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Key Facts You Need to Know About: Income Definitions for Marketplace and Medicaid Coverage

Health reform provides new opportunities for millions of Americans to get affordable health coverage. Eligibility and benefit amounts are determined in part by household income. For premium tax credits, most categories of Medicaid eligibility, and the Children's Health Insurance Program (CHIP), states and the federal government use a new tax-based measure of income called Modified Adjusted Gross Income (MAGI) to assess financial eligibility. The following key facts explain MAGI and what counts as income in determining eligibility for premium tax credits, Medicaid, and CHIP.

How do Marketplaces, Medicaid, and CHIP measure a person's income?

For premium tax credits, most categories of Medicaid eligibility, and CHIP, all Marketplaces and state Medicaid and CHIP agencies determine a household's income using MAGI. States' previous rules for counting income continue to apply to people who qualify for Medicaid on the basis of age or disability or because they are children in foster care.

MAGI is Adjusted Gross Income (AGI) plus tax-exempt interest, Social Security benefits not included in gross income, and excluded foreign income. Each of these items has a specific tax definition; in most cases they can be located on an individual's tax return (see Figure 1). (Medicaid does not count certain Native American and Alaska Native income in MAGI.)

What Is Adjusted Gross Income?

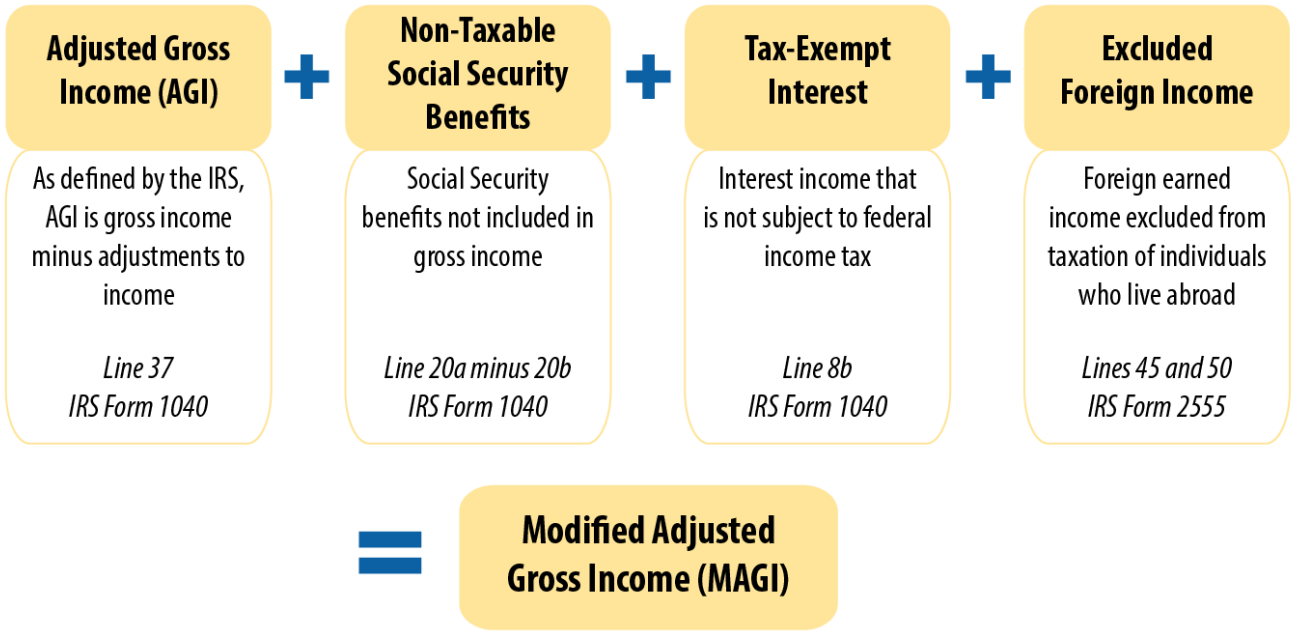
Adjusted Gross Income is the sum of an individual's gross income (that is, total earnings subject to income tax) minus deductions for certain expenses.

