

THE NET INVESTMENT INCOME TAX, IN GENERAL

BEGINNING JANUARY 1, 2013, § 1411 OF THE INTERNAL REVENUE CODE (IRC) WILL IMPOSE A TAX OF 3.8% ON THE “NET INVESTMENT INCOME” OF CERTAIN INDIVIDUALS, ESTATES, AND TRUSTS. THE FOLLOWING WORKSHEETS EXAMINE THE EFFECT OF THE NEW LAW ON INDIVIDUAL TAXPAYERS:

WHO IS SUBJECT TO THE NET INVESTMENT INCOME TAX (NIIT)?

- Citizens and residents of the United States ^{i,ii}
- Bona Fide Residents of United States Territories ⁱⁱⁱ
- Bankruptcy Estates ^{iv}
- Certain Trusts and Estates (See § 1411(a)(2)).

WHAT IS NET INVESTMENT INCOME?

Prop. Reg. § 1.1411-4 defines NI as:

- Interest, dividends, capital gains, rent and royalty income, and non-qualified annuities. ^{vi}
- Other income and gains from passive activities. ^{vii}
- Other income and gains from businesses involved in the trading of financial instruments and commodities. ^{viii}
- Gains from the sale of interests in partnerships and S corporations, subject to exceptions. ^{ix}

Please see the accompanying pages for the determination of the types of income included in a taxpayer's net investment income.

WHAT ARE THE THRESHOLD AMOUNTS? ^{xi}

- Married filing jointly or surviving spouse: \$250,000
- Married filing separately: \$125,000
- All other taxpayers: \$200,000

IS THE NET INVESTMENT INCOME TAX SUBJECT TO ESTIMATED TAX PROVISIONS?

Yes, the NIIT is subject to the estimated tax provisions. Individuals who anticipate exceeding the applicable thresholds should adjust withholdings or increase estimated tax payments to avoid underpayment penalties.

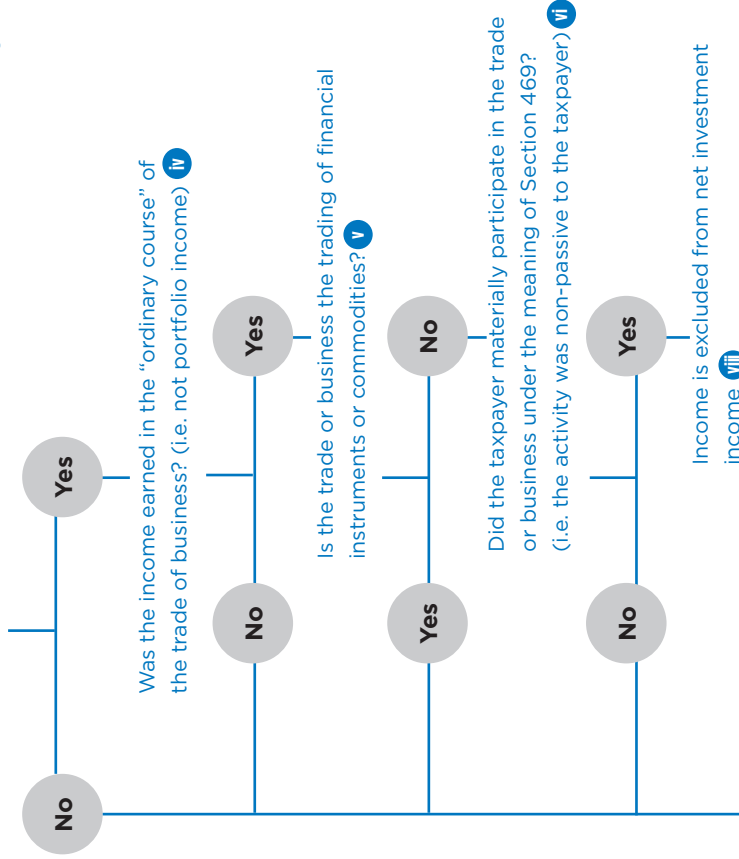
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- i Prop. Reg. § 1.1411-2(a)(1). Nonresident aliens are not subject to the NIIT.
 - ii A U.S. resident or citizen who is married to a nonresident alien spouse must compute net investment income and MAGI separately, and must use a \$125,000 threshold, unless the taxpayers have made or make an election to file jointly pursuant to § 6013(g). Consult Prop. Reg. §§ 1.1411-2(a)(2)(i)(B)(2).
 - iii Prop. Reg. § 1.1411-2(a)(2)(iv).
 - iv Prop. Reg. § 1.1411-2(a)(iii).
 - v Prop. Reg. § 1.1411-2(b).
 - vi Prop. Reg. § 1.1411-4(a)(i).
 - vii Prop. Reg. § 1.1411-4(a)(i)(i).
 - viii Id.
 - ix Prop. Reg. § 1.1411-4(a)(i)(iii).
 - x Prop. Reg. § 1.1411-2(c). If a taxpayer does not have foreign earned income, MAGI will equal the taxpayers' adjusted gross income.
 - xi Prop. Reg. § 1.1411-2(d).

