The keystone of the Patient Protection and Affordable Care Act (PPACA) is an unprecedented individual mandate tax requiring virtually all U.S. citizens and legal residents to either have health insurance or pay a tax for not doing so, beginning in 2014.

**Insurance Or Tax.** The individual mandate tax is unprecedented. As written, PPACA established an individual mandate to buy health insurance and a penalty for not doing so. This was the first time in American history that the federal government ordered the general population to purchase a commercial product. Responding to the lawsuit by NFIB and 26 states, the Supreme Court refashioned the mandate and penalty into a choice between two options: buy insurance or pay a tax for failing to do so.

Beginning in 2014, PPACA requires most U.S. citizens and legal residents to have qualifying health insurance coverage (public or private) or pay a tax for not carrying insurance. “Qualifying” is broadly defined by the law, with specific definitions left to current and future regulators.

A relatively small number of Americans will be exempt from the tax. Those exempted include: (1) people with religious objections; (2) American Indians with coverage through the Indian Health Service; (3) undocumented immigrants; (4) those without coverage for less than three months; (5) those serving prison sentences; (6) those for whom the lowest-cost plan option exceeds 8% of annual income; and (7) those with incomes below the tax filing threshold ($9,500 for singles and $19,000 for couples under 65 in 2011.)

**Defining Insurance.** The individual mandate tax rests on a legal definition of insurance, and PPACA’s definitions differ across markets. Government programs like Medicare, Medicaid, and CHIP automatically qualify, as do self-insured ERISA policies (mostly for larger employers). Small-group and individual policies (except for grandfathered plans) must cover services comprising an “essential health benefits” (EHB) package – though the definition of that package is now clouded by uncertainty.

The essential health benefits (EHB) package is a menu of health care services that must be covered by all qualifying insurance plans in the fully-insured small-group market (“small” here means fewer than 100 employees); EHB also applies to the individual market. Self-insured groups (mostly big businesses, labor unions, and governments), fully-insured plans covering 100 or more employees, and government-provided insurance, in contrast, are exempt from most of the EHB’s costly requirements.

In late 2011, the Secretary of Health and Human Services (HHS) temporarily changed the EHB rules, adding new uncertainty. As written, the law specifies a process in which the Secretary solicits advice on EHB components, after which the Secretary unilaterally selects and revises a uniform national package. In December, the Secretary upended this scheme by authorizing each state to compile its own list of EHB coverage mandates. In the near term, this change makes it harder to predict future health insurance costs. Over the longer term, the change introduces new state and federal vagaries.

**Tax Calculations:** Taxes begin in 2014 and rise in years following. In each year, the tax consists of the higher of a dollar amount or a percentage of household income. For a given household, the tax applies to each individual, up to a maximum of three. Following is the schedule of taxes:

- **2014:** The higher of $95 per person (up to 3 people, or $285) OR 1.0% of taxable income.
- **2015:** The higher of $325 per person (up to 3 people, or $975) OR 2.0% of taxable income.
- **2016:** The higher of $695 per person (up to 3 people, or $2,085) OR 2.5% of taxable income.
- **After 2016:** The same as 2016, but adjusted annually for cost-of-living increases.

Aside from these formulae, a household’s penalty is capped at a dollar figure based on the cost of a bronze-level health insurance policy.
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(note: line-to-line changes in variables are in red, underlined type)

- 2014; family of 2; taxable income=$26,000;
tax=$260
  because $260 (=26,000x1%) is higher than $190 (=95x2).

- 2014; family of 3; taxable income=$26,000;
tax=$285
  because $285 (=95x3) is higher than $260 (=95x2).

- 2016; family of 3; taxable income=$26,000;
tax=$2,085
  because $2,085 (=695x3) is higher than $650 (=26,000x2.5%).

- 2016; family of 3; taxable income=$85,000;
tax=$2,125
  because $2,125 (=85,000x2.5%) is higher than $2,085 (=695x3).

- 2016; family of 8; taxable income=$85,000;
tax=$2,125
  because $2,125 (=85,000x2.5%) is higher than $2,085 (=695x3).

- 2016; family of 8; taxable income=$300,000;
tax=$7,500
  because $7,500 (=300,000x2.5%) is higher than $2,085 (=695x3).

Some Americans will qualify for subsidies.

The individual mandate tax forces households to purchase an expensive product or to pay a tax in lieu of that purchase. The law softens this blow for some households by providing subsidies, called “health insurance premium tax credits.” To be eligible for the subsidies, a household must meet two conditions: (1) Household income must be less than 400% of the Federal Poverty Level (FPL), which varies with family size. For a family of four in 2012, 400% FPL = $92,200. (2) The household’s portion of the employer-sponsored health insurance premium must exceed 9.5% of household income.