Planning for the 3.8% Investment Surtax

What?
Beginning in 2013, taxpayers with high Adjusted Gross Income (Line 37 of Form 1040) started paying a 3.8% surtax on their investment income. This applies to single taxpayers with $200,000 Adjusted Gross Income and joint filers with $250,000.

Investment Income defined:
For purposes of this surtax, investment income is:
- Taxable Interest
- Dividends
- Capital gains
- Net rental income
- Passive K-1 investments

How it works:
- If your Adjusted Gross Income is less than $200,000 (single) or $250,000 (married joint), you will **not** owe the 3.8% surtax.
- If your Adjusted Gross Income is more than the above amounts, **and** you have investment income, you will pay the 3.8% surtax.
- Subtract $200,000 (single) or $250,000 (married joint) from your Adjusted Gross Income. Compare the result with your total investment income, and multiply the **smaller** by 3.8%.

For example:
- A single person with Adjusted Gross Income of $180,000 consisting of wages of $170,000 and interest of $10,000 would owe no surtax because the total income is under $200.000.
- A single person with Wages of $220,000 and no other income would owe no surtax because there is no investment income.
- If the two above taxpayers were married, they would pay the 3.8% surtax on the lesser of $150,000 or the $10,000 in interest. This calculates to $380.

Planning ideas:
- Married high-income taxpayers with a lot of investment income might be better off divorcing.
- Decrease earned income at work by increasing retirement contributions and non-taxable fringe benefits.
- Avoid Roth conversions or unnecessary additions to income.
- Purchase municipal bonds as an investment. The tax-free element of municipal bonds helps reduce income and does not count for this surtax.
- If you are retired, draw from your Roth IRAs and savings rather than regular retirement accounts to reduce income.