**FIVE KEY POINTS REGARDING THE NET INVESTMENT INCOME TAX YOU NEED TO BE AWARE OF**

1. Do not be confused by the word “investment.” Certainly, the net investment income tax base includes what most would consider to be traditional “investment” income such as dividends, interest, royalties, rents and capital gains. However, it also includes “passive” income from a business that many would not consider to be investment type income.
2. The net investment income tax of 3.8% is imposed on the lesser of net investment income or the excess of modified adjusted gross income (for most taxpayers modified adjusted gross income is adjusted gross income) over the applicable threshold amount (i.e., $250,000 for a married couple filing a joint return). So the lower a taxpayer’s adjusted gross income, the lower the amount of net investment income that may be subject to the tax. This means that deductions for adjusted gross income (above the line deductions) are more important than ever.
3. Beware of the application of the net investment income tax to the gain on the sale of a principal residence in excess of the excluded amount. All income excluded from gross income for regular income tax purposes is also excluded for net investment income tax purposes. Generally, a married couple filing a joint return may exclude up to $500,000 of the gain from the sale of a principal residence from gross income. However, gain in excess of $500,000 is included in gross income. For that reason, the same gain would be included in net investment income potentially subject to the 3.8% tax.
4. Trusts are much more likely to be subject to the net investment income tax as well as higher qualified dividend and capital gains rates than individuals. For example, with respect to the net investment income tax, the applicable threshold is the dollar amount at which the trust’s highest tax bracket begins. So, in 2014, the 3.8% net investment income tax is imposed on the lesser of a trust’s undistributed net investment income or the difference between its adjusted gross income over $12,150 (the amount at which the trust’s highest tax bracket begins). In addition, the qualified dividend and capital gain rate of 15% increases to 20% once a trust’s adjusted gross income exceeds $12,150. Thus, for many trusts, the combination of those two additional taxes will increase the tax rate of capital gains and qualified dividends from 15% to 23.8%, and increase of 8.8%.
5. Beware of the application of the Additional Medicare Surtax. In addition to the regular Medicare tax on wages and self-employment income, taxpayers are subject to an additional tax of 0.9% on amounts of such income in excess of certain thresholds. If an item of income could be subject to both the net investment income tax and the additional Medicare surtax, it is subject to the latter and not the former.

An extensive discussion of these key elements (and much more) of the net investment income tax can be found in *The Tools & Techniques of Income Tax Planning* scheduled for publication on September 15, 2014.