

TAXING THE RICH TO PAY FOR HEALTH CARE

That's part of the plan. How will you be affected?

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In 2013, wealthy Americans will pay extra Medicare taxes. Congress, President Obama and the IRS are putting a surcharge on the wealthy to help fund the health care reforms.

- Beginning in 2013, joint filers with adjusted gross incomes of \$250,000 or greater and single filers with AGI of \$200,000 or greater will have to pay 0.9% extra in FICA taxes (that is, Social Security and Medicare taxes). The employers of these taxpayers face no such increase.¹
- Also, joint filers with modified adjusted gross income (MAGI) of \$250,000 or more and single filers with MAGI of \$200,000 or more will be docked with a 3.8% tax on investment income. (Even estates and trusts will be subject to this new 3.8% levy.)¹

What might the dollar impact be? The Tax Foundation, a politically conservative watchdog organization, thinks that the richest 1% of American families will pay an average of \$52,000 more in federal taxes by 2016.²

What are the chances of these tax hikes being repealed? Think slim and none. Basically, you'd have to repeal the health care reforms to make it happen.

How can you avoid the 3.8% tax on dividends, capital gains & interest? It won't be easy. Real estate investors may luck out the most, because federal law characterizes rental income as "active" rather than "passive". On the other hand, if you sell a home you've owned for decades and see a taxable gain above the home sale exclusion (\$250,000 single, \$500,000 married), you'll face the 3.8% tax.¹

Some forms of unearned income won't be slapped with the tax. IRA distributions and income distributions from 401(a), 403(b) and 457(b) plans will be exempt. The same goes for pension income and Social Security income. Annuities that are part of a pension plan will be exempt. Any income from a business that you participate in won't be hit with the 3.8% tax. Veterans' benefits, life insurance payouts and interest earned by municipal bonds will also be spared.^{1,3}

As a result of this tax, you might start to see subtle shifts in financial strategy. You might see more muni bond purchases, more interest in life insurance, and more installment sales. As qualified Roth IRA distributions don't boost AGI, you might be looking at another factor promoting Roth IRA conversions.³ Everybody will think about taking some capital gains prior to 2013.

The richest Americans have paid less tax in recent decades. Wealth for the Common Good (a liberal non-profit looking at this matter) notes that in 1955, the 400 largest incomes in America paid 51.2% of those incomes back in federal taxes. That led to the “tax shelters” of the 1960s and 1970s. In comparison, the top 400 incomes in America in 2007 paid out only an average of 16.6% in federal taxes.²

So how can you reduce your taxes in 2013? It is not too early to think about it. You might want to devote a planning session to this topic, or start to read up on your options.

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Citations

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