

NEW INVESTMENT INCOME SURTAX – What it Means for You

"The only difference between death and taxes is death does not get worse every time Congress meets." - Will Rogers

In March of 2010 President Obama signed into law the 2010 Healthcare Reconciliation Bill. The bill has more than 2,500 pages that detail numerous provisions for offering new health insurance coverage to 32 million people. To help finance this new healthcare package, Congress added new tax provisions to the Internal Revenue Code. Several notable tax changes include: an increased percentage of the FICA tax going toward Medicare; an excise tax on high-end or "Cadillac" insurance plans; an excise tax on uninsured individuals; and a surtax on taxable investment income.

Overview of the Medicare Surtax

Beginning this year, 2013, a new 3.8% Medicare tax will be imposed on investment income for taxpayers with "Modified Adjusted Gross Income" (MAGI) over certain thresholds. The MAGI threshold amount for a single individual is \$200,000 and for a married couple is \$250,000 (\$125,000 if married filing separately). Non-grantor irrevocable trusts face a \$12,000 threshold.

The types of investment income that qualify for the new surtax include taxable interest, dividends, realized capital gains, annuity distributions, rents, royalties, and passive income. Investment income not subject to the surtax include:

- Distributions from qualified retirement plans
- Withdrawals from Roth IRAs
- Non-qualified deferred compensation plans
- Income from an active business
- Gain on the sale of a partnership or S corporation

In 2013, the highest marginal federal tax bracket for ordinary income went from 35% to 39.6. The surtax will then extend the highest rate to 43.4%. Prior to this year, investors with qualified high dividend income paid a 15% tax on that income. But this year, dividend income will be taxed as ordinary income, plus the additional surtax, which could result in an increase of over 200% in investment taxes.

How It Works - Examples of the Surtax

A single person has earned income of \$100,000 and investment income of \$50,000 for a total MAGI of \$150,000. This person would not be subject to the surtax since MAGI is under \$200,000.

A married couple has required minimum distributions of \$200,000 and investment income of \$150,000 for a total MAGI of \$350,000. They are subject to the tax on the \$100,000 of investment income above the threshold.

A married couple with a Roth IRA withdrawal of \$200,000 and investment income of \$250,000 would not be subject to the surtax. All qualified distributions from Roth IRAs are not part of MAGI.

Planning for the Surtax

Taxpayers likely to face the surtax tax should consider the follow planning opportunities:

- Convert IRAs to Roth and pay tax in a lower tax environment
- Employ tax sensitive asset allocation
- Invest in (tax-exempt) municipal bonds
- Contribute to defined contribution and retirement plans
- Deferred compensation plans
- Fund non-modified endowment high cash value life insurance contracts
- Intra-family income shifting strategies
- Charitable remainder trusts to avoid capital gains
- Installment sales
- Pay close attention to tax loss selling at the end of the year

Planning for this new surtax in a higher tax environment is complicated. Each taxpayer has unique circumstances and planning objectives. Taxpayers and advisors must be aware of the various strategies and investment vehicles that can reduce the impact of the tax. The integration of financial planning and investment management is a very important aspect of the planning we do at *Wheaton Wealth Partners*.

We're committed to serving you and helping you handle financial complexities, such as reducing the impact a high tax environment has on your wealth. As always, our team strives to provide you with forward-thinking, innovative solutions with a profound underlying commitment to your well-being. If you have any questions or wish to discuss how the new tax environment might impact you, please call us at 630-221-9222.