

PLANNING FOR THE NEW 3.8% MEDICARE TAX ON UNEARNED INCOME

JULY 18, 2011

New Tax

- Effective in 2013
- Applies To Taxpayers with Gross Income Above \$200k (Single) & \$250k (Married)
- Unearned Income Includes:
 - Interest, Dividends, Annuities, Royalties, Rents,
 - Passive activity income, and
 - Capital gains (including the taxable portion of a sale of a personal residence)
- Estates And Trusts (Other Than Charitable Trusts) Taxed On Undistributed Income.
- Medicare Tax Is Not Deductible For Federal or State Tax Purposes
- Estimated Tax Payments are Required

Planning Through Q4 2012

- Take unrealized gains
 - “Wash Sale” rules only apply to losses so repurchasing within 30 days permitted.
- Reversal of Trend Toward 15% Rated Dividends?
- Growth & low yield securities would defer the taxable event & could avoid tax if gains taken in lower-income retirement years.
- Tax-Exempt Bonds Yields Effect?
 - With the tax rate on taxable interest income going up by 10% (3.8%/35%) the current 65% “taxable-equivalent gross-up” becomes 61.2%. Does this mean that the taxable equivalent yields will go up by 10% or 40 basis points on a 4% long term Municipal Bond?
- Maximize Investments in Qualified Plans
- Insurance Products Exempt:
 - Inside buildup of life insurance cash surrender value
 - Death benefit
- Rents Taxed if “Passive” –
 - “Active” status requires over 50% of time & over 750 hours
- Other “Passive” Business Activities Taxed
 - Complex rules to qualify as “Active” & may attract the 15% self-employment tax!
- Active Business’s Taxed on Idle Cash Earnings and Gains
- Gain on Sale of Flow-through Entity Attributable to “Passive” Assets Taxed
- No Hedge Fund Exception – Unlike “Active” Status Exception for Regular Tax Purposes
- Certain Oil & Gas Working Interest Royalties May Avoid Tax- IRS Clarification Needed