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WHAT TYPES OF INCOME ARE INCLUDED IN NET INVESTMENT INCOME?

INTEREST, DIVIDENDS, ANNUITIES, ROYALTIES i ii

Was the income earned in a trade or business under the meaning of Section 162? iii



Income is net investment income (less properly allocable deductions) vii

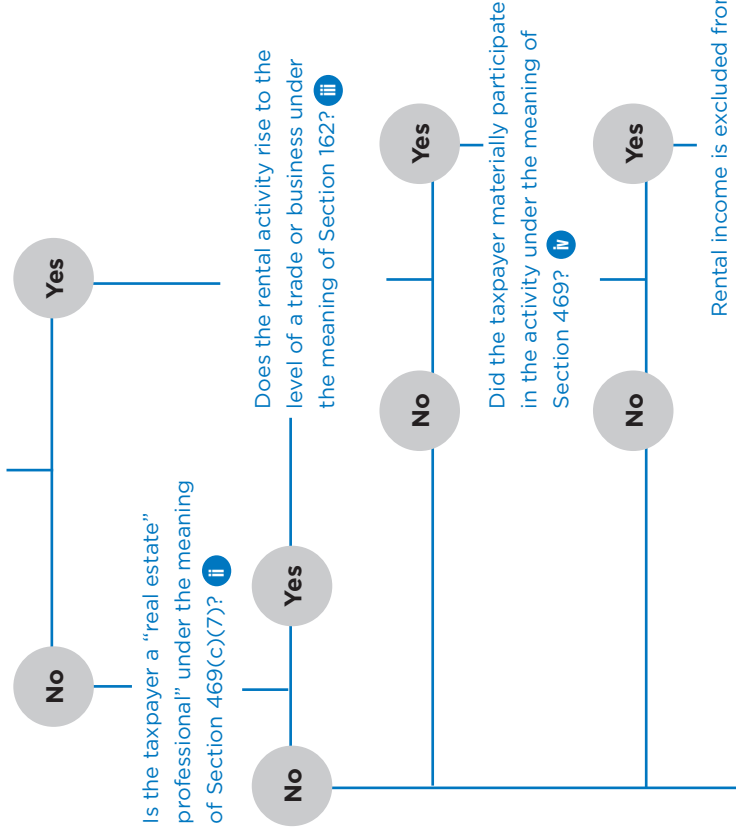
Income is excluded from net investment income viii

- i Prop. Reg § 1.1411-4 (a)(1)(i)
- ii Includes substitute interest and dividend payments, see Prop. Reg § 1.1411-4(a)(1)(i)
- iii Prop. Reg § 1.1411-4(b), see Prop. Reg § 1.1411-4(b)(3) Example 1
- iv Id.
- v Id., Prop. Reg § 1.1411-5(a)(1)
- vi Id., Prop. Reg § 1.1411-5(g)(2), see Prop. Reg § 1.1411-4(b)(3) Example 2
- vii See Prop. Reg § 1.1411-4(f)
- viii See Prop. Reg § 1.1411-4(b)(3) Example 3

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RENTAL INCOME i

Was the income earned in an activity that meets an exception to "rental activities" under Treas. Reg. 1.469-1T?



Income is net investment income (less properly allocable deductions) v

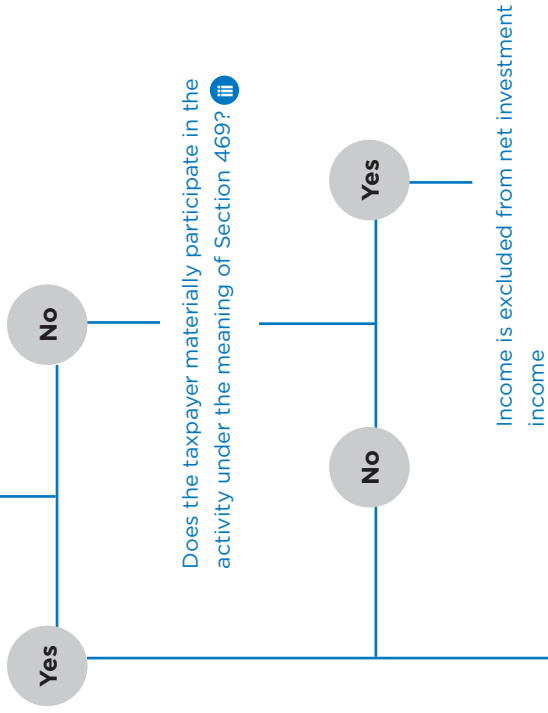
Rental income is excluded from net investment income.

