How a dollar can add up to more when it comes to taxes

TAX PLANNING

One measly dollar can have more impact than you'd think—especially during tax season.

Not only can an extra dollar of income push you into the next highest tax bracket (thankfully, with a progressive tax system, only those excess dollars will be subject to the higher incremental tax), but that dollar can mean you're paying more taxes in other ways. Let's take a look at two of them.

Medicare tax

If your wage or compensation exceed certain thresholds by even $1, you'll be subject to the 0.9% additional Medicare surtax on the excess. While $1 over only means you'll pay an extra cent or so, it can add up quickly the further you are over the limit. Your employer will withhold the tax for you, but you'll still have to file Form 8959 to report the excess income that is subject to this tax. The calculations are a little more complicated if you have self-employment income in the mix, so be sure to discuss this with a qualified tax professional.

And speaking of Medicare and taxes, you'll pay an income-related adjustment in addition to your standard Medicare Part B premium if you made even a dollar over the applicable threshold, which is based on your income from **two years ago**. For example, those who made $97,000 or less (single) or $194,000 or less (married filing jointly) in 2021 pay $164.90 per month for this coverage in 2023. But those who made $97,001 (single) or $194,001 (joint) pay $230.80 per month, an extra $790.80 over the course of the year.

Net investment income tax

Certain individuals, trusts and estates may be subject to an additional 3.8% net investment income tax (NIIT) on the lesser of their net investment income or the amount by which their modified adjusted gross income exceeds the threshold based on their filing status. (Again, that's $200,000 for those filing single or head of household in 2023 and $250,000 for those married filing jointly.)

In general, net investment income includes but is not limited to interest, dividends, capital gains not offset by capital losses, rental and royalty income, and nonqualified annuities; it excludes wages, unemployment compensation, Social Security benefits, alimony, and most self-employment income. So, it is possible to be subject to this tax and/or the Medicare surtax since they apply to different income pools.

Another difference is that your employer doesn't withhold anything for this tax. You may request that additional income tax be withheld if you think you'll owe come April. To determine if you are liable, you will use Form 8960 to compute the tax, and will report and pay the tax on the appropriate income tax return form.

For example, let's look at Debra, who files as head of household with $180,000 in wages. She is *not* subject to the Medicare surtax, but she received $90,000 from a passive partnership interest, which the IRS considers net investment income. Now her modified adjusted gross income is $270,000, exceeding the applicable threshold by $70,000. NIIT is based on the *lesser* of the amount that exceeds her modified gross income threshold or the actual net income ($70,000 is less than $90,000 in this case). So she owes $2,660 in NIIT this year ($70,000 x 3.8%).

Note: The real estate market is competitive in many areas of the country. If you've decided to sell your primary residence, please note that up to $250,000 in capital gains from the sale may be excluded from your gross income for regular income tax purposes (if you meet IRS qualifications) and, as a result, is also exempt from the net investment income tax.

Estates and trusts are liable for the tax if they have undistributed net investment income and adjusted gross income over the threshold. As with most tax-related calculations, professional help can be invaluable as computations get complicated for different types of trusts.

Sources: irs.gov; Centers for Medicare & Medicaid Services; Raymond James research

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