



Health Care Reform and Taxes

Income taxes will be going up for certain taxpayers as part of the health care legislation passed in March. Here's a quick rundown of who will be affected, and how, courtesy of our subscription to The Kiplinger Tax Letter, which keeps us posted on possible, emerging, and actual income tax changes as they occur.

For individual taxpayers, there are two new taxes in the legislation (they're the key revenue raiser for the program, according to Kiplinger's). Both taxes will take effect in 2013, and both target taxpayers who are well-off. The two taxes are collectively referred to as the "Medicare surtax", but apply to very different types of income.

The first tax applies to **earned income** - wages, and earnings from self-employment. If you're retired, and have no earned income, this tax is not going to apply -- the tax is basically an increase in the amount of Medicare tax that an employee or self-employed individual has to pay during their working years.

Right now, we all pay 1.45% of our wages in Medicare taxes; our employer kicks in an equal amount, for a total Medicare tax paid of 2.9%. Starting in 2013, people whose earnings are over \$200,000 (single filer) or \$250,000 (married filing joint) will pay an extra 0.9% from their wages (not matched by their employer).

The second tax is a new 3.8% tax on **unearned income** - interest, dividends, capital gains, royalties, and rental income, for example (this tax **does not** apply to pension benefits, or IRA/401(k)/403(b) distributions). This tax is going to be assessed on unearned income if total income exceeds \$200,000 (single filer) or \$250,000 (married filing joint) - talk about a marriage penalty!

Here's an example. Let's say we have a married couple, with total income of \$270,000. As part of that total, they've got \$50,000 in unearned income. The new tax will be assessed on the smaller of:

- Their income over \$250,000, which is \$20,000
- Or their unearned income, which is \$50,000

So in this case, the Medicare surtax would be applied to \$20,000. 3.8% of \$20,000 would result in \$760 in additional taxes for this taxpayer.

I'm simplifying a bit to get the basics across; for those of you who can bear the details, income for the purposes of this tax is actually Modified Adjusted Gross Income.

There's not much planning that can be done to avoid the first tax -- wages are wages. The second tax, however, may drive some behavior. Tax-free municipal bonds (tax-free income is not subject the surtax) are going to be more attractive to people with significant income, and taxpayers who are planning on selling positions with large capital gains in the near term have added incentive to do so before 2013.

Life is never boring in the world of tax! Let us know if you have any questions.

-- Karen O'Brien. Posted 05/19/10.