- i Prop. Reg § 1.1411-5(b)(2) Example 5
- ii Prop. Reg § 1.1411-4 (a)(1)(i)
- iii See the preamble to the proposed regulations page 50 Prop. Reg § 1.1411-5(b)(2) Example 1
- iv Consider the effect of any grouping elections made pursuant to Treas. Reg § 1.469-4 See Prop. Reg § 1.1411-5(b)(2) Example 2
- v Prop. Reg § 1.1411-4(f)

WHAT TYPES OF INCOME ARE INCLUDED IN NET INVESTMENT INCOME?

ALL OTHER FORMS OF INCOME EARNED IN A TRADE OR BUSINESS I

Is the trade or business the trading of financial instruments or commodities? **ii**



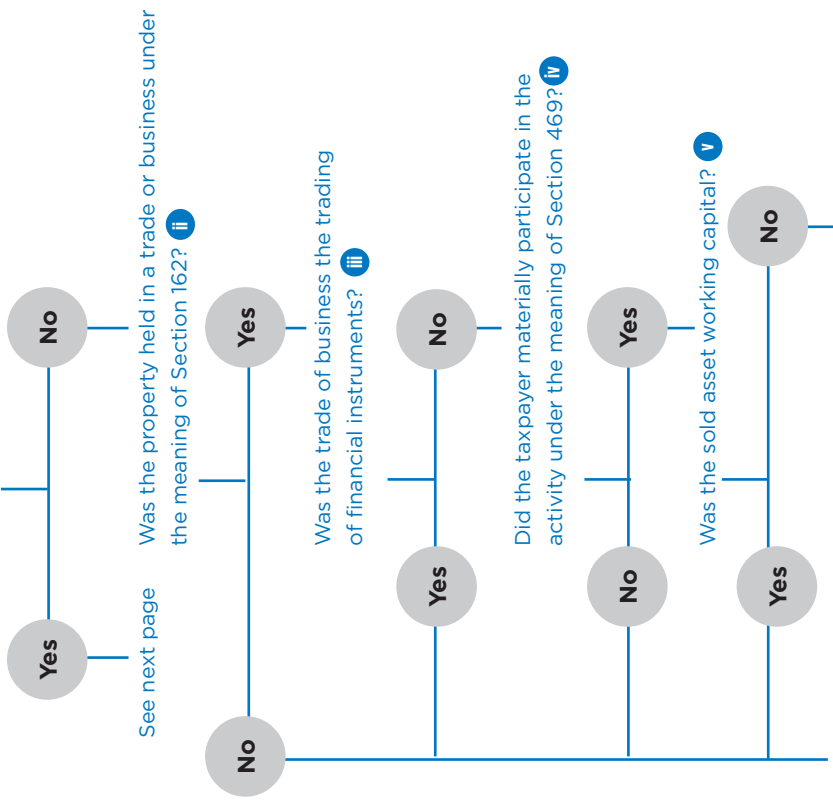
Income is net investment income (less properly allocable deductions)

- i Income other than interest, dividends, annuities, royalties, rents, or gains from the sale of property. Prop. Reg § 1.1411-4(c)(1). Income that is not earned in a trade or business (for example, hobby income under Section 183) is not included in net investment income unless the income is interest, dividends, annuities, royalties, rent, or gains from the disposition of property. See the preamble to the proposed regulations on page 48.
- ii Prop. Reg § 1.1411-4(c)(2)
- iii Prop. Reg § 1.1411-4(c)(1). See Prop. Reg § 1.1411-5(b)(2) Example 5

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GAIN FROM THE SALE OF ASSETS I

Was the gain from the sale of S corporation stock or a partnership interest?



