

2018 Tax Planning for Investment Income

3.8% Surtax on Net Investment Income

What Will Be Considered Investment Income?

Investment Income

Investment Income
Interest, Dividends, Capital Gains (long and short - including the gain on the sale of investment real estate and second homes)
Annuities (but not annuities in IRAs or company plans)
Royalty Income
Passive Rental Income and Other Passive Activity Income

NOT Investment Income

Wages and Self-Employment Income
Active Trade or Business Income (including interest, dividends, capital gains)
Distributions from IRAs, Roth IRAs, and Company Plans – Including Net Unrealized Appreciation
Excluded Gain from the Sale of a Principal Residence
Municipal Bond Interest
Proceeds of Life Insurance Policies
Social Security and Veterans' Benefits
Gains on the Sale of an Active Interest in a Partnership or S Corporation

Taxable income from items that are **NOT** investment income can push taxpayers over the income threshold and cause investment income to be subject to the 3.8% surtax.

MAGI Thresholds for 3.8% Surtax

Married Filing Joint	\$ 250,000
Individuals	\$ 200,000
Married Filing Separate	\$ 125,000
Trusts and Estates	\$ 12,500*

* Trusts are hit hard – The 3.8% surtax kicks in at much lower income levels for trusts. The threshold for trusts and estates is the amount at which the top trust tax bracket takes effect. This amount is \$12,500 in 2018. All other threshold amounts are NOT indexed for inflation.

MAGI (Modified Adjusted Gross Income)

The 3.8% surtax applies to net investment income when MAGI exceeds these threshold amounts

For this purpose, MAGI is a taxpayer's regular AGI, plus any foreign income excluded from AGI

The 3.8% Medicare tax is imposed on the lesser of (1) net investment income or (2) the amount of MAGI over the threshold amount.

Taxpayers with income below these MAGI levels will not be subject to the tax

Other Health Care Tax Provisions:

- * Additional 0.9% Medicare tax on wages and self-employment income over the threshold amounts
- * Medical expenses must exceed 7.5% of AGI to be deductible – the 7.5% also applies to the medical expense exception to the 10% penalty on early IRA or plan withdrawals

– Tax Planning Points –

- 1 - The 3.8% tax is **in addition** to the tax rates for high income individuals. Those at the top brackets can have long-term capital gains and dividends taxed at 23.8% and other investment income taxed at 40.8%
- 2 - IRA and plan distributions (including sales of employer securities with net unrealized appreciation) are exempt from the 3.8% surtax on net investment income, but taxable distributions from these accounts can push income over the threshold amounts causing other investment income to be subject to the tax
- 3 - Roth conversions will increase current income, but future tax-free Roth distributions will be more valuable as a means to eliminate taxable income and required minimum distributions from traditional IRAs
- 4 - The 3.8% surtax is subject to the estimated tax provisions
- 5 - Taxpayers who have named a discretionary (accumulation) trust as their IRA beneficiary should consider Roth conversions to avoid potential harsh trust tax rates at low trust income levels - or consider a conduit trust
- 6 - Salary deferrals (401(k), 403(b), etc.) can reduce MAGI for the 3.8% surtax but cannot reduce earned income for the 0.9% additional Medicare tax