

# Robert S. Keebler, CPA/PFS, MST, AEP: The 3.8% NIIT

## Threshold Amounts

Single Person	\$200,000
Married Couple	\$250,000
Trust or Estate – 2020	\$ 12,950
Trust or Estate – 2021	\$ 13,050

## MAGI:

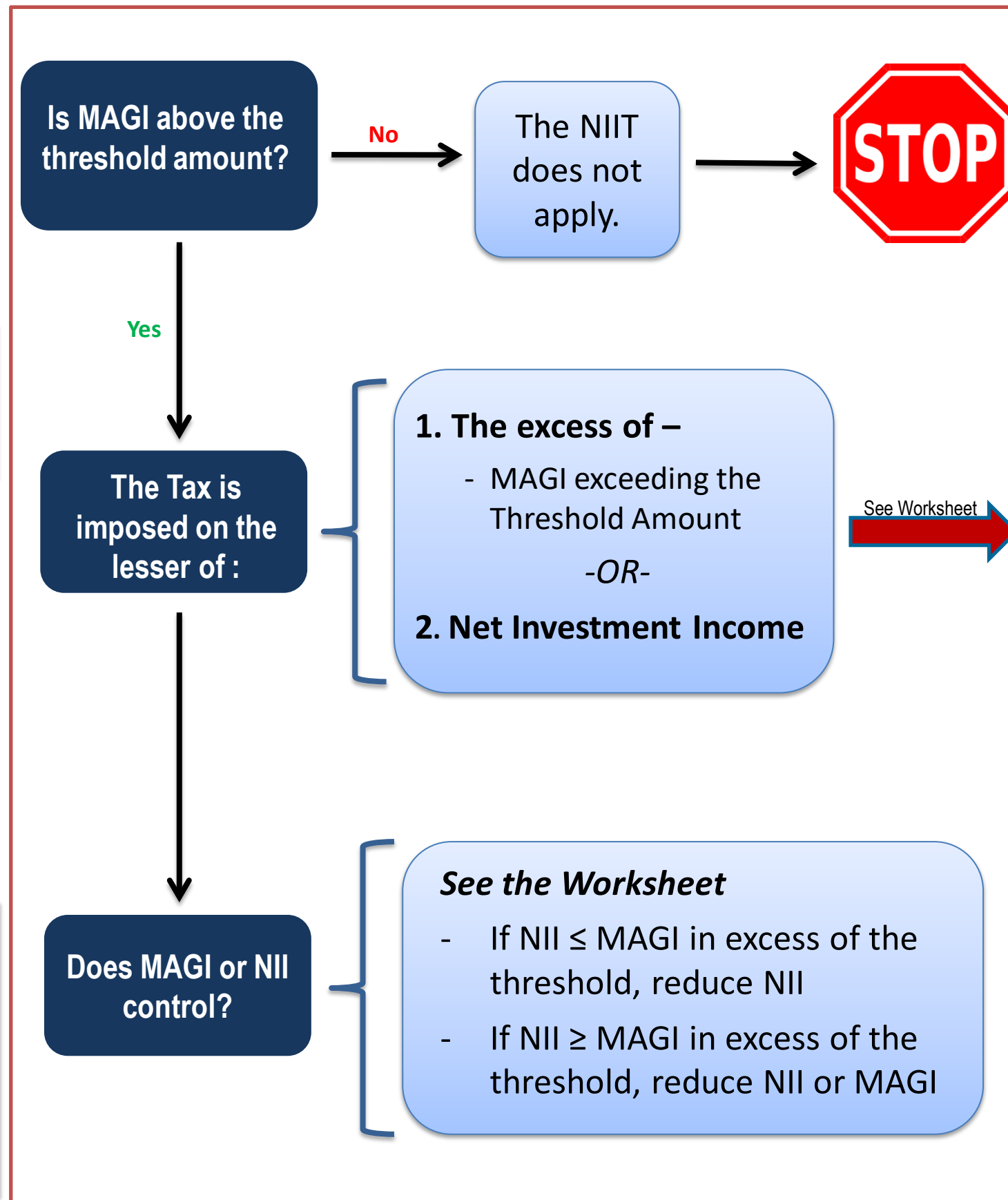
Adjusted gross income (Form 1040, Line 37)  
**PLUS** Net foreign earned income exclusion

## Net Investment Income (NII)

- Interest
- Dividends
- Annuity Distributions
- Rents
- Royalties
- Income derived from passive activities
- Net capital gain derived from the disposition of property

## Strategies for Reducing MAGI

- Roth IRAs
- Charitable Remainder Trusts (CRTs)
- Non-grantor Charitable Lead Trusts (CLTs)
- Installment Sales
- Change filing status



