Navigating the Health Care Taxes in 5 Easy Steps

What is considered investment income? Investment Income: Interest, dividends, capital gains (long and short), annuities (not those in IRAs or company plans), royalty income, passive rental income, other passive activity income. NOT Investment Income: Wages and self-employment income, active trade/ business income, distributions from IRAs, Roth IRAs and employer plans, excluded gain from the sale of a principal residence, municipal bond interest, proceeds of life insurance policies, veterans' benefits, Social Security benefits, gains on the sale of an active interest in a partnership or S corporation.

1. **Identify the surtax income thresholds.** The first step is to know the MAGI (modified adjusted gross income) thresholds to avoid the 3.8% surtax on net investment income. They are as follows: Married Filing Jointly ($250,000); Individuals ($200,000); Married Filing Separately ($125,000); Trusts and Estates ($15,650 in 2025). Trusts and estates are hit particularly hard with the surtax kicking in at a much lower income level.

2. **Look at TAXABLE income.** Taxable income from all sources can push taxpayers over the MAGI threshold and cause their investment income to be subject to the 3.8% surtax. Income tax-free Roth distributions will NOT affect MAGI.

3. **Understand how much will be taxed.** The 3.8% surtax is imposed on the lesser of (1) net investment income or (2) the amount of MAGI over the applicable income threshold. Taxpayers with income below those MAGI levels will NOT be subject to this tax.

4. **Know other health care tax provisions.** The 3.8% surtax gets the attention, but there is also an additional 0.9% Medicare tax on wages and self-employment income over the MAGI thresholds. Also, medical expenses must exceed 7.5% of AGI to be deductible. That 7.5% also applies to the medical expense exception to the 10% penalty on early IRA or plan withdrawals.

5. **Discuss these tax planning points.** You need to know that while IRA and plan distributions are exempt from the surtax, taxable distributions from these accounts can push income over MAGI thresholds. Roth conversions can be a valuable tool to eliminate future taxable income, especially for taxpayers with significant investment income or a discretionary trust as their IRA beneficiary. However, conversions could push you above your threshold in the short-term. Salary deferrals (401(k)s for example) can reduce MAGI for the 3.8% surtax but NOT earned income for the 0.9% additional Medicare tax.

AMERICA'S IRA EXPERTS

100 Merrick Road, Suite 200E, Rockville Centre, New York 11570
800-663-1340 toll-free ▪ 516-536-8282 telephone
516-536-8852 fax ▪ info@irahelp.com

For More IRA Expertise

website: irahelp.com
blog: irahelp.com/slottreport
twitter: @theslottreport
facebook: /AmericasIRAExperts