The deductions taken to calculate AGI are referred to as "adjustments to income" or "above the line" deductions. These are specific expenses that the Internal Revenue Service (IRS) allows people to deduct to reduce their taxable income. Among the most common are alimony payments, IRA contributions, job-related moving expenses, student loan interest, and tuition and fees. For many of these adjustments, the amount of the deduction is capped or limited based on the person's income. IRS Publication 17 explains how to qualify for these adjustments.

What types of income are taxable and count towards MAGI?

All income is subject to taxation unless it's specifically exempted by law. Income does not only refer to cash wages. It can come in the form of money, property, or services that a person receives.

Figure 1
Formula for Calculating Modified Adjusted Gross Income



An applicant's most recent tax return can be useful in estimating income if their income has not changed. If a tax return is not available, or if income is different for any reason, the tax return can still be a useful list of what income and adjustments to include.

Table 1 provides examples of taxable and non-taxable income. IRS Publication 525 provides a detailed discussion of many kinds of income and explains whether they are subject to taxation.

Is income deducted from workers' paychecks for pre-tax deductions counted in MAGI?

No. Pre-tax deductions are deductions that can be used to discount the amount of taxable wages. Among the most common are health care expenses such as insurance premiums or health savings account contributions, retirement account contributions, and flexible spending accounts for medical or child care expenses. Since income set aside for these purposes is not taxed, it does not count towards a household's MAGI.

Does MAGI count any income sources that are not taxed?

Yes. Some forms of income that are non-taxable or only partially taxable are included in MAGI and thus affect financial eligibility for premium tax credits and Medicaid, specifically:

- **Tax-exempt interest.** Interest on certain types of investments is not subject to federal income tax but is included in MAGI. These investments include many state and municipal bonds as well as exempt-interest dividends from mutual fund distributions. However, some other forms of tax-exempt interest, such as interest earned on an IRA, HSA, Archer or Medicare Advantage MSA, or Coverdell education savings account, is *not* included in MAGI.

Table 1	
Examples of Taxable Income	
Wages, salaries, bonuses, commissions	IRA distributions
Alimony	Jury duty fees
Annuities	Military pay
Awards	Military pensions
Back pay	Notary fees
Breach of contract	Partnership, estate, and S-corporation income
Business income/Self-employment income	Pensions
Compensation for personal services	Prizes
Debts forgiven	Punitive damages
Director's fees	Unemployment compensation
Disability benefits (employer-funded)	Railroad retirement—Tier I (portion may be taxable)
Discounts	Railroad retirement—Tier II
Dividends	Refund of state taxes
Employee awards	Rents (gross rent)
Employee bonuses	Rewards
Estate and trust income	Royalties
Farm income	Severance pay
Fees	Self-employment
Gains from sale of property or securities	Non-employee compensation
Gambling winnings	Social Security benefits (portion may be taxable)
Hobby income	Supplemental unemployment benefits
Interest	Taxable scholarships and grants
Interest on life insurance dividends	Tips and gratuities
Examples of Non-Taxable Income	
Aid to Families with Dependent Children (AFDC)	Meals and lodging for the employer's convenience
Child support received	Payments to the beneficiary of a deceased employee
Damages for physical injury (other than punitive)	Payments in lieu of worker's compensation
Death payments	Relocation payments
Dividends on life insurance	Rental allowance of clergyman
Federal Employees' Compensation Act payments	Sickness and injury payments
Federal income tax refunds	Social Security benefits (portion may be taxable)
Gifts	Supplemental Security Income (SSI)
Inheritance or bequest	Temporary Assistance for Needy Families (TANF)
Insurance proceeds (accident, casualty, health, life)	Veterans' benefits
Interest on tax-free securities	Welfare payments (including TANF) and food stamps
Interest on EE/I bonds redeemed for qualified higher education expenses	Worker's compensation and similar payments
Source: Internal Revenue Service, Income Quick Reference Guide	

