



Abbott, Stringham  
& Lynch

# Income Tax Implications

Patient Protection & Affordable  
Care Act and Tax Relief Act of  
2012

March  
2013

CERTIFIED PUBLIC  
ACCOUNTANTS & BUSINESS  
ADVISORS

# Tax Provisions in the Healthcare Act

- Starting in 2013 (if EI > \$200,000 single / \$250,000 MFJ):
  - Additional 0.9% Medical Hospital Insurance Tax (HI tax) on Earned Income above thresholds.
  - Additional 3.8% Medicare tax on net investment income above thresholds. (Capital gains, dividends, rents, royalties, gain on sale of residence after taking into account Sec 121 exclusion, gain on sale of second home, etc.)
- Medical expenses must exceed 10% of AGI to be deductible.

# Additional Medicare Tax

## Example 1 – Additional HI tax on Net Investment Income (3.8%)

A retired couple has taxable income of \$100,000 from IRAs and other retirement plans, plus pension and Social Security payments of \$60,000. They also have dividends and interest of \$40,000, plus \$45,000 from selling some investments. Because all this income totals below their **\$250,000** threshold, the 3.8% additional HI tax does not affect them.

$$\$100,000 + \$60,000 + \$40,000 + \$45,000 = \mathbf{\$245,000}$$

# Additional Medicare Tax

## Example 2 – The HI Tax (0.9%)

Jon's salary is \$240,000. He has additional HI withholding of \$360 ( $\$40,000 \times 0.9\%$ ). Jill earns \$80,000. No additional HI is withheld from Jill's salary.

Jon:	\$240,000	Add'l HI Tax	\$630
<u>Jill:</u>	<u>\$ 80,000</u>	<u>Withheld</u>	<u>(\$360)</u>
Total:	\$320,000	<b>Balance due</b>	<b>\$270</b>
<u>Exclusion:</u>	<u>(\$250,000)(MFJ)</u>		
Subject to tax: \$ 70,000			
<u>Rate:</u>	<u>0.9%</u>		

# Additional Medicare Tax

## Example 3 – Additional Medicare tax on Net Investment Income (3.8%)

Jon's (single T/P) salary is \$175,000, and he earns net investment income of \$80,000.

MAGI: \$255,000

Threshold: \$200,000

Excess: \$ 55,000

Inv. Income: \$ 80,000

Lesser of both: \$ 55,000 (MAGI is less than Net

Rate: 3.8% Investment Income)

**Add'tl HI Tax: \$ 2,090**

# Additional Medicare Tax

## Example 4 – Capital Gain: Sale of a Non-Real Estate Asset

Barry and Michelle inherited stocks and bonds that they have decided to liquidate. The sale of these assets generates a capital gain of \$120,000. Their AGI before the gain is \$140,000.

*The tax applies as follows:*

AGI Before Capital Gain	\$140,000	
Gain on Sale of Stocks and Bonds	\$120,000	
New AGI	\$260,000	
Excess of AGI over \$250,000	\$ 10,000	(\$260,000 - \$250,000)
Lesser Amount ( <i>Taxable</i> )	\$ 10,000	(AGI excess)
<b>Tax Due</b>	<b>\$ 380</b>	(\$10,000 X 0.038)

**NOTE:** In this example, only \$10,000 of their capital gain is subject to the 3.8% tax. If their gain had been smaller (less than \$110,000), they would not pay the 3.8% tax because their AGI would be less than \$250,000.

# Additional Medicare Tax

## Example 5 – Capital Gains, Interest & Dividends: Securities

Harry and Sally have substantial income from their securities investments. Their AGI before including that income is \$190,000. Their investment income is listed below.

*The tax applies as follows:*

Interest Income ( <i>Bonds, CDs</i> )	\$ 60,000	
Dividend Income	\$ 75,000	
Capital Gains	\$ 10,000	
Total Investment Income	\$ 145,000	
New AGI	\$ 335,000	<i>(\$190,000 + \$145,000)</i>
Excess of AGI over \$250,000	\$ 85,000	<i>(\$335,000 - \$250,000)</i>
Lesser Amount ( <i>Taxable</i> )	\$ 85,000	<i>(AGI excess)</i>
<b>Tax Due</b>	<b>\$ 3,230</b>	<i>(\$85,000 X 0.038)</i>

# Additional Medicare Tax

## Example 6 – Rental Income: Rental Income as Sole Source of Earnings – Real Estate Trade or Business

Henrietta’s sole livelihood is derived from owning and operating commercial buildings. Thus, these assets are treated as business property and not as investment property. Her income stream is outlined below.

