Another look at the 2013 tax hikes

The increased capital gain rates, the 0.9% Medicare surtax and the 3.8% net investment income tax have been in effect since 2013. So although these are "old news", the widespread impact they had on so many taxpayers warrants another look.

Capital gains rate

Sales of stock, investment property, and rental properties could all be subject to the increased capital gain rate. In pre-2013 tax years, the maximum capital gain rate was 15%. Beginning in 2013, the American Taxpayer Relief Act resulted in a maximum tax rate increase to 20%, but only for certain individuals above a threshold. The thresholds for 2015 are:

- $464,851 for married filing joint and surviving spouse
- $439,001 for head of household
- $413,201 for single
- $232,426 for married filing separate

For taxpayers below these thresholds, the capital gain tax rates remain as they were in pre-2013 tax years. This is a maximum 15% for taxpayers in the middle brackets and a zero capital gains rate for taxpayers in the 10% and 15% tax brackets.

Since these thresholds include ALL income (not just income derived from capital gains), consider timing the sale of investments to coordinate with a lower income year, if possible. Another possibility to avoid exceeding these thresholds is to consider selling other stocks or investments at a loss to reduce both your *total* adjusted gross income and your capital gains.

Medicare surtax

As a result of the Patient Protection and Affordable Care Act of 2010, an additional 0.9% Medicare tax is applied to an individual's wages (before pre-tax deductions) and self-employment income that exceeds certain thresholds based on the individual's filing status. The thresholds are:

- $250,000 for married filing joint
- $200,000 for single, head of household and surviving spouse
- $125,000 for married filing separate

Your employer is responsible for withholding the additional Medicare surtax once your wages or compensation exceeds $200,000 (there is no opt-out). However, keep in mind that your filing status dictates your applicable threshold, so you might be required to pay the additional surtax even if your earned income is less than $200,000. Additionally, multiple employers each compensating less than $200,000, but in sum exceeding $200,000 will also trigger the additional Medicare surtax.

Under/overwithheld tax will be calculated when filing your annual income tax return. While you cannot request additional Medicare tax to be withheld from your wages, you can increase your federal income tax withholding, which can then be applied to the under-withheld Medicare tax. Self-employed individuals anticipating income to exceed their applicable threshold should take into consideration the additional Medicare surtax when determining their estimated tax payments.

Net investment income tax (NIIT)

The Patient Protection and Affordable Care Act also enacted the net investment income tax (NIIT). This tax is applied at a rate of 3.8% to certain net investment income of individuals, estates and trusts. The tax is calculated on the lesser of net investment income or the excess of adjusted gross income over certain thresholds. These thresholds are:

- $250,000 for married filing joint or surviving spouse with qualifying child
- $200,000 for single or head of household
- $125,000 for married filing separate

In general, net investment income includes interest, dividends, capital gains, rental and royalty income, and passive business income. For purposes of determining net investment income, the first $500,000 of gain from the sale of a personal residence is excluded ($250,000 if single). Investment expenses (broker fees, rental and royalty expenses, etc.) are all included as a deduction when determining your net investment income.

The Affordable Care Act
revisited

The Patient Protection and Affordable Care Act of 2010 required most people to have health insurance by 2014. Taxpayers (including their dependents) that *did not* have the "minimum essential coverage" and *did not* qualify for an exemption, were required to make a "shared responsibility payment" beginning with their 2014 tax return. The same holds true for 2015 and beyond, except the "shared responsibility payment" (essentially a penalty) has increased dramatically for 2015. For 2015, the annual payment is the greater of:

- 2 percent of your household income that is above the tax return filing threshold for your filing status (1% in 2014), or
- Your family's flat dollar amount, which is \$325 per adult and \$162.50 per child (the family maximum is \$975; the family maximum in 2014 was \$285)

These amounts approximately double in 2016.

As was the case for 2014, **<u>we will need to know whether you and your dependents have the minimum essential coverage</u>**! Your 2015 tax package will include a letter for you to sign confirming that you had coverage. Additionally, the 2015 questionnaire will include a question regarding healthcare coverage. ***We cannot file your 2015 income tax return unless you sign the letter, answer the question OR provide us with a 1095-A, 1095-B or 1095-C (see next paragraph).***

In 2014, taxpayers who obtained their health coverage from a marketplace were provided with a form 1095-A. The form 1095 is a new information form (like a form 1099) and can be either a 1095-A, 1095-B or 1095-C. Taxpayers who are covered under an employer-sponsored plan, government-sponsored plan, or other insurance plan will receive a 1095-B or 1095-C. For 2014, only the 1095-A was required to be filed; for 2015, ALL form 1095 types are required. Therefore, if you have health insurance, you should receive a form 1095 by January 31, 2016. ***<u>Please include your form(s) 1095 with your tax package!</u>***

Taxpayers who enrolled for health care through the marketplace are eligible for the premium tax credit (subject to income limits and only if you are ineligible for coverage through an employer or government plan). The information necessary to calculate this credit will be reported on the form 1095-A. The premium tax credit was implemented to ease the burden of the out-of-pocket costs of health care through the marketplace and can be claimed throughout the year (paid directly to your insurance company to lower your monthly premiums) or all at once on your 2015 federal tax return as a credit. ***Note – if you receive the premium tax credit throughout the year and your 2015 income exceeds the estimate used to calculate the credit, you WILL be required to pay it back with your 2015 tax return. For many of our clients, this resulted in substantial balance due amounts last year!***

California Mandatory Sick Pay

On September 10, 2014, Governor Brown signed the Healthy Workplaces, Health Families Act of 2014 ("HWHFA"). Effective July 1, 2015, California law will mandate paid sick leave accrual for employees at a rate of one hour for every 30 hours worked, allowing employers to cap employee use of paid sick leave to 24 hours per year. There are no exclusions for small employers or nonprofits. Please contact our office for more information or if you are an employer that does not currently have a paid sick leave plan in place and would like our assistance in setting one up.