UNDERSTANDING THE NET INVESTMENT INCOME TAX

The net investment income tax (NIIT), also known as the unearned income Medicare contribution tax, assesses an additional 3.8% federal tax on the lesser of net investment income or excess modified adjusted gross income (MAGI) above certain threshold amounts for high income individuals. Trusts and estates are assessed the tax on the lesser of undistributed net investment income or excess adjusted gross income (AGI) over the applicable threshold amount.

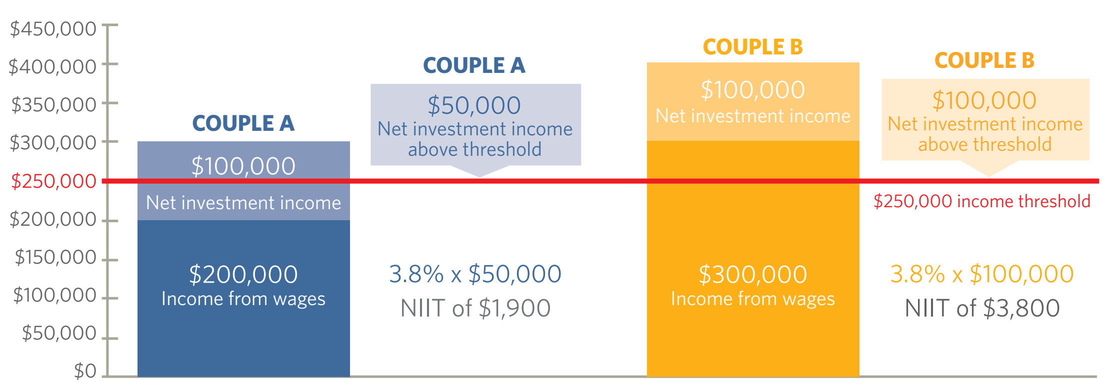
WHO OWES THE NIIT?

Individuals, trusts and estates that have a net investment income and MAGI/AGI greater than the following threshold amounts based on filing status owe the NIIT.

FILING STATUS	THRESHOLD AMOUNT
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household	$200,000
Qualifying widow(er) with dependent child	$250,000
Trusts and estates	$12,750

HOW DOES THE NIIT WORK?

For starters, the NIIT tax is based on the lesser of the excess of MAGI over the threshold or the net investment income. In this example, two couples – A and B – sell stock positions that trigger a $100,000 long-term capital gain in 2019. Their filing status is married filing jointly, and so their threshold amount is $250,000. Couple A with MAGI of $300,000 will be assessed the 3.8% tax on $50,000 ($300,000 MAGI minus $250,000 threshold). Couple B with MAGI of $400,000 will be assessed the 3.8% tax on the entire $100,000 ($400,000 is more than $100,000 over the threshold).



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COMMONLY ASKED QUESTIONS

Q: WHAT IS INCLUDED IN NET INVESTMENT INCOME?

A: Interest, dividends, capital gains, rental and royalty income, distributed gain from nonqualified annuities, income from businesses involved in trading of financial instruments or commodities, and businesses that are passive activities to the taxpayer.

Q: WHAT TYPES OF INCOME ARE NOT CONSIDERED NET INVESTMENT INCOME?

A: Wages, unemployment compensation, operating income from a non-passive business, Social Security benefits, alimony, tax-exempt interest, self-employment income, and distributions from qualified plans.

Q: WHEN DID THE NIIT TAKE EFFECT?

A: The NIIT went into effect on January 1, 2013.

Q: HOW DOES THE 3.8% TAX AFFECT CAPITAL GAINS?

A: For individuals, trusts, and estates with income above the stipulated thresholds, capital gains not otherwise offset by capital losses will be assessed the NIIT.

Q: ARE INVESTMENT EXPENSES DEDUCTIBLE IN COMPUTING NIIT?

A: Yes; interest expense, investment advisory and brokerage fees, expenses related to rental and royalty income, and state and local income taxes are deductible.

Q: ARE TRUSTS AND ESTATES SUBJECT TO THE NIIT?

A: Estates and trusts will be subject to the NIIT if they have undistributed net investment income and also have AGI over the dollar amount at which the highest tax bracket for an estate or trust begins for that tax year.

Q: WHAT IS THE NET INVESTMENT INCOME THRESHOLD FOR TRUSTS AND ESTATES?

A: For tax year 2019, the threshold amount is $12,750.

CONTROLLING NET INVESTMENT INCOME FOR INDIVIDUALS

Tax-planning strategies can help keep MAGI below the stipulated thresholds or minimize recognition of net investment income for individuals over the thresholds.

TAX DEFERRAL: Undistributed gains from tax-deferred investments, such as deferred annuities and life insurance, do not count as current income. Repositioning taxable investments to tax-deferred investments may keep income below the applicable threshold and provide control over when to recognize these gains as income.

QUALIFIED PLANS: An investor may be required to take required minimum distributions (RMDs), which are not considered net investment income. Even though qualified plan distributions are not counted as net investment income, distributions from qualified plans can increase MAGI, potentially subjecting distributions from other assets to the NIIT. Minimizing distributions from qualified plans and increasing qualified plan contributions may reduce income and keep an individual from going over the thresholds.

MUNICIPAL BONDS: Tax-exempt interest is not included in net investment income and does not increase MAGI for purposes of the tax.

ROTH IRAS: Distributions from Roth IRAs are not considered net investment income. Additionally, tax-free income distributed from Roth IRAs may provide a source of additional income without increasing MAGI.

PLANNING FOR TRUSTS AND ESTATES

Certain trusts and estates will be subject to the 3.8% NIIT when ordinary income retained in the trust or estate reaches the highest ordinary income tax bracket. In 2019, that amount is $12,750. With such a low threshold, investments that provide tax deferral or income not included in net investment income for assets that will be retained by the trust or estate may be worth consideration.

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