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On June 28, 2012, the U.S. Supreme Court ruled that the Patient Protection and Affordable Care Act (ACA) is constitutional. The ACA made many reforms to healthcare coverage. Some of the provisions in this law already took effect, and many more will take effect in the coming years. In order to pay for all these reforms, there were many different tax changes in this law.

Two of the tax changes that will take effect in 2013 are Medicare tax on earnings is increased by 0.90% for earnings above a threshold amount<sup>1</sup>, and a 3.8% Medicare Surtax on net investment income above a threshold<sup>2</sup>. Assuming the Bush tax cuts expire at the end of this year, some taxpayers could be paying federal income taxes as high as 43.4% in 2013.

Currently, the Medicare tax on all of your earnings is 1.45%. Earnings include wages and self-employment income. Starting next year, any earnings above the threshold amount will incur an additional 0.90% for a total of 2.35%. The threshold amounts for Medicare tax are:

Single Tax Payer: \$200,000 of earnings  
Married Filing Jointly: \$250,000 of earnings

The 3.8% Medicare Surtax on net investment income will be calculated on the lesser of net investment income or the amount of modified adjusted gross income (MAGI) greater than the threshold. The thresholds for this Medicare Surtax are:

Single Tax Payer: \$200,000 MAGI  
Married Filing Jointly: \$250,000 MAGI

In order to understand this new tax, it is important to understand what is included in net investment income and modified adjusted gross income.

Modified adjusted gross income is your adjusted gross income plus any net foreign earned income exclusion.

Net investment income includes the following:

- Taxable Interest
- Dividends
- Capital Gains
- Annuity Income
- Passive Royalties
- Net Rental Income

Net investment income **does not** include:

- Wages
- Exempt Interest
- Active Royalties
- IRA & 401(k) Distributions
- Pension Income
- Social Security Income

Even though these items are not investment income, they could trigger your modified adjusted gross income to be above the threshold amount, which could trigger this additional tax on your net investment income.

Here are a few quick examples to help you understand this tax:

- Jim is a single taxpayer and has wages of \$250,000 and doesn't have any net investment income. Even though his earnings are greater than the threshold, he will not have to pay the 3.8% Medicare Surtax since this tax is calculated on the **lesser** of net investment or amount of modified adjusted gross greater than the threshold.
- Bob is a single taxpayer and his only income is net investment income of \$250,000. He will have to pay the 3.8% Medicare Surtax on \$50,000. (\$250,000 MAGI minus \$200,000 threshold)
- Bill and Betty are married tax payers filing jointly. They have combined wages of \$225,000, and net investment income of \$50,000. In this example their modified adjusted income is \$275,000. They would have to pay the 3.8% Medicare Surtax on \$25,000 of their net investment income (\$275,000 MAGI minus \$250,000 threshold).

Please give me a call at (941) 907-0374 to determine if you will be subject to the 3.8% Medicare Surtax on net investment income. There might be strategies that we can implement to reduce your exposure to this new tax.

Thank You,

Aaron Niec CPA, CFP®

1 IRS Code Secs. 1401(b)(2), 3101(b)(2) [in effect after 2012]

2 IRS Code Sec 1411[in effect after 2012]

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