

# NAR Frequently Asked Questions

## Health Insurance Reform

### **NEW MEDICARE TAX ON EARNED INCOME: WAGES, SALARIES AND COMMISSIONS**

#### **Q-1: Who will be subject to the new taxes imposed in the health legislation?**

**A:** A new 0.9% tax will apply to the “earned” income of “High Income” taxpayers. Another 3.8% tax will apply to the “unearned” income of many of these same individuals. Both are described as “Medicare” taxes. (For a description of the 3.8% tax on unearned income, see separate Q&A entitled “NEW MEDICARE TAX ON “UNEARNED” NET INVESTMENT INCOME.)

#### **Q-2: Who is a “High Income” Taxpayer?**

**A:** Those whose tax filing status is “single” will be subject to the new taxes on earned income *if* the earned income that is part of Adjusted Gross Income (AGI) is more than \$200,000. Married couples filing a joint return with earned income of more than \$250,000 will also be subject to the new tax. (The earned income threshold for married filing separate returns is \$125,000)

#### **Q-3: Are the \$200,000 and \$250,000 thresholds indexed for inflation?**

**A: No.** Thus, over time, more individuals could become subject to this tax.

#### **Q-4: When does this tax go into effect?**

**A:** Implementation will begin January 1, 2013.

#### **Q-5: What is “earned” income?**

**A:** The term “earned income” is essentially the income derived from an individual’s labor. It can take the form of wages, salaries, commissions or similar compensation arrangements. Employees of an organization and self-employed individuals are generally compensated for the work they do in some form of earned income.

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### **Q-6: Does the new 0.9% tax apply to all of an individual's earned income?**

**A: No.** The 0.9% tax applies only to the portion of a high income taxpayer's earnings that exceed the \$200,000 or \$250,000 thresholds. Taxpayers with adjusted gross income below those amounts will experience no change in their Medicare taxes.

### **Q-7: Does the new tax apply to gross commissions?**

**A: No.** The tax applies only to *net* commissions, i.e., gross commissions minus the expenses of earning the commission. For many Realtors, this will be the amount reflected in the Schedule C they file as part of their annual Form 1040 income tax filings.

### **Q-8: So will a self-employed person pay an additional tax of 1.8% (i.e., both the "employer" and "employee" portions of the Medicare tax) on the taxable portion of earnings?**

**A: No.** There is no "employer" portion of this new tax. The rate for all individuals subject to the tax will be 0.9%, whether they are employees or they are self-employed. Real estate professionals who have employees would not be required to pay any portion of this tax for any of their employees who might become subject to it. (Note, however, that real estate professionals who have employees may have responsibility to withhold the new tax on behalf of employees who might be subject to it.) Independent contractor sales agents will always pay the full share of this tax they might owe on their earned income.

### **Q-9: How does the new tax on self-employment income interact with the current rules for the Self-employment Tax (SECA)?**

**A:** Under current law, self-employed individuals must pay a Medicare tax (also known as Hospital Insurance tax, or HI) of 2.9 percent (1.45% "employer" and 1.45% on "employee") on ALL self-employment income. Generally, self-employment income is comprised of earnings from self-employment activities minus the expenses associated with generating those earnings.

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For example, a Realtor might have gross commissions of \$95,000 and expenses associated with that income of \$35,000. That individual's self-employment income would be \$60,000 (\$95,000 minus \$35,000). Assuming no other earned income sources, this Realtor would *not* be subject to the new tax.

By contrast, a high producer Realtor might have net self-employment income of \$280,000. If that Realtor were single, the tax would apply *only* to the \$80,000 that exceeds the \$200,000 AGI threshold. Thus, the additional new tax would be \$720. (\$280,000 minus \$200,000 = \$80,000) (\$80,000 x .009 = \$720). A married couple with earned income of \$280,000 would pay an additional new tax of \$270 (\$280,000 minus \$250,000 = \$30,000) (\$30,000 x .009 = \$270).

(Note that these examples are over-simplified. Determination of self-employment income requires more calculations than are presented here. The example is intended to illustrate that the new tax applies *only* to a portion of an individual's or couple's earned income.)

**Q-10: Under current law, a self-employed Realtor deducts one-half of his/her SECA/HI payment for income tax purposes. Can all or some portion of this new tax be deducted?**

**A: NO AMOUNT** of any payment of the new 0.9 percent HI tax on self-employment income will be deductible for income tax purposes.

**Q-11: Why is this tax called a "Medicare" tax when it is structured so differently from SECA?**

**A:** The revenues generated from this tax will be allocated to the Medicare Trust Fund that is part of the Social Security System. That fund is currently on shaky financial footing. The additional revenues generated from the new earned income and unearned income taxes are intended to shore up the Medicare Trust Fund.

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**Q-12: Is there a real estate “sales tax” or a transfer tax in the new health care bill?**

**A: No.** There is neither a real estate “sales tax” nor a real estate transfer tax in the bill.

**Q-13. Will “High Income Filers” also see a reduction in the amount of Mortgage Interest they are allowed to deduct?**

**A: No.** The mortgage interest deduction is unchanged. No cap was imposed on any itemized deductions.