IRA UPDATE: AUGUST 2012

The 3.8% surtax on Investment Income is here to stay, most likely. The decision by the US Supreme Court to uphold the 2010 Health Care acts means the tax to help pay for it is upheld. The tax is not new however was not scheduled to go into effect until 2013. This tax will only effect those with high incomes and it is on the investment income, not regular income. For this purpose, investment income is defined as interest, dividends, capital gains, non-qualified annuity distributions, and rental and royalty income. Distributions from Traditional and Roth IRAs are not counted as investment income however these distributions can cause overall income to increase resulting in the investment income being assessed the extra tax.

The tax is assessed on the lesser of a client's net investment income or their MAGI (Modified Adjusted Gross Income) over the applicable threshold which is $200,000 for single filers and $250,000 for joint filers. These thresholds are significantly lower for Trusts and Estates which is about $12,000. Itemized deductions will have no impact on these thresholds because they are "below the line," or in other words, itemized deductions may reduce taxable income but they do not reduce Adjusted Gross Income.

Salary deferral contributions to retirement plans such as 401k's and 403b's help to reduce gross income as do deductible IRA contributions and self-employed retirement plan contributions. Business owners can consider defined benefit retirement plans which allow much higher contributions than traditional defined contribution retirement plans.

Roth Conversions in 2012 can help to reduce the exposure to the 3.8% surtax, but time is running out on 2012 conversions as they must be done by the end of the year. By paying tax on the conversion using taxable funds, the overall income that can put investment income above the threshold would be reduced as would the actual investment income since some of those funds were used to pay the tax. Roth conversions essentially help to shift funds that are taxable to tax-free territory. Plus any conversions in 2012 will be taxed at a maximum marginal rate of 35% before they are scheduled to go up.

The results of the Presidential election are likely to determine whether some of the scheduled tax increases such as the 3.8% surtax and expiration of the Bush tax cuts are implemented in the short-term. In the long-term I am firm believer that taxes are going up no matter who is in office. It is best to plan now to reduce future tax burdens.

As always if you believe this surtax will impact you, give me a call to discuss your situation.

Sincerely,

Jeremy E. Portnoff

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