

# Navigating the new tax regime

## Calculating the new 3.8% net investment income tax for the year 2013



The **net investment income tax** is triggered if your **modified adjusted gross income (MAGI)** crosses a threshold. Compare the amount exceeding the threshold to your **net investment income (NII)**.

<b>Step 1</b>	<b>What is the MAGI amount?</b> Note: In this instance, MAGI = adjusted gross income + certain excluded adjusted foreign earned income.	\$						
<b>Step 2</b>	<table><tr><th colspan="3">Tax thresholds</th></tr><tr><td><b>\$200,000</b> if single or head of household</td><td><b>\$250,000</b> if married filing jointly*</td><td><b>\$125,000</b> if married filing separately</td></tr></table> <p><b>Determine if the MAGI has crossed a tax-triggering threshold listed above.</b> If yes, by how much</p> <p><input type="checkbox"/> No <input type="checkbox"/> Yes</p> <p><b>MAGI amount exceeding the tax threshold</b> Example: Joe is a single filer and has \$220,000 in MAGI in 2013. He is \$20,000 over the threshold for a single filer. *Includes qualifying widow(er) with dependent child</p> <p><b>Box 1</b> \$</p>	Tax thresholds			<b>\$200,000</b> if single or head of household	<b>\$250,000</b> if married filing jointly*	<b>\$125,000</b> if married filing separately	
Tax thresholds								
<b>\$200,000</b> if single or head of household	<b>\$250,000</b> if married filing jointly*	<b>\$125,000</b> if married filing separately						
<b>Step 3</b>	<b>What is the total NII amount?</b> Note: Refer to the table below for what is and is not included in NII.	<b>Box 2</b> \$						
<b>Step 4</b>	<b>Compare the MAGI amount exceeding the tax threshold (Box 1) to the total NII (Box 2).</b> Example: Joe has \$20,000 more than the MAGI threshold. His NII is \$10,000. \$10,000 is the lesser amount and is therefore the amount subject to the NII tax.							
<b>Step 5</b>	<b>Which amount is lower?</b> The 3.8% tax applies to the lesser amount (Box 3).	<b>Box 3</b> \$						

### Determining net investment income

Includes income from:

- > Taxable interest, dividends, rents and royalties
- > Distributions of earnings from nonqualified annuities (not held in an IRA or qualified plan)
- > Net gain from the sale/disposition of certain property (Does not include property sold by an active business or gains excluded from income.)
- > Substitute dividend/interest (payments in lieu of dividends or interest)
- > Income from a trade or business that is considered a passive activity (under the passive loss rules) and is in the business of trading in financial instruments or commodities/related derivatives

Does not include income from:

- > Wages, commissions, compensation and nonqualified deferred compensation distributions
- > Self-employment income that is taken into account for SECA tax purposes
- > Taxable Social Security income
- > Qualified retirement plan distributions
  - IRAs, 401(k) plans, 403(b) plans, pensions
  - Roth IRA/qualified plan distributions
- > Tax-exempt income
  - Municipal bond interest
  - Excluded gain on the sale of a principal residence
  - Life insurance death benefit
- > A trade or business income that is **not** considered a passive activity (under the passive loss rules) and is not in the business of trading in financial instruments or commodities/related derivatives  
Note: Income from working capital investments does not fall within this exception
- > Distributions from 529 college savings plans
- > Inheritance and gifts

## Examples: Calculating the new 3.8% net investment income tax

Marital status	MAGI	MAGI exceeding tax threshold	NII	Lesser of:	Amount subject to 3.8% tax
Married filing jointly	\$500,000 salary +\$75,000 in taxable investment income =\$575,000 MAGI	Threshold amount: \$250,000 Amount exceeding threshold: \$325,000	\$75,000	\$325,000 or \$75,000	<b>\$75,000</b>
Single	\$180,000 wages +\$40,000 in taxable dividends =\$220,000 MAGI	Threshold amount: \$200,000 Amount exceeding threshold: \$20,000	\$40,000	\$20,000 or \$40,000	<b>\$20,000</b>
Single	\$0 wages +\$100,000 taxable interest =\$100,000 MAGI	Threshold amount: \$200,000 Amount exceeding threshold: \$0	\$100,000	\$0 or \$100,000	<b>\$0</b>
Single	\$195,000 in taxable investment income +\$50,000 in taxable IRA RMD =\$245,000 MAGI	Threshold amount: \$200,000 Amount exceeding threshold: \$45,000	\$195,000	\$195,000 or \$45,000	<b>\$45,000</b>

## Definitions of income

### Adjusted gross income (AGI)

Adjusted gross income (AGI) is gross income from taxable sources such as:

- > Wages, interest, dividends, capital gains, plan distributions, royalties, rent, applicable portions of Social Security payments, etc. minus allowable above the line deductions, such as certain unreimbursed business expenses of reservists, health savings account contributions, self-employed health insurance payments, alimony and deductible retirement plan and IRA contributions.