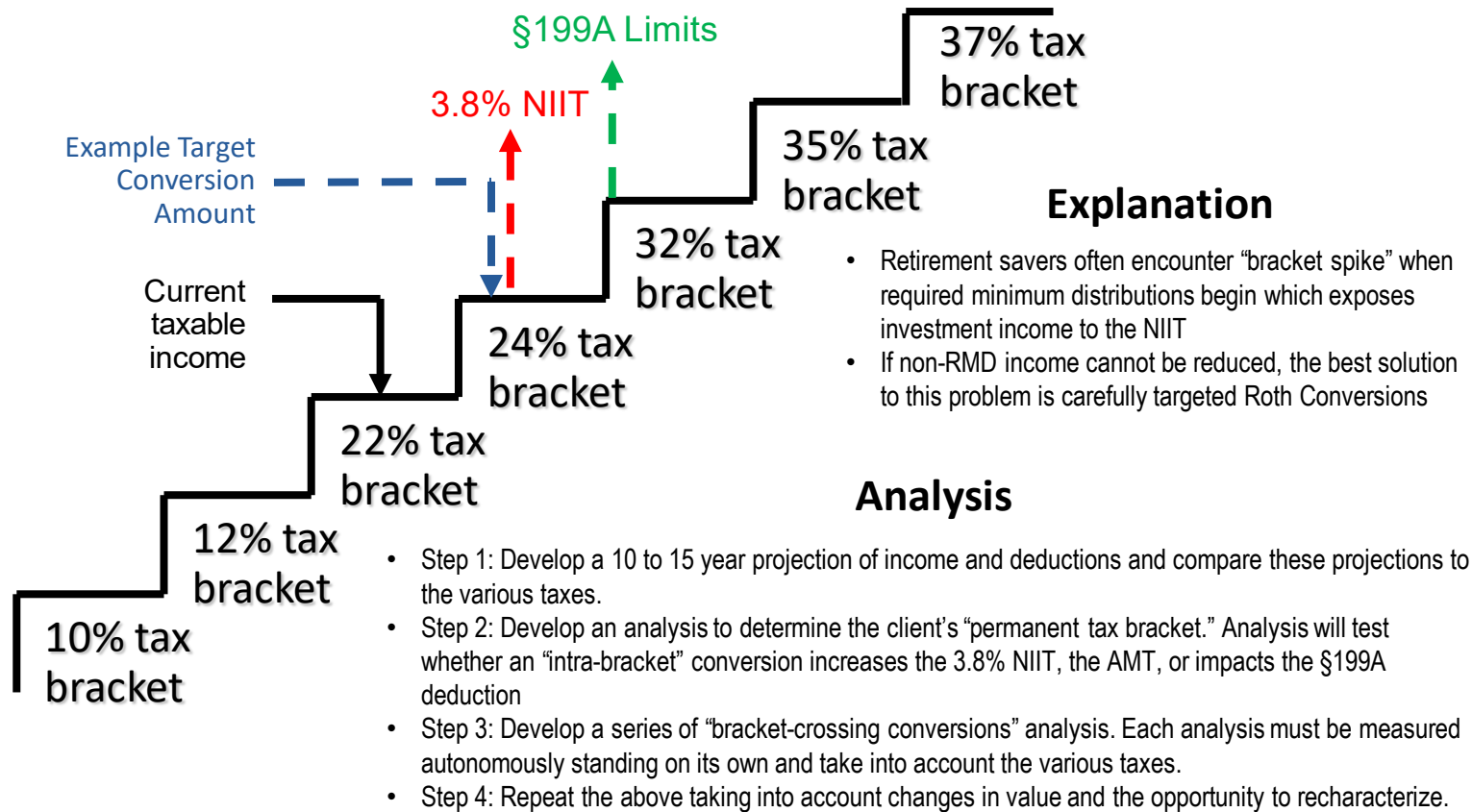
NIIT Worksheet – Does MAGI or NII Control?	
<b>MAGI</b>	
Less: Threshold Amount	( )
Excess over threshold (1)	
<b>NII (2)</b>	
Lesser of (1) or (2)	
Rate	X 3.8%
NIIT	

## Strategies to Reduce NII & MAGI

- Low-turnover strategies
- Municipal bonds
- Tax-deferred annuities
- Life insurance
- Rental real estate (see §1411 Regs.)
- Oil & gas investments
- Choice of accounting year for estate/trust
- Timing of estate/trust distributions

