The New Health Care Reform Legislation: Higher Medicare Taxes on the Way

Articles

03.30.2010

Under the very recently enacted Health Care and Education Reconciliation Act of 2010 and the Patient Protection and Affordable Care Act of 2010, higher-income taxpayers are going to face two big tax hikes: a tax increase on wages and a new tax on investment income.

Higher Medicare Tax on Wages and Self-Employment Income. FICA Taxes are going to increase for many people.

Under current law, the Medicare component of FICA taxes is equal to 2.9% of wages paid. Wage earners and their employers each pay one-half of that component, or 1.45% each. Self-employeds pay both halves.

Under the new law, wage earners will continue to pay the 1.45% Medicare tax, but beginning in 2013, they'll have to pay more: singles whose wages exceed $200,000 and joint filers whose combined wages exceed $250,000 will pay an additional tax of 0.9% on the excess. Self-employeds will also pay an additional 0.9% on earnings over those amounts.

The $200,000/$250,000 thresholds are not indexed for inflation, so it's likely that more and more people will become subject to the higher tax in coming years as their wages increase over time.

Employers will be required to collect the extra 0.9% on wages exceeding $200,000 just as they would withhold other taxes. However, they will not be responsible for determining whether a worker's wages (when combined with the spouse's wages) make the couple subject to the additional 0.9% tax on combined wages in excess of $250,000. Married couples with combined wages of $250,000 or more must be aware of this tax in order to avoid an unexpected tax bill when they file their returns.

Medicare Tax Extended to Investment Income. Under current law, the Medicare tax applies only to wages and self-employment income. Beginning in 2013, the Medicare tax will, for the first time ever, be imposed on investment income: the net investment income of single taxpayers with adjusted gross income in excess of $200,000 and joint filers over $250,000 will be subject to a new 3.8% tax. This tax will be in addition to the income taxes which traditionally apply to investment income.

Net investment income includes interest, dividends, royalties, rents, income from a trade or business involving passive activities and net gains from the disposition of property (in other words, capital gains will be subject to this additional 3.8% tax beginning in 2013). However, it does not include income earned in tax-deferred retirement accounts (such as 401(k) plans) or interest on tax-exempt bonds.

The tax planning point is this: the new tax takes effect in about three years, and it has to be taken into account in making all investment decisions (including the decision to sell or not sell capital gain assets as we head into 2013).

We hope this is helpful. Look for other tax alerts relating to the new legislation over the next few weeks. Don't hesitate to reach out to your contacts here at Archer with any questions, or feel free to contact Gordon Moore who heads our Tax Group [856-354-3087 or gmoore@archerlaw.com].

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