

**ALERTS****Tax Law Alert - Final Rules Implement Key Aspects Of 3.8 Percent Net Investment Income Tax**

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The Treasury Department and the IRS have issued Final Regulations implementing the 3.8 percent tax on the investment income of certain “high income” individuals, estates, and trusts (the **NIIT**).

For individuals, the tax is 3.8 percent of the lesser of: (1) the individual’s **Net Investment Income**; or (2) the excess of the individual’s **Modified Adjusted Gross Income** over a specified **Threshold Amount** (\$250,000 for joint filers, \$200,000 for single filers, and \$125,000 for separate filers). Similar rules apply to the **Undistributed Net Investment Income** of estates and trusts, but at a lower threshold (\$12,150 for 2014).

Net Investment Income includes interest, dividends, annuities, royalties, rents, gains, and trade or business income from passive activities and trading in financial instruments or commodities (NIIT Trades or Businesses). These items may be excluded if they are derived in or from a trade or business that is not an **NIIT Trade or Business**. Net Investment Income does not include distributions from qualified retirement plans or amounts subject to self-employment tax. Taxpayers are allowed certain deductions to reduce Net Investment Income.

The Final Regulations address numerous public comments submitted in response to the 2012 Proposed Regulations. Some of the significant developments include:

- Rental income from qualifying “self-rental” properties and a portion of “self-charged interest” will be deemed to be derived in the ordinary course of trade or business and be excluded from the NIIT.
- Income from a rental activity that a taxpayer materially participates in through a proper grouping with a trade or business will be excluded from the NIIT.
- Rental income earned by “real estate professionals” can be excluded from the NIIT if the real estate professional participates in the rental for a specified number of hours.

The Treasury Department and the IRS also issued a new set of proposed regulations. The **2013 Proposed Regulations** provide new rules relating to gain or loss from the sale of interests in partnerships and S corporations. The 2013 Proposed Regulations provide two methods for calculating gain or loss subject to the NIIT. The primary method provides that the gain or loss subject to the NIIT is the lesser of the gain or loss for

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regular tax purposes, or the amount of gain or loss that would be allocated upon a deemed sale of assets (applied on an activity-by-activity basis). The simplified method applies where the amount of gain subject to the NIIT is likely to be relatively small.

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