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Federal Tax Coordinator 2d

¶A-6361. Tax on net investment income of individuals.

Individuals (defined at ¶A-6362) are subject to a net investment income tax (NIIT), also known as the unearned income Medicare contribution (UIMC) tax. For each tax year, the tax is equal to 3.8% of the lesser of: ¹

(1) net investment income (NII, defined at ¶A-6363) for the tax year, or ²

(2) the excess (if any) of: ³

... the modified adjusted gross income (MAGI, defined below) for the tax year, ⁴ over

... the threshold amount ⁵ (defined below).

 **RIA observation:** In other words, certain unearned income of an individual is subject to a 3.8% surtax that is imposed in addition to any other tax payable on that income.

For this purpose, "MAGI" means adjusted gross income (AGI, see ¶A-2601) increased by the excess of: ⁶

(1) the income excluded under the **Code Sec. 911(a)(1)** foreign earned income exclusion (¶O-1101), over ⁷

(2) any deductions (if taken into account in computing AGI) or exclusions with respect to the excluded income in (1) that are disallowed under **Code Sec. 911(d)(6)** (¶O-1112). ⁸

 **RIA observation:** Thus, for individuals who don't have any excluded foreign earned income, MAGI is the same as AGI.

For adjustments to MAGI as a result of investments in controlled foreign corporations and passive foreign investment companies, see ¶A-6376.

The "threshold amount" is: ⁹

... \$250,000 for joint returns and surviving spouses, ¹⁰

... \$125,000 for separate returns, ¹¹ which is half the dollar amount for joint returns and surviving spouses, ¹² and

... \$200,000 in all other cases. ¹³

Proposed regs that are effective for tax years beginning after Dec. 31, 2013, and on which taxpayers may rely until the effective date of the final regs, ¹⁴ clarify that the principles and rules of chapter 1 of the Code (i.e., income tax) apply in determining taxable income for purposes of the NIIT, except as otherwise provided. ¹⁵ All references to an individual's AGI are treated as references to AGI as defined in **Code Sec. 62** (see ¶A-2601). ¹⁶

Individuals will owe the tax only if they have NII and have MAGI above the applicable threshold. Even individuals who are exempt from Medicare taxes may still be subject to the NIIT if they have NII and their MAGI exceeds the applicable threshold. ¹⁷

Illustration 1: A, an unmarried U.S. citizen, has MAGI of \$190,000 for the tax year, which includes \$50,000 of NII. A isn't liable for the NIIT because the threshold amount for a single individual is \$200,000. ¹⁸

Illustration 2: B, an unmarried U.S. citizen, has MAGI of \$220,000 for the tax year, which includes \$50,000 of NII. B

pays a NIIT on only the \$20,000 amount by which his MAGI exceeds his threshold amount of \$200,000, because that is less than his NII of \$50,000. B's NIIT is \$760 ($\$20,000 \times 3.8\%$).¹⁹

 **RIA observation:** An individual will pay the 3.8% tax on the full amount of his NII if his MAGI exceeds his threshold amount by at least the amount of the NII.

 **RIA illustration 3:** Assume that the taxpayer in Illustration (2) had MAGI of \$260,000. Because taxpayer's MAGI exceeds his threshold amount by \$60,000, he would pay a NIIT on his full \$50,000 of NII. Thus, taxpayer's NIIT would be \$1,900 ($\$50,000 \times 3.8\%$).

The proposed regs provide that in the case of an individual who has a tax year consisting of less than twelve months (short tax year), the threshold amount generally isn't reduced or prorated. For example, in the case of an unmarried person who dies on June 1, the threshold amount is \$200,000 for the decedent's short tax year that begins Jan. 1 and ends June 1.²⁰

However, individuals who have a short year as a result of a change of annual accounting period under [Code Sec. 442 \(¶ G-1222\)](#) must reduce the applicable threshold amount to an amount that bears the same ratio to the full threshold amount as the number of months in the short tax year bears to twelve.²¹

 **RIA observation:** In other words, for those taxpayers, the threshold is prorated.

The threshold amounts aren't indexed for inflation.²²

 **RIA observation:** As a result, inflation will cause more taxpayers to become subject to the NIIT.

A taxpayer may be subject to both the NIIT and the 0.9% additional Medicare tax but not on the same income. The additional Medicare tax applies to wages ([¶ H-4687](#)) and self-employment income ([¶ A-6001](#)) over certain thresholds, but it doesn't apply to items included in NII.²³

 **RIA observation:** So, taxpayers who have both high wages or self-employment income and high investment income may be hit with both taxes.

