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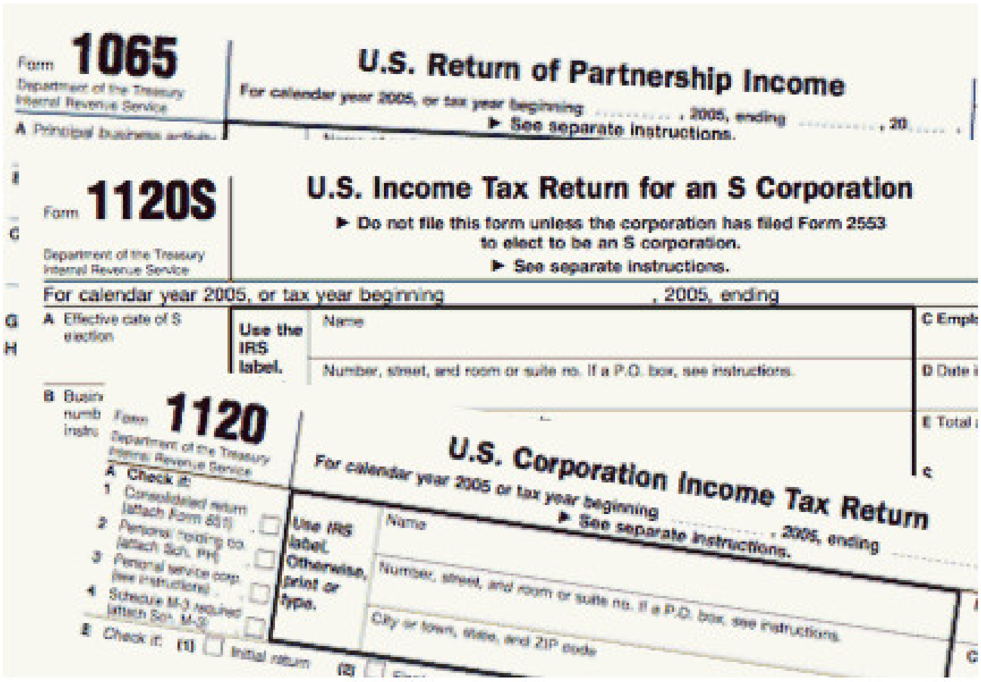

[Updated: Sept. 19, 2020]

The Affordable Care Act (ACA)—the massive healthcare law known as Obamacare—has been under the gun ever since its enactment in 2010. In the latest legal development, the U.S. Supreme Court has agreed to review a challenge as to whether the individual healthcare mandate, which was modified in 2017, is constitutional. The nation's top court is expected to render its verdict by June of next year.

The outcome could be significant on a number of fronts. One issue that has largely flown under the radar: The ACA authorizes the imposition of several taxes, including the “net investment income tax” (NIIT) affecting certain high-income investors. It’s

your modified adjusted gross income (MAGI) exceeds an annual threshold of $200,000 for single filers and $250,000 for joint filers. (Note: These figures are not indexed for inflation.) The tax is also imposed on trusts and estates with income above a threshold based on the dollar amount of the highest tax bracket.

For this purpose, NII includes interest and dividends; distributions from annuities (other than tax-deferred distributions); rent and royalties; gains from investments in passive activities; trades of financial instruments and commodities; and net capital gain from the sale of property (other than property held in an active trade or business). Significantly, it does NOT include salary or wages; distributions from IRAs and qualified retirement plans; taxable Social Security income; active trade or business income; self-employment income; gain on the sale of active interests in a partnership, S corporation or limited liability company; income from tax-exempt municipal bonds; and tax-deferred income from nonqualified annuities.

Even though some items like retirement plan distributions don’t count as NII, they can still increase MAGI and trigger a tax liability.

For example, suppose a single filer has NII of $50,000 and an MAGI of $195,000 in 2020. As things stand now, the taxpayer doesn’t have to pay the tax because his or her MAGI is under $200,000. However, if the taxpayer takes a $30,000 IRA distribution before the end of the year, the MAGI increases to $225,000. Now the taxpayer owes an NII tax of $950 (3.8% of $25,000 of excess MAGI).

Fortunately, there still is time to deflate the NII tax for 2020 by lowering NII or MAGI or both. Here are several prime examples.

- Harvest capital losses from securities transactions. The losses can offset capital gains that are counted both for NII and MAGI.

- Sell real estate on the installment basis. By deferring tax instead of paying the full

mentioned above, passive income counts toward NII.

- Convert a traditional IRA funds into a Roth. Although the conversion is a taxable event in the year it occurs, Roth payouts after five years won’t increase either NII or MAGI.

These are just some of the ideas you may discuss with clients. Of course, every situation is different. Provide the guidance needed for the particular circumstances.