*The tax applies as follows:*

Gross Rents	\$ 750,000	
Expenses <i>(including depreciation and debt service)</i>	\$	520,000
Net Rents	\$ 230,000	
New AGI <i>(Net rental income)</i>	\$ 230,000	
Excess of AGI over \$200,000	\$ 30,000	
Lesser Amount <i>(Taxable)</i>	\$	0 (No investment income)
<b>Tax Due</b>	<b>\$</b>	<b>0</b>

*Henrietta’s rental income is from a trade or business so it is NOT treated as investment income. Thus, she is NOT subject to the 3.8% investment income tax.*



# Additional Medicare Tax

## Example 7 – Sale of a Second Home with No Rental Use (or no more than 14 days rental)

The Bridges own a vacation home that they purchased for \$275,000. They have never rented it to others. They sell it for \$335,000. In the year of sale they also have earned income from other sources of \$225,000.

*The tax applies as follows:*

Gain on Sale of Vacation Home	\$ 60,000	<i>(\$335,000 - \$275,000)</i>
Income from Other Sources	\$ 225,000	
New AGI	\$ 285,000	<i>(\$60,000 + \$225,000)</i>
Excess of AGI over \$250,000	\$ 35,000	<i>(\$285,000 - \$250,000)</i>
Capital Gain	\$ 60,000	
Lesser Amount ( <i>Taxable</i> )	\$ 35,000	<i>(AGI excess)</i>
<b>Tax Due</b>	<b>\$ 1,330</b>	<i>(\$35,000 X 0.038)</i>

# Other Expiring Provisions – That Didn't Expire

- Dollar cap on FSA contributions limited to \$2,500.
- AMT Exemption Amounts – We got the patch! Indexed for inflation.

	<u>2013</u>	<u>2012</u>
□ MFJ	\$80,800	\$78,750
□ Single	\$51,600	\$50,600
□ MFS	\$40,400	\$22,500

- Research Credit under 41(h)(1)(B) extended...again.
- 50% Bonus Depreciation for qualifying property expires 12/2013.
- Section 179 expensing of \$500,000 extended for both 2012 and 2013.
- Higher threshold for medical expense deduction

# 2013 Tax Brackets (MFJ)

Taxable Income	
\$0 - \$17,850	10%
\$17,851 - \$72,500	15%
\$72,501 - \$146,400	25%
\$146,401 - \$223,050	28%
\$223,051 - \$398,350	33%
\$398,351 - \$450,000	35%
\$450,000 +	39.6%
Standard Deduction	\$9,950
Personal Exemption	Phase-Outs
AMT Patch Exemption	\$80,800 (MFJ)
Source: Tax Policy Center and the Internal Revenue Service	

# Tax Planning for the HCA/2013

- Dividends from C and S Corps
- Recognition of LTCG in 2013 15% or 20%
- Plan the Use of Available Losses
- Qualified Distributions from Roths instead of traditional IRA's – need a Roth??
- Rollover to a Roth in 2013, or over time?
- Buy Depreciable Property in 2013 to Lock In 50% Bonus/Sec 179 deduction
- Use Roth IRAs instead of traditional IRAs
  - Qualified distributions from a Roth IRA are tax-free, and are not included in both MAGI and net investment income. In contrast, distributions from regular IRAs (except to the extent of after-tax contributions) will be included in MAGI and subject to the additional HI tax on investment income (3.8%).

# Who Pays Taxes? – '09 IRS Data (140m returns)

- Total tax Generated = \$953 Billion / Deficit in same FY = **\$1.4T**
  - 81.9M taxable returns = 58.3% of all returns filed
- Top 1% = > \$344,000 (Average AGI = \$960,000)
  - Received 17% of all income
  - Paid 37% of all federal taxes = \$352,610,000,000
  - Average Tax Rate = 24%
  - If you taxed them at 100%, IRS would collect **\$1.5Trillion**
- Top 10% = > \$112,000 (Average AGI = \$245,000)
  - Received 43% of all income
  - Paid 71% of all federal taxes
  - Average tax rate = 18.1%
- Bottom 50% = Income under \$32,000 (Average AGI = \$15,000)
  - Received 13% of all income
  - Paid 2% of all federal taxes
  - Average tax rate = 1.9%
- 41.7% of ALL federal filers have \$0 income tax liability (the majority of which come from the bottom 50%)
- In 2012, 67.3M Americans depend on fed assistance.