AGI is reported on line 37 of a 1040 filing (for tax year 2012).

### Modified adjusted gross income (MAGI)

Modified adjusted gross income (MAGI) is an individual's adjusted gross income plus the inclusion of certain items exempt from AGI.

- > The MAGI varies depending on the circumstance to which it is applied.
- > For the purpose of the NII tax, MAGI = AGI + the foreign income exclusion (subject to certain related deductions).

### Net investment income (NII)

Net investment income (NII) (includes items below) reduced by those deductions properly allocable to the investment income.

Included as NII are:

- > Taxable interest, dividends, rents and royalties
- > Distributions of earnings from nonqualified annuities
- > Net gain on the sale/disposition of certain property (does not include property sold by an active business or gains excluded from income)
- > Income from a trade or business that is considered a passive activity (under the passive loss rules) and is in the business of trading in financial instruments or commodities/related derivatives

Not included as NII are:

- > Wages, commissions, compensation, Social Security income and nonqualified deferred compensation distributions
- > Qualified retirement plan distributions: IRAs, 401(k), 403(b), 457 plans and defined benefit plans
- > Tax-exempt income: municipal bond interest, excluded gain on the sale of a principal residence, life insurance death benefit, etc.
- > Income from a trade or business that is not considered a passive activity (under the passive loss rules) and is not in the business of trading in financial instruments or commodities/related derivatives

The NII tax of 3.8% is in addition to the tax rate on investment income, which is taxed at the:

- > Ordinary income tax rate (taxable interest or ordinary dividend income and short-term capital gains)
- > Capital gains tax rate (long-term capital gains and qualified dividends from dividend-paying securities like equities and certain mutual funds)

## 2013 federal income tax rates

Single individuals					Joint returns and surviving spouses				
Taxable income					Taxable income				
Over (\$)	But not over (\$)	Tax (\$)	(%) on excess	Of the amount over (\$)	Over (\$)	But not over (\$)	Tax (\$)	(%) on excess	Of the amount over (\$)
0	8,925	0.00	10	0	0	17,850	0.00	10	0
8,925	36,250	892.50	15	8,925	17,850	72,500	1,785.00	15	17,850
36,250	87,850	4,991.25	25	36,250	72,500	146,400	9,982.50	25	72,500
87,850	183,250	17,891.25	28	87,850	146,400	223,050	28,457.50	28	146,400
183,250	398,350	44,603.25	33	183,250	223,050	398,350	49,919.50	33	223,050
398,350	400,000	115,586.25	35	398,350	398,350	450,000	107,768.50	35	398,350
400,000	—	116,163.75	39.6	400,000	450,000	—	125,846.00	39.6	450,000

### Estates and trusts

Taxable income					Estates and trusts will be subject to the NII tax if they have undistributed NII and also have adjusted gross income over the dollar amount at which the highest tax bracket for an estate or trust begins for such taxable year (for tax year 2013, this threshold amount is \$11,950). There are special computational rules for certain unique types of trusts, and not all trusts are affected.
Over (\$)	But not over (\$)	Tax (\$)	(%) on excess	Of the amount over (\$)	
0	2,450	0.00	15	0	
2,450	5,700	367.50	25	2,450	
5,700	8,750	1,180.00	28	5,700	
8,750	11,950	2,034.00	33	8,750	
11,950	—	3,090.00	39.6	11,950	

## Federal tax on net capital gains and qualified dividends

2013 rates for individuals				
Type of gain	Holding period	Top rate for taxpayer in 39.6% marginal tax bracket	Top rate for taxpayer in 25% through 35% marginal tax brackets	Top rate for taxpayer in 10% or 15% marginal tax bracket
Short-term	12 months or less	Taxed at the same rate as ordinary income	Taxed at the same rate as ordinary income	Taxed at the same rate as ordinary income
Long-term	More than 12 months	20%	15%	0%
Qualified dividends	More than 60 days	20%	15%	0%

### Notes:

## How to manage the new tax regime effectively

A Columbia Management representative can provide tools and resources to potentially lower the NII amount and/or prevent crossing a tax threshold. Financial advisors can call **800.426.3750** today to receive new material and additional information on:

- > Understanding which securities are more tax-favored
- > Determining which securities may be more favorable when held in tax-deferred accounts
- > Ways to maximize retirement account contributions
- > Asset allocation strategies and ways to manage after-tax returns
- > Asset location strategies to help defer taxes on investment returns now and potentially lower net investment income later

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To help you navigate the new tax regime, ask your financial advisor to contact a Columbia Management representative at **800.426.3750**.

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