

New Medicare Taxes on Wages and Investment Income

Two new Medicare tax increases were included in the recently enacted health care reform law, the Patient Protection and Affordable Care Act, as amended. The tax increases are targeted toward higher income taxpayers. You and other physicians on your staff may be affected. Here are the details.

Additional Hospital Insurance Tax

The new law imposes a Medicare tax increase on individual taxpayers who earn more than \$200,000 annually, married taxpayers who file jointly and earn more than \$250,000, and married taxpayers who file separately and earn more than \$125,000. Beginning in 2013, taxpayers in these categories will have to pay an additional Medicare tax equal to .9% of their wages above the relevant threshold amount for their filing status. This effectively raises the Medicare tax rate from 1.45% to 2.35% on those earnings. The employer portion of the Medicare payroll tax is not affected by this change and will remain at 1.45% of earnings (with no cap).

Self-employed individuals will be liable for an additional tax of .9% of their self-employment income to the extent it exceeds the relevant threshold amount. The additional self-employment tax is not deductible.

Surtax on Investment Income

The new law also imposes a 3.8% surtax, referred to as the "unearned income Medicare contribution," on the investment income of higher income individuals, estates, and trusts. The surtax also becomes effective in 2013.

For individuals, the tax is equal to 3.8% of the lesser of (1) net investment income for the year or (2) the amount by which modified adjusted gross income (AGI) exceeds an annual threshold amount. The thresholds are the same as those used for the additional Medicare tax on earnings, and they are not adjusted for inflation.

Net investment income includes gross income from interest, dividends, annuities, royalties, rents, net capital gain, and income earned from passive trade or business activities. However, you should be aware that the 3.8% surtax does not apply to qualified retirement plan and individual retirement account distributions.