Planning for the .9% Earned Income Surtax

What?

Starting in 2013, taxpayers with high earned income will start paying a .9% surtax on earned income in excess of $200,000 (single) and $250,000 (married filing joint).

Earned income defined:

Earned income for this surtax is the sum of
- Medicare wages (box 5 of Form W-2)
- Sole Proprietorship income
- Farm income
- K-1 income from LLCs and partnerships
- Guaranteed payments from LLCs and partnerships

For example:

- A single taxpayer with earned income of $180,000 would not pay a surtax
- A single taxpayer with earned income of $220,000 would pay a surtax of $20,000x .9% or $180.
- If the two taxpayers above were married, the surtax would be $150,000x .9% or $1,350.

Planning ideas:

- In the above example, divorce seems like an obvious answer.
- Other than divorce, for regular wage earners, reducing earned income is the answer
  - Sign up for an HRA (Health Reimbursement Account) at work.
  - Utilize every available pretax fringe benefit such as child care and education reimbursements.
  - Maxing out pretax retirement accounts will not save you from the surtax because earned income is defined as line 5 of Form W-2.
  - Instead of a preset auto allowance, have your employer set up an accountable plan.
- Self-employed individuals can reduce earned income by setting up an S Corporation with a reasonable wage. The profits of the Corporation are not earned income, so only the wage would be part of the surtax calculation.