2014 FINANCIAL PLAYBOOK

Paying for the ACA: The Medicare and net-investment tax

Taxes intended to pay for the Affordable Care Act impact physicians, practice owners and employees alike

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HIGHLIGHTS

01 Funding additional money into your retirement plan may reduce your modified adjusted gross income and possibly reduce or eliminate the new taxes on both earned and unearned income.

02 If you are active in a business and sell it, this is generally considered a non-passive activity and the sale proceeds would not be subject to this new ACA tax.

The Affordable Care Act (ACA) imposes new taxes on higher earners. It adds a new Medicare tax on earned income as well as a new net investment income tax on unearned income. These may have an impact on your bottom line.

If you have modified adjusted gross income (line 37 of Form 1040) exceeding $250,000 if married or $200,000 if single, you are now subject to two additional taxes as a result of the ACA.

Prior to year end, it would make sense to confer with your tax counsel to review whether there are opportunities to minimize or eliminate these new taxes or other options to enable you to pay the least tax permitted under the law.

MEDICARE SURTAX

Your earned income, including self-employment earnings, is subject to a new .9% Medicare tax if you (or you and your spouse if married) exceed the stated thresholds.

Your earned income and the earned income of your spouse are aggregated in determining whether you exceed the threshold and the amount of the excess. For example, if you and your spouse earn $150,000, then $50,000 ($300,000 minus the $250,000 threshold) would be subject to the .9% tax.

Unlike regular Medicare and Social Security taxes, your employer does not match this payment to the government.

If you are a W-2 employee, your employer is required to start withholding this tax after your income exceeds $200,000, whether you are married or single. If you do not exceed the $250,000 threshold and you are married, the additional withheld amount will eventually be credited or refunded to you.

If you work two or more jobs, all your earnings are aggregated for purposes of determining whether this tax is due. For example, if you are single and earn $150,000 from each of two jobs, to the extent that the $300,000 total exceeds the $200,000 threshold, you will owe an additional .9%. With your Form 1040, you must file Form 8959 each year specifying the calculation of the additional tax due.

One way to reduce the tax is to employ your children in your business. To the extent that monies are paid to them instead of to you, such income would not be subject to the new Medicare tax.

THE NET-INVESTMENT INCOME TAX

A second new tax was also imposed as part of the ACA. The net investment income tax is a 3.8% tax levied on most forms of unearned income.

Historically, taxpayers have not been subject to Medicare taxes on their unearned income, only their wages. But now it applies if you have modified adjusted gross income above the applicable threshold amount.

If your income exceeds the aforementioned thresholds, you are subject to a new 3.8% tax on certain forms of unearned income. The types of income subject to this tax include most capital gains, the sale of rental property, interest, dividends, annuity interest, rent, S-Corporation passive income and partnership passive income. It also applies to large gains on the sale of your primary residence if otherwise taxable, as well as the sale of vacation homes.

As an example, if you are married and your earned income is $230,000 and you have interest and dividends of $50,000 for a total income of $280,000, the $50,000 of interest and dividends will be subject to the new tax but only to the extent that your modified adjusted gross income exceeds $250,000. In this example, therefore, $30,000 is subject to the tax.

Furthermore, the new tax also applies to trusts and estates to the extent that modified adjusted gross income from them exceeds $12,150. Although most trusts and estates pass income through to the beneficiaries and most income is not subject to tax at the trust/estate level, you might review your estate planning to verify whether any testamentary trust is a complex trust retaining income, possibly subjecting it to this new tax.

If you are active in a business and sell it, the proceeds are generally considered a non-passive activity and the sale proceeds would not be subject to this new ACA tax.

Gifted income to your children yielding interest and dividends, such as stocks and bonds, may not be subject to the tax. Furthermore, funding additional money into your retirement plan may reduce your modified adjusted gross income and possibly reduce or eliminate the new taxes on both earned and unearned income.

If your children subject you to the "kiddie tax," their income should not be included on your tax return if you are subject to the new net-investment income tax because you have the option of including such income on their returns instead and they would likely not be subject to the tax.

Medicare surtax

An individual is subject to additional Medicare taxes if the individual's wages, compensation, or self-employment income (together with that of his or her spouse if filing a joint return) exceeds the threshold amount for the individual's filing status.

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying widow(er) with dependent child	$200,000

The net-investment income tax

Individuals will owe the tax if they have net-investment income and also have modified adjusted gross income over the following thresholds.

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying widow(er) with dependent child	$250,000

Source: Internal Revenue Service

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