The recently enacted health-care reform legislation includes new Medicare-related taxes. These new taxes take effect in 2013, and target high-income individuals and families. While additional details and clarifications will become available between now and 2013, here's what you need to know.

**The Medicare payroll tax**

If you receive a paycheck, you probably have some familiarity with the Federal Insurance Contributions Act (FICA) employment tax. The hospital insurance or Medicare portion of the tax is equal to 1.45% of covered wages, and is not subject to a wage cap. FICA tax is assessed on both employers and employees, and therefore the combined Medicare tax portion is 2.9% of wages.

**2010 Health-Care Reform – Big changes ahead**

Beginning in 2013, the new health reform legislation increases the Medicare tax on high-wage individuals by 0.9% (to 2.35%). Who's subject to the additional tax? If you're married and file a joint federal income tax return, the additional Medicare tax will apply 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 will apply to wages that exceed $125,000. For everyone else, the threshold is $200,000 of wages. So, in 2013, a single individual with wages of $230,000 will owe Medicare tax at a rate of 1.45% on the first $200,000 of wages, and Medicare tax at a rate of 2.35% on the remaining $30,000 of wages for the year.

Employers will be 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 will be responsible for the additional tax if the amount withheld from your wages is insufficient. The employer portion of the Medicare tax remains unchanged (at 1.45%).

**New Medicare contribution tax on unearned income**

Beginning in 2013, a new 3.8% Medicare contribution tax will be imposed on the unearned income of high-income individuals. The tax is equal to 3.8% of the lesser of:
(i) 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

(ii) Your modified adjusted gross income 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're only subject to the additional 3.8% 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.

**Medicare taxes on Trust income**

In addition to the application of the new 3.8% Medicare tax on unearned income, the **new tax will also apply to trust and estate income**. For trusts and estates, the tax is imposed on the lesser of (i) undistributed net investment income or (ii) the excess of adjusted gross income over the dollar amount at which the highest trust and estate income tax bracket beings (i.e., $11,200 for 2010). It should be noted, however, that the tax does not apply to certain types of trusts, such as charitable remainder trusts and tax-exempt trusts.

Together, these two new Medicare-related taxes are expected to provide a major source of revenue to finance other parts of health-care reform. **The Joint Committee on Taxation projects that the combined revenue attributable to these two new taxes will exceed $210 billion over the ten-year period ending in 2019** (Source: Joint Committee on Taxation, Publication JCX-17-10, March 20, 2010).

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