

3.8 Percent Medicare Surtax ... Explained

By Robert S. Keebler

Over the past several months, there has been quite a bit of accounting-related media attention about the 3.8 percent Medicare surtax—and for good reason. CPA financial planners need to know all they can about the surtax in order to help their clients plan for the future. Here's a summary of the latest news about the surtax and advice on how to work with your clients.



Beginning January 1, 2013, provisions from the Patient Protection and Affordable Care Act will go into effect. Specifically, the 3.8 percent Medicare surtax on investment income will apply to individuals, trusts, and estates whose income exceeds certain threshold amounts. The surtax will, in essence, raise the marginal income tax rate for clients in the 31 percent tax bracket and above, with a few exceptions. The marginal tax rate for these clients will be further increased by a reinstated phase out of itemized deductions.

Taxpayers in the highest marginal income tax rate, 39.6 percent, will pay 43.4 percent with the surtax in 2013. Many clients will see their tax rate jump by nearly 10 percent, or to nearly 45 percent, due to the surtax and the loss of the itemized deductions.

For individuals, the 3.8 percent surtax is imposed on the lesser of (1) net investment income for the tax year or (2) modified adjusted gross income (MAGI) above the

threshold amount in that year, allocable to such income. For purposes of the surtax, investment income includes dividends, interest, rents, capital gains, annuities royalties, and passive activity income.

The threshold amount for estates and trusts is \$11,650. For individuals, the threshold amount depends on the filing status of the taxpayer:

- Married, filing jointly: \$250,000
- Married, filing separately: \$125,000
- All other filers: \$200,000

For example, Tom and Sue, age 69, have investment income of \$249,000. Next year they are required to begin required minimum distributions. If they take a required minimum distribution of \$100,000, their MAGI will increase to \$349,000; \$99,000 of that is subject to the surtax.

For trusts and estates, the 3.8 percent surtax is imposed on the lesser of (1) the undistributed net investment income for the tax year or (2) the excess of the taxpayer's adjusted gross income over the dollar amount at which the highest tax bracket begins (as defined in Internal Revenue Code Section 67[e]).

How You Can Help Your Clients

It is essential that you understand the implications of the surtax and help determine the best ways your clients can mitigate the tax increase. All of this may sound familiar. Tax and legal practitioners who were in business during the '70s and '80s will have some benefit, as



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Between now and the end of 2012, there are many solutions you can discuss with your clients, including the following:

- Municipal bonds
- Tax-deferred annuities
- Life insurance

- Rental real estate
- Oil and gas investments
- Choice of accounting year for estate or trust
- Timing of estate or trust distributions
- Roth IRA conversions
- Charitable trusts

Determining which of these strategies to employ will be a complicated chess game. Every time you move a piece around the chessboard, you will have to look at the big picture to determine the impact one change will have on the entirety. Clients will need long-term strategic plans for tax planning. As a result, CPA financial planners will need to move from a tactical approach to something more strategic, an effort that should be in place throughout the year, not just during crunch periods.

Medicare Surtax Resources Available in Proactive Planning in Preparation for 2013 Toolkit

The PFP Division's [Proactive Planning in Preparation for 2013 Toolkit](#) was created to help you prepare your clients for the potential 2013 tax hikes. The toolkit includes planning flowcharts, seminar recordings and slide decks, customizable communication resources, podcasts, and more.

This toolkit contains the following resources to plan for the new 3.8 percent surtax:

- [Seminar recording](#) and [presentation materials](#) from Bob Keebler and Jere Doyle's August 15 Web seminar, *The 3.8% Medicare Surtax and Its Impact on Estates and Trusts*
- [Seminar recording](#) and [presentation materials](#) from Bob Keebler's May 31 Web seminar, *Planning Strategies in Wake of the New 3.8% Medicare Surtax*
- [Detailed analysis of the 3.8% Medicare Surtax](#) by Bob Keebler, originally published by Leimberg Information Services, Inc.
- [Planning Strategies in Wake of the New 3.8% Medicare Surtax Podcast](#) (recorded on May 31, 2012)
- [Chart on Understanding The Health Care Surtax](#) from Bob Keebler
- Checklists to plan for the Medicare surtax for [individuals](#) and [estates & trusts](#)
- [Customizable client PowerPoint](#) to illustrate issues and planning strategies with the Medicare surtax
- [Customizable client letter](#) that identifies and encourages clients to begin planning now
- [Forefield Alert](#), *What Does the Supreme Court Ruling on the Health-Care Reform Law Mean for You?*, which you can customize and send to your clients
- [In-depth newsletter](#) on planning with the 3.8 percent Medicare surtax from Michael Kitces (Note that PFP/PFS members save 10 percent on a monthly subscription to [The Kitces Report](#) by using discount code AICPAPFP)

PFP/PFS members also qualify for a more than a 50 percent discount on [Preparing Your Client for the 2013 Tax Increases: Tools, Tips, and Tactics](#), by Robert Keebler. This toolkit addresses planning for potential higher tax rates in 2013 across the board, and includes PDFs, a gain harvesting calculator, PowerPoint client presentations, a downloadable book detailing the 2013 tax implications for your clients, and more. It is essential to model various scenarios with your clients now that you can trigger as needed based on what transpires at year-end.

Is there something missing from the toolkit that would be particularly useful for you to plan effectively for and communicate with your clients? [Send](#) a note to the PFP team.