

Beware payroll tax changes in new federal health care reform law

President Obama implemented groundbreaking change of federal health care law on Mar. 30, 2010, when he signed the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act.

There has been much debate about the reach of the new health care law. Equally important are the changes to payroll tax laws, which play a significant part in financing much of the Act's initiatives.

Federal law dictates that officers and owners of businesses are personally liable for the collection and payment to the government of payroll taxes, subjecting those persons to potential criminal penalties. With this in mind, it is important for those exposed to possible criminal sanction to understand the new changes and how they will affect them and their potential tax liability.

Ordinarily, employees pay only half of the 2.9 percent Medicare Tax (1.45 percent), while the self-employed pay the entire 2.9 percent Medicare Tax, but may deduct half of that amount for federal income tax purposes.

Beginning Jan. 1, 2013, the act broadens the Medicare tax base for higher income taxpayers in two significant ways. First, it imposes a 0.9 percent increase in the FICA (Federal Insurance Contribution Act) tax on earned income in

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excess of \$200,000 for individuals or \$250,000 for married couples filing jointly.

As a result, while employees will see their Medicare tax rise to 2.35 percent, the self-employed will see their burden increase to 3.8 percent. It is especially of note for the self-employed that this 0.9 percent increase is not subject to deduction for federal income tax purposes.

The act's second and, possibly, more fundamental change is the expansion of the Medicare Tax to a taxpayer's net investment income. Traditionally, the Medicare tax only has applied to an employee's wages or a self-employed person's self-employment income.

For taxpayers with modified adjusted gross income of \$250,000 for joint filers or \$200,000 for individual filers, the Act imposes a 3.8 percent Medicare tax on the lesser of all of the taxpayer's net investment income.

This includes interest, gains on financial trading, dividends and passive income from a business in which the taxpayer does not participate, or the adjusted gross income in excess of \$200,000.

The individual's adjusted gross income of \$290,000 exceeds the threshold amount of \$200,000 by \$90,000.

Because the \$90,000 adjusted gross income is in excess of the threshold amount is less than the \$100,000 net investment income, the new Medicare tax only applies to the \$90,000 adjusted gross income in excess of the threshold amount. As such, the individual's new Medicare tax would be \$3,420 or \$90,000 times 3.8 percent.

Alternatively, in 2013, a single individual has net investment income of \$100,000 and adjusted gross income of \$310,000 will exceed the threshold amount of \$200,000 by \$110,000.

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ment income is less than the \$110,000 adjusted gross income in excess of the threshold amount, the new Medicare tax applies to the \$100,000 net investment income.

Consequently, the individual's new Medicare tax would be \$3,800 or \$100,000 times 3.8 percent. Merely explaining these fundamental changes in assessment of payroll taxes is a challenging task.

Understanding them from the perspective of the business owner or officer is especially challenging, yet important given the potential criminal penalties which may be incurred for failing to accurately determine the applicable tax to be paid.

Given the current conditions of entitlement programs — which significantly depend upon these new taxes — there likely will be increasing pressure upon the government to collect these new taxes to support the new programs created by the act.

Successful business people and self-employed business owners should prepare appropriately for this potentiality by consulting with their accounting and legal professionals to plan their finances accordingly.

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