 **RIA illustration 4:** A single taxpayer has NII of \$50,000, wages of \$300,000, and MAGI of \$350,000. In addition to paying a NIIT of \$1,900, as explained in RIA illustration (3), the taxpayer also pays an additional Medicare tax of \$900 ($\$100,000 \times 0.9\%$) on his wages in excess of \$200,000, as discussed at [¶ H-4687](#).

IRS has indicated it will closely review transactions that manipulate a taxpayer's NII to reduce or eliminate the amount of the NIIT. In appropriate circumstances, the IRS will challenge those transactions based on applicable statutes and judicial doctrines. So, for example, if an investment arrangement that in form gives rise to income that isn't NII is in substance properly treated for tax purposes as the holding of securities by on party as agent for another, the arrangement will be subject to the NIIT.²⁴

The NIIT on individuals is in addition to any other tax imposed by Subtitle A of the Code, relating to income taxes.²⁵ So, it isn't deductible in computing the other subtitle A taxes.²⁶

The NIIT is reported on, and paid with, the Form 1040.²⁷

 **Forms to use:** Form 1040, reproduced in e-FormRS.

The NIIT is subject to the individual estimated tax provisions, see [¶ S-5209](#).

No provision is made for the transfer of the NIIT from the general fund of the U.S. Treasury to any trust fund.²⁸

*For tax years beginning before Jan. 1, 2013,*²⁹ the NIIT wasn't in effect.

¹
[Code Sec. 1411\(a\)](#); [Prop Reg § 1.1411-2\(b\)\(1\)](#).

²
[Code Sec. 1411\(a\)\(1\)\(A\)](#); [Prop Reg § 1.1411-2\(b\)\(1\)\(i\)](#).

³

Code Sec. 1411(a)(1)(B); Prop Reg § 1.1411-2(b)(1)(ii).

⁴

Code Sec. 1411(a)(1)(B)(i); Prop Reg § 1.1411-2(b)(1)(ii)(A).

⁵

Code Sec. 1411(a)(1)(B)(ii); Prop Reg § 1.1411-2(b)(1)(ii)(B).

⁶

Code Sec. 1411(d); Prop Reg § 1.1411-2(c)(1).

⁷

Code Sec. 1411(d)(1); Prop Reg § 1.1411-2(c)(1)(i) .

⁸

Code Sec. 1411(d)(2); Prop Reg § 1.1411-2(c)(1)(ii) .

⁹

Code Sec. 1411(b); Prop Reg § 1.1411-2(d)(1).

¹⁰

Code Sec. 1411(b)(1); Prop Reg § 1.1411-2(d)(1)(i).

¹¹

Prop Reg § 1.1411-2(d)(1)(ii).

¹²

Code Sec. 1411(b)(2).

¹³

Code Sec. 1411(b)(3); Prop Reg § 1.1411-2(d)(1)(iii).

¹⁴

Prop Reg § 1.1411-1(c); Preamble to Prop Reg, 11/30/2012.

¹⁵

Prop Reg § 1.1411-1(a).

¹⁶

Prop Reg § 1.1411-1(b).

¹⁷

Miscellaneous IRS Documents niitfaqQ&A 3.

¹⁸

Prop Reg § 1.1411-2(b)(2).

¹⁹

Prop Reg § 1.1411-2(b)(2); Miscellaneous IRS Documents niitfaq.

²⁰

Prop Reg § 1.1411-2(d)(2)(i).

²¹

Prop Reg § 1.1411-2(d)(2)(ii).

²²

Preamble to Prop Reg, 11/30/2012; Miscellaneous IRS Documents niitfaqQ&A 3.

²³

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²⁴

Preamble to Prop Reg, 11/30/2012.

²⁵

Code Sec. 1411(a)(1).

²⁶

Joint Comm Staff, Tech Expln of the Revenue Provisions of the Reconciliation Act of 2010, as Amended, in Combination With the Patient Protection and Affordable Care Act (JCX-18-10), 3/21/2010, p. 135.

²⁷

Miscellaneous IRS Documents niitfaqQ&A 14.

²⁸

Joint Comm Staff, Gen Expln of Tax Legislation Enacted in The 111th Congress (JCS-2-11), 3/16/2011, p. 363.

²⁹

Sec. 1402(a)(4), PL 111-152, 3/30/2010.