

FTA FAMILY TAX ADVANTAGE

Toll Free (877) FAMTAX-7

Sun Lakes, AZ	Stamford, CT
(480) 802-5-TAX	(203) 322-4888
(480) 802-8147 or (917) 464-7519 Fax	Fax (203) 968-0666

Daniel M. Morson, CPA	Eric B. Morson
Managing Member	Tax Advisor

NEWS FLASH

New Rules for High-Income Taxpayers

JANUARY, 2013

Effective in 2013, taxpayers with Adjusted Gross Income (AGI) greater than \$250,000 will be subject to the new 3.8% Net Investment Income Tax, and an extra 0.9% Medicare tax on salaries and self-employment income that exceed \$250,000. Those with AGI over \$300,000 will lose all or a portion of their Itemized Deductions and Personal Exemptions. Taxpayers with Taxable Income (TI) greater than \$450,000 will have two additional tax increases: A top rate of 39.6% (versus 35% in 2012), and a top capital gains rate of 20% (versus 15% in 2012). For the sake of readability, the dollar figures (known as "Threshold Amounts") in this letter are based upon married persons filing joint returns; the Threshold Amounts are lower those filing as Single, Head-of-Household, and Married Filing Separately. See the chart at the end of this letter for all the threshold amounts.

The Net Investment Income (NII) tax of 3.8% is imposed on the lesser of:

- (a) Investment income (interest, dividends, capital gains, net rental income, passive investment income, and more) minus Investment Expenses incurred to produce the investment income (such as brokerage fees).
- (b) The amount by which AGI (with certain modifications) exceeds \$250,000.

Example: John and Mary have AGI of \$300,000. They have income from dividends, interest, and net capital gains that total \$41,000 and have paid \$1000 in fees to their investment advisor. Their Net Investment Income is \$41,000 – \$1,000 = \$40,000. Their AGI exceeds \$250,000 by \$50,000 (\$300,000 – \$250,000). The lesser of these two amounts is \$40,000, so the NII tax is 3.8% x \$40,000 = \$1,520.

Contrary to rumors that have been circulating on the internet for several years, the NII tax is not imposed on the gross selling price of a personal residence.

The first \$500,000 of gain (\$250,000 for Single persons) is exempt from tax. Only gain over that amount is subject to capital gains tax and NII tax.

Additional 0.9% Medicare Tax is imposed on salaries and self-employment income excess of \$250,000. Example: Fred is self-employed and had net income from his business of \$180,000. His wife Karen earned \$225,000 in salary. Their total salaries are therefore $\$180,000 + \$225,000 = \$405,000$, which exceeds the \$250,000 threshold by \$155,000. They will therefore owe $0.9\% \times \$155,000 = \$1,395$ in additional Medicare Tax. However, since Karen earned over \$200,000, her employer was required to withhold an extra 0.9% on the amount of her salary over \$200,000 = $\$25,000 \times 0.9\% = \225 . This withholding tax would be credited against their combined extra Medicare tax of \$1,395, leaving \$1,170 owing when they file their income tax return.

The threshold amounts for the NII and Additional Medicare tax *will not* be adjusted for inflation in the future.

Personal Exemption Disallowance occurs when AGI exceeds \$300,000. Personal exemptions (about \$3900 each in 2013) are reduced by 2% of the amount by which AGI exceeds \$300,000; however this computation is done in \$2,500 increments. Example: Joe and Clara have AGI of \$408,000. They have two dependent children, so have 4 personal exemptions = \$15,600. The disallowance is computed by subtracting \$300,000 from AGI of \$408,000 = \$108,000, then dividing that by 2,500 and rounding up any fractions. $\$108,000 \div \$2,500 = 43.2$ rounded = 44. Then $44 \times \$2,500 \times 2\% = \$2,200$. Therefore their personal exemptions are reduced by \$2,200 to \$13,400 ($\$15,600 - \$2,200$).

Itemized Deduction Disallowance occurs when AGI exceeds \$300,000. Total Itemized Deductions are reduced by 3% of the amount by which AGI exceeds \$300,000. Joe and Clara, with AGI of \$408,000 would therefore lose $3\% \times (\$408,000 - \$300,000) = \$3,240$ of their Itemized Deductions. Certain itemized deductions are not subject to the disallowance, and the total disallowance cannot be more than 80% of total itemized deductions.



Except for the threshold amounts, the rules for disallowance of Personal Exemptions and Itemized Deductions are the same as the rules that were in effect in the 1990s and early 2000s. The threshold amounts *will be* adjusted for inflation starting in 2014.

Higher Tax Rates are in effect starting in 2013 for those with Taxable Income (TI) over \$450,000. In 2012 the highest tax bracket was 35% on taxable income over \$388,350. Beginning in 2013, TI over \$450,000 will be taxed at 39.6%. Also in 2013, the **capital gains tax rate** will increase from 15% to 20% for anyone who is in the 39.6% bracket on taxable income. Example: Jack and Jill have taxable income of \$1,000,000, which includes long-term capital gains of \$200,000. In 2012 their income tax would be $\$249,140 + 15\% \times \$200,000 = \$279,140$. In 2013 their income tax would be approximately $\$264,446 + 20\% \times \$200,000 = \$304,446$, an increase of \$25,306. Note that this *does not include* the 3.8% NII tax, nor the effects

of the disallowance of itemized deductions and exemptions, so the actual 2013 tax would be even higher. These amounts *will be* adjusted for inflation starting in 2014.

This all sounds very complex and convoluted, and it is. Depending upon individual circumstances, these changes may have an effect on your 2013 quarterly estimated taxes. As always, we are here to answer any questions you may have.

	Dan	Eric
Direct	(480) 802-5-TAX	(203) 322-4888
Toll Free	(877) FAMTAX-7, Ext. 1	(877) FAMTAX-7, Ext. 2
E-Mail	Dan@FamTax.com	Eric@FamTax.com
Fax	(917) 464-7519 or (480) 802-8147	(203) 968-0666

 and 

Threshold Amounts

	Based on	Married / Joint	Single	Head of Household	Married / Separate
Net Investment Income Tax 3.8% (*)	AGI	\$250,000	\$200,000	\$200,000	\$125,000
Additional Medicare Tax 0.9% (*)	Salary	\$250,000	\$200,000	\$200,000	\$125,000
Personal Exemption Disallowance (\$)	AGI	\$300,000	\$250,000	\$275,000	\$150,000
Itemized Deduction Disallowance (\$)	AGI	\$300,000	\$250,000	\$275,000	\$150,000
39.6% bracket (\$)	TI	\$450,000	\$400,000	\$425,000	\$225,000
20% capital gains rate (\$)	TI	\$450,000	\$400,000	\$425,000	\$225,000

(*) Not adjusted for inflation.

(§) Adjusted for inflation starting in 2014.