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## Medicare tax primer

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Although the new Medicare tax has been much discussed, it is still likely that many will be caught by surprise by it. The Health Care and Education Reconciliation Act of 2010 imposes a new tax of 3.8% on the net investment income of individuals, estates, and trusts that exceeds \$200,000, or \$250,000 for joint filers. Net investment income includes capital gains, dividends, annuities, royalties, interest, rents, and income from some trades or businesses.

This new tax does not apply to wages or service compensation, tax-exempt bond interest, veterans' benefits or gain from the sale of a principal residence. In addition, the tax does not apply to distributions from qualified pension plans, profit-sharing plans, stock bonus plans, qualified annuity plans, individual retirements accounts, Roth IRAs and deferred compensation plans of state and local governments and tax-exempt organizations.

The tax applies to the lesser of (i) the taxpayer's net investment income, and (ii) the excess of the taxpayer's modified annual gross income over (a) \$250,000 for married taxpayers filing jointly or qualified surviving spouses, (b) \$125,000 for married individuals filing separately, and (c) \$200,000 for other taxpayers. Net investment income is the sum of (1) the taxpayer's gross income from interest, dividends, annuities, rents, and royalties other than such income derived in the ordinary course of a trade or business, and (2) the net gain to the extent taken into account in computing taxable income, attributable to the sale or other taxable disposition of property other than net gain from property held in a trade or business, less the allowable deductions which are properly allocable to such income or net gain.

Income from an active trade or business (other than a financial instrument or commodities trading business) is not treated as net investment income, whether the business is conducted through a sole proprietorship, a partnership, a limited liability company, or an S corporation. Proposed IRS regulations that are effective for tax years beginning after Dec. 31, 2013, provide that, if an individual owns or engages in a trade or business (a) directly or (b) indirectly through a limited liability company that he owns alone, then the determination of whether an item of gross income from interest, dividends, annuities, royalties, and rents is derived in a trade or business is made at the individual's level, rather than at the company level.

If you are anticipating the receipt of net investment income this year, you may want to consult a tax advisor to determine if there is any type of tax planning that may be of use.

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