



## *A Message from the Tax Practice Group*

### **3.8% Tax on Net Investment Income**

In 2010, when the Patient Protection and Affordable Care Act (Obamacare) was signed, some of the tax implications seemed distant. Well, three short years later here we are now in 2013. One of these tax implications is the 3.8% tax on Net Investment Income (3.8% tax).

As with many tax laws and regulations, it is not as straightforward as it may sound. However, the first step is determining if you are subject to the 3.8% tax. For individuals, this determination is made based on your Modified Adjusted Gross Income (MAGI). MAGI is your AGI plus any excluded foreign earned income. For trusts, the determination is made based on AGI in excess of the top trust tax bracket.

While there are income items that are not subject to the 3.8% tax, they can still affect the 3.8% tax by causing AGI levels to exceed the thresholds. For instance, distributions from retirement plans are typically not subject to the 3.8% tax; however, a distribution from a retirement plan could push income over the thresholds causing other investment income to be subject to the 3.8% tax. With some careful planning and timing, the 3.8% tax on Net Investment Income can be reduced or avoided for taxpayers that would otherwise be over the thresholds.

Please don't hesitate to call us and let us help determine if you are subject to this tax, and identify the impact this may have on your tax situation.

All the best,

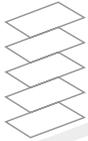
George Warner and Michael Resnick  
Tax Practice Group  
Batchelor, Frechette, McCrory, Michael & Co.

## THINGS TO KNOW

- 3.8% tax applies to individuals, trusts and estates.
- MAGI threshold for the 3.8% tax for individuals are \$250,000 married filing joint, \$200,000 single, \$200,000 head of household and \$125,000 married filing separate. For trusts, the 2013 threshold is \$11,950.
- Net Investment Income includes:
  - a. Interest, dividends, annuities, royalties, net gain on sale of securities and most rental income (net of investment expenses)
  - b. Any other gross income from a *passive* trade or business activity
  - c. Net gain on sale of property unless from a non-passive trade or business
- Generally, a passive activity is an activity where you do not materially participate. Material participation means that you are involved in business activities on a "regular, continuous and substantial basis."



**George Warner and Mark Everson,  
Former IRS Commissioner at an  
IRS Update event in August.**



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## **Did you know?**

1. Rental income that is not subject to 3.8% tax:
  - a. Property rented on average 7 days or less at a time (i.e. vacation rental)
  - b. Rental income earned by a real estate professional
  - c. Possibly self-rented property (although current regulations are not clear on this)
  
2. A NOL (net operating loss) carry forward does not reduce MAGI for purposes of determining the threshold.
  
3. A gain from the disposal of a partnership or S corporation interest may be subject to the 3.8% tax.

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