High-Income Individuals Face New Medicare-Related Taxes in 2013
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The health-care reform legislation enacted in 2010 included new Medicare-related taxes. Effective this year, these new taxes target high-income individuals and families. Here are the basics:

**New additional Medicare payroll tax**

If you receive a paycheck, you probably have some familiarity with the Federal Insurance Contributions Act (FICA) employment tax; at the very least, you've probably seen the tax deducted on your paystub. The old age, survivors, and disability insurance ("OASDI") portion of this FICA tax is equal to 6.2 percent of covered wages (up to $113,700 in 2013). The hospital insurance or HI portion of the tax (commonly referred to as the Medicare payroll tax) is equal to 1.45 percent of covered wages, and is not subject to a wage cap. FICA tax is assessed on both employers and employees (that is, an employer is subject to the 6.2 percent OASDI tax and the 1.45 percent HI tax, and each employee is subject to the 6.2 percent OASDI tax and the 1.45 percent HI tax on wages as well), with employers responsible for collecting and remitting the employees' portions of the tax.

Self-employed individuals are responsible for paying an amount equivalent to the combined employer and employee rates on net self-employment income (12.4 percent OASDI tax on net self-employment income up to the taxable wage base, and 2.9 percent HI tax on all net self-employment income), but are able to take a deduction for the employer portion of the self-employment taxes paid.

Beginning this year, the hospital insurance (HI) tax on high-wage individuals increases by 0.9 percent (to 2.35 percent). Who is subject to the additional tax? If you're married and file a joint federal income tax return, the additional HI tax applies to the extent that the combined wages of you and your spouse exceed $250,000. If you're married but file a separate return, the additional tax applies if your wages exceed $125,000. For everyone else, the threshold is $200,000 of wages. So, a single individual with wages of $230,000 will owe HI tax at a rate of 1.45 percent on the first $200,000 of wages, and HI tax at a rate of 2.35 percent on the remaining $30,000 of wages for the year.

Employers are responsible for collecting and remitting the additional tax on wages that exceed $200,000. (Employers will not factor in the wages of a married employee's spouse.) You'll be responsible for the additional tax if the amount withheld from your wages is insufficient (if too much is withheld, you'll be entitled to a credit on your federal income tax return). The employer portion of the HI tax remains unchanged (at 1.45 percent).

If you're self-employed, the additional 0.9 percent tax applies to self-employment income that exceeds the dollar amounts above (reduced, though, by any wages subject to FICA tax). If you're self-employed, you won't be able to deduct any portion of the additional tax.

**New Medicare contribution tax on unearned income**

This year is also the first year that a new 3.8 percent Medicare contribution tax (referred to as the "unearned income Medicare contribution tax," or the "net investment income tax") is imposed on the unearned income of high-income individuals (the new tax is also imposed on estates and trusts, although slightly different rules apply). The tax is equal to 3.8 percent of the lesser of your net investment income (generally, net income from interest, dividends, annuities, royalties and rents, and capital gains, as well as income from a business that is considered a passive activity or a business that trades financial instruments or commodities), or your modified adjusted gross income (basically, your adjusted gross income increased by any foreign earned income exclusion) that exceeds $200,000 ($250,000 if married filing a joint federal income tax return, $125,000 if married filing a separate return).

So, effectively, you'll only be subject to the additional 3.8 percent tax if your adjusted gross income exceeds the dollar thresholds listed above. It's worth noting that interest on tax-exempt bonds, veterans' benefits, and excluded gain from the sale of a principal residence that are excluded from gross income are not considered net investment income for purposes of the additional tax. Qualified retirement plan and IRA distributions are also not considered investment income.
Both taxes can apply

You can be subject to both taxes, but not on the same income. In other words, if your wages exceed the dollar threshold that applies to your filing status, you'll be subject to the new additional Medicare payroll tax. If you also have unearned income, that unearned income may (assuming your modified adjusted gross income exceeds the relevant threshold) be subject to the new Medicare tax on unearned income.