- **Non-taxable Social Security benefits.** For many people, particularly those with no other source of income, Social Security benefits are not taxable. However, the full amount of a person's Social Security benefits as indicated on Form SSA-1099 (the Social Security Benefit Statement) — whether or not those benefits are taxable — is included in MAGI.
- **Foreign income.** Under section 911 of the Internal Revenue Code, U.S. citizens and resident aliens living outside the U.S. can exclude up to $97,600 (in 2013) of earned income for tax purposes if they meet certain residency or physical presence tests. Any foreign income excluded under this section must be added back when calculating MAGI.

Whose income is included in a household's MAGI?

A household's MAGI is the sum of the MAGI of each household member who has a tax filing requirement. The *requirement* to file taxes, not whether someone actually files taxes, determines whether an individual's income must be included in a household's MAGI.

Is a tax dependent's income ever counted in determining the household's MAGI?

Sometimes a dependent files a tax return even though he is not required to do so — for example, to get a refund of taxes withheld from his paycheck. In this situation, the dependent's income would not count toward the household's MAGI. However, if a dependent has a tax filing requirement, his MAGI is calculated and added to the taxpayer's MAGI to determine the household's MAGI.

In general, individuals claimed as dependents on someone else's tax return must file taxes if they receive at least $6,100 in earned income or $1,000 in unearned income (for the 2013 tax year). Supplemental Security Income (SSI) and Social Security benefits are not counted for the purposes of determining whether a dependent will be required to file a tax return. However, if the dependent does have a tax filing requirement, then the dependent's Social Security benefits will be counted toward the household's MAGI.

What time frame is used to determine a household's MAGI?

Financial eligibility for premium tax credits and Medicaid is based on income for a specified "budget period." For premium tax credits, the budget period is the tax year (which coincides with the calendar year) during which the advance premium tax credit is received. When determining eligibility for advance premium tax credits, the Marketplace estimates the applicant's household MAGI over the entire calendar year for which the applicant seeks coverage.

Medicaid eligibility, however, is based on current monthly income. Some states allow current Medicaid beneficiaries to project their income for the rest of the calendar year; the state assesses eligibility based on the average monthly total. So, for example, if a family member has seasonal work that temporarily raises household income, that increase is effectively spread across all months of the year. States may also allow both applicants and beneficiaries to account for any reasonably predictable increases or decreases in income they anticipate over the year. These options help minimize coverage gaps that could result if beneficiaries had to recertify their income every month.

How does MAGI differ from Medicaid's former rules for counting household income?

The MAGI methodology for calculating income differs significantly from previous Medicaid rules.

Table 2		
Differences in Counting Income Sources Between Former Medicaid Rules and MAGI Medicaid Rules		
Income Source	**Former Medicaid Rules**	**MAGI Medicaid Rules**
Self-employment income	Counted with deductions for some, but not all, business expenses	Counted with deductions for most expenses, depreciation, and business losses
Salary deferrals (flexible spending, cafeteria, and 401(k) plans)	Counted	Not counted
Child support received	Counted	Not counted
Alimony paid	Not deducted from income	Deducted from income
Veterans' benefits	Counted	Not counted
Workers' compensation	Counted	Not counted
Gifts and inheritances	Counted as lump sum income in month received	Not counted
TANF & SSI	Counted	Not counted

Some income that Medicaid used to consider part of household income is no longer counted, such as child support received, veterans' benefits, workers' compensation, gifts and inheritances, and Temporary Assistance for Needy Families (TANF) and SSI payments. Table 2 summarizes the differences between the former Medicaid rules and the new MAGI rules.

In addition, states can no longer impose asset or resource limits, and various income disregards have been replaced by a standard disregard equal to 5 percent of the poverty line. There are also changes to who is included in a household and, therefore, whose income is counted.