New investment taxes for 2013

With the confirmation that the Affordable Care Act is constitutional comes the realization that the associated new taxes for higher-income taxpayers will be going into effect on January 1, 2013:

• an additional 0.9% payroll tax for Medicare, through creation of a new 2.35% tax bracket.

• a 3.8% surtax on investment income.

These new taxes will apply to a single taxpayer with Adjusted Gross Income (AGI) greater than $200,000. Restoring a "marriage penalty," the taxes apply to marrieds filing jointly at AGI of $250,000, not the $400,000 that would be double the single's threshold. Because the taxes apply to AGI, they are not affected by itemized deductions, such as charitable contributions.

To lower the payroll tax pain, one might accelerate income into the 2012 tax year, when possible. There is somewhat greater flexibility in planning for the investment taxes.

We don't yet have IRS guidance on the new investment tax, but tax observers expect that it will apply to rents, royalties, interest payments (except for municipal bond interest), capital gains (both long- and short-term) and the sale of a principal residence when the profit exceeds the $250,000/$500,000 exclusion, among other items. Income from a business is not considered investment income if one is paying the self-employment tax. The new tax won't apply to distributions from regular or Roth IRAs, or to pension or 401(k) payouts.

The actual tax rates for 2013 are impossible to predict. If the "Bush tax cuts" expire, as required under current law, the top rate for long-term gains will rise to 23.8%, and the top rate on dividends will almost triple to 43.4%.

Three ideas to consider:

• *Sell appreciated assets in 2012.* This year's lower tax rate will be locked in.

• *Invest in tax-free municipal bonds.* One may be able to secure the same or higher after-tax income.

• *Convert IRAs to Roth IRAs this year, not later.* The conversion won't be subject to the 3.8% tax, but it will push up AGI, making it more likely that other investment income will be hit by the tax. Also, if the other tax cuts do expire, the conversion itself may be more heavily taxed in 2013.

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