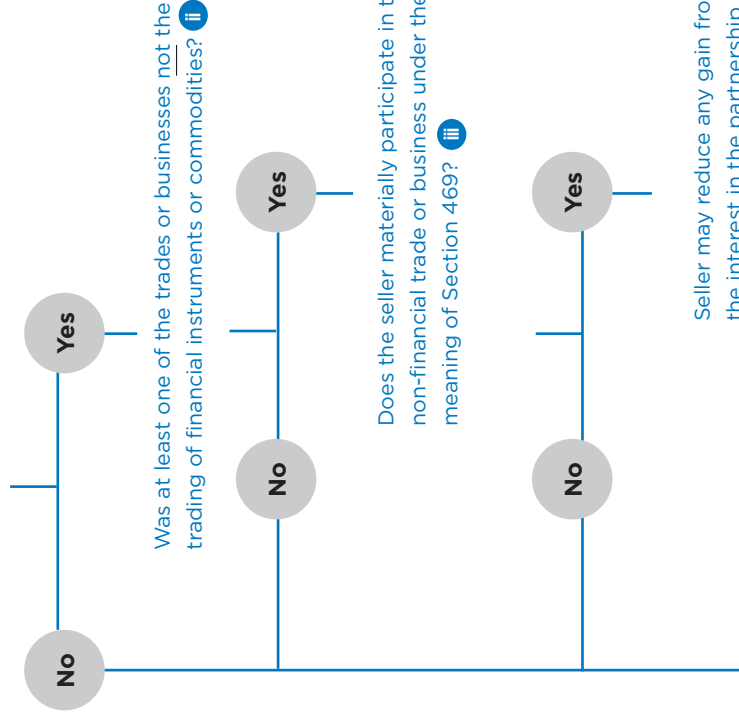
Gain is net investment income. **vi** Gain is not net investment income.

- i Prop. Reg § 1.1411-4(d)
- ii Prop. Reg § 1.1411-4(d)(5)(ii). See Prop. Reg § 1.1411-4(d)(5)(ii)(c) Example 1
- iii Id.
- iv Id.
- v Id.
- vi Prop. Reg § 1.1411-4(d)(2). Gain may be reduced by net losses, but not below zero.

WHAT TYPES OF INCOME ARE INCLUDED IN NET INVESTMENT INCOME?

GAIN FROM THE SALE OF INTERESTS IN PARTNERSHIPS AND S CORPORATIONS

Was the S corporation or partnership engaged in one or more trades or businesses under the meaning of Section 162? **i**



Gain is net investment income **vii**

Seller may reduce any gain from the sale of the interest in the partnership or S corporation pursuant to Prop. Reg. § 1.1411-7(e) **iv**

i Prop. Reg § 1.1411-7 (a)(1)(A)

ii Id.

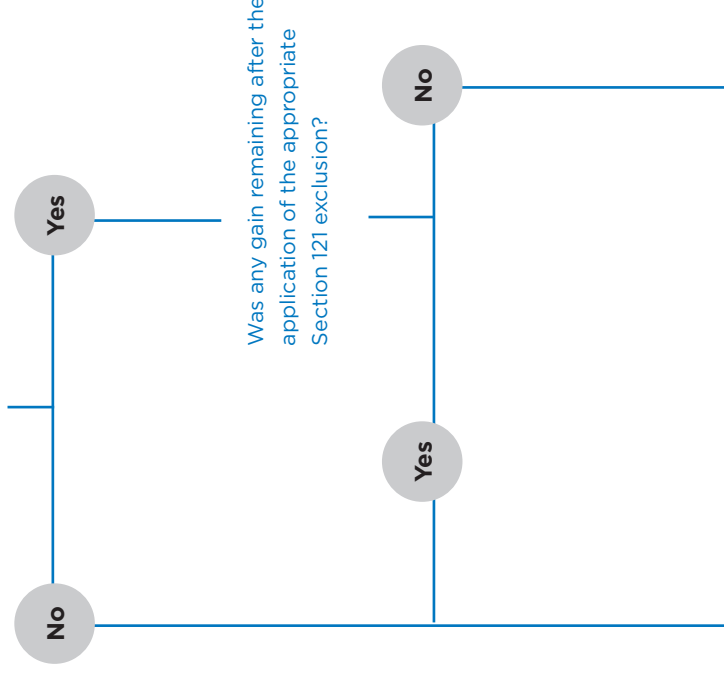
iii Prop. Reg § 1.1411-7 (a)(2)(i)(B)

iv Prop. Reg § 1.1411-7 (c), Prop. Reg § 1.1411-7 (e), Examples 1-8

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GAIN FROM THE SALE OF A RESIDENCE

Did the residence meet the definition of the taxpayer's principle residence under the meaning of Section 121?



Gain is net investment income.

Gain is not included in net investment income. **i**

i Prop. Reg § 1.1411-4(b) Example 4

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