3.8% Medicare Contribution Tax

Is your gross income over $250,000? $200,000 if unmarried?

Do you have significant net investment income, which includes things like, interest, dividends, annuities, royalties, rent and capital gains?

Do you have significant income from Partnership or S Corporation investments where you don't actively participate in the business ("passive activities")?

If you answered yes to the first, and either the second or third questions above, you need to be aware of your potential exposure to this unprecedented new tax. The Health Care and Education Reconciliation Act of 2010 created a Medicare contribution tax on unearned income. For individuals, the Act adds a 3.8% tax on income from interest, dividends, annuities, royalties, rent and certain capital gains. For estates and trusts, the tax is 3.8% of the lesser of undistributed net investment income or the excess of adjusted gross income over the dollar amount at which the highest income tax bracket begins (for 2012, $11,650).

Examples:

- **Scenario 1:** For 2013, a single taxpayer has net investment income of $50,000 and AGI of $180,000. The taxpayer won't be liable for the Medicare contribution tax, because his AGI ($180,000) doesn't exceed his threshold amount ($200,000).
- **Scenario 2:** For 2013, a single taxpayer has net investment income of $100,000 and AGI of $220,000. The taxpayer would pay a Medicare contribution tax only on the $20,000 amount by which his AGI exceeds his threshold amount of $200,000, because that is less than his net investment income of $100,000. Thus, taxpayer's Medicare contribution tax would be $760 ($20,000 x 3.8%).
- **Scenario 3:** Assume that the taxpayer in **scenario 2** had AGI of $300,000. Because taxpayer's AGI exceeds his threshold amount by $100,000 he would pay a Medicare contribution tax on his full $100,000 of net investment income. Thus, taxpayer's Medicare contribution tax would be $3,800 ($100,000 x 3.8%).

Our goal is to work with our clients to:

- Eliminate or minimize this additional 3.8% tax
- Provide a benefit that is permanent in nature
- Enhance the benefit of general 2012 vs. 2013 planning in an uncertain tax rate environment

This additional Medicare tax is scheduled to begin on 01/01/13 but it is not too early to start thinking about this issue and monitoring the amounts and types of income being generated in 2012 vs. later years. Waiting much longer could hamper your ability to begin to shift investments, plan for the payment of interest/dividends, and potentially accelerate gains into 2012.

Contact:
Rich Lundy, CPA
rlundy@gbq.com
614.947.5264