfortunate people in this country using ACA plans have income levels at or just above the 4x poverty level.



If you are receiving an ACA subsidy through the PTC, and you make less than four times the poverty rate, and you are considering any year-end income moves, be aware that your income adjustments are subject to a subtax. By all means, if you can avoid crossing the 4x threshold, do so. Nobody should pay 121,100% in marginal taxes.