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## Roth IRA Conversions



## Charitable Remainder Trusts

### Explanation

- Charitable remainder trusts are also exempt from the NIIT (Reg. § 1.1411-3(b)).
- Trust beneficiaries may be subject to the NIIT when they receive annuity or unitrust distributions, though
- One of two methods may be used to calculate the beneficiary’s NIIT as distributions are received:
  - Simplified method: Reg. Reg. § 1.1411-3(c)(2)(i) of the 2012 Prop. Regs.: Distributions from a CRT to a beneficiary for a taxable year consist of NII in an amount equal to the lesser of the total amount of the distributions for that year, or the current and accumulated NII of the CRT
  - Section 664 Method – Reg. §1.1411-3(d)(2): Categorize and distribute NII based on the existing section 664 category and class system
- Reg. §1.1411-3(d)(3): Reserved for a rule allowing the CRT to elect between the two methods

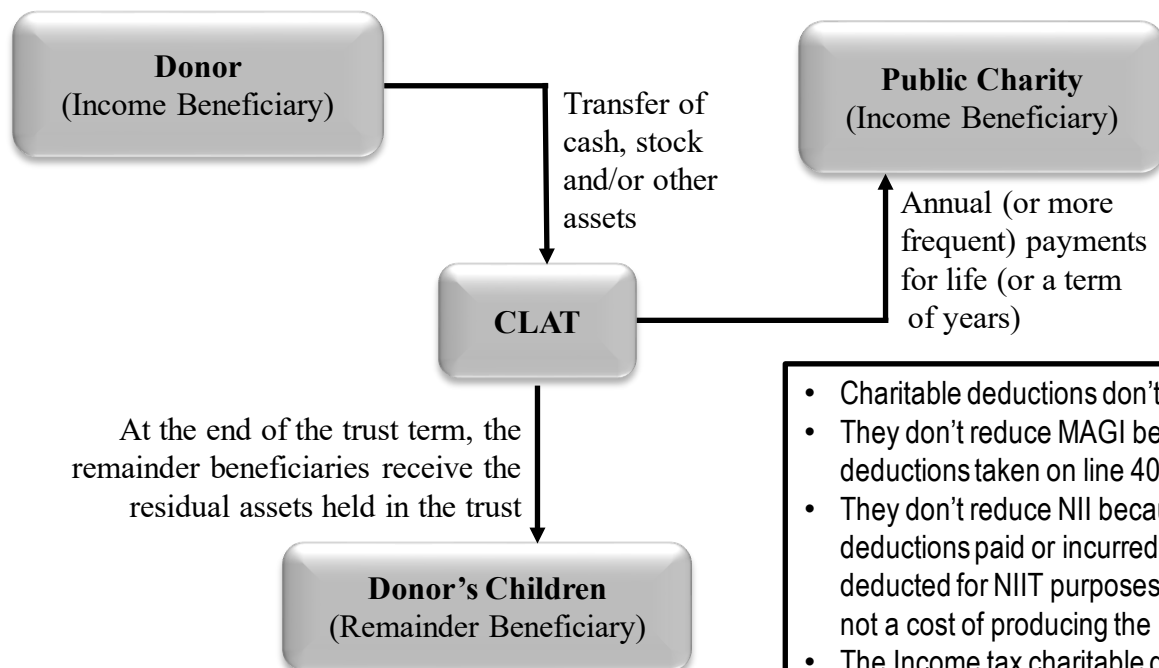
### Types of CRT Strategies

- Substantive Sale CRT (Standard CRT)**  
CRT to eliminate or reduce/defer the 3.8% NIIT and 5% incremental capital gains tax upon sale of a property, security, or business interest. The CRT will smooth out gain to avoid the 3.8% NIIT or the incremental capital gains tax.
- Retirement CRT (Flip-CRT)**  
CRT to harvest annual real estate and securities gains while harvesting losses in your outside account. “Flip” trust upon retirement when distributions will not be subject to the 3.8% NIIT or the incremental capital gains tax.
- Income Shifting CRT (Standard CRT for children)**  
CRT to eliminate or reduce/defer the 3.8% NIIT and 5% incremental capital gains tax while shifting the incidence of taxation to children and grandchildren.

## Non-Grantor Charitable Lead Trusts

A Charitable Lead Trust (CLT) is a split interest trust consisting of an income interest and a remainder interest. During the term of the trust, the income interest is paid out to a named charity. At the end of the trust term, the remainder (whatever is left in the trust) is paid to non-charitable beneficiaries (e.g. children of the donor) that have been designated in the trust document.

### Explanation



- Charitable deductions don't help individuals with the NIIT.
- They don't reduce MAGI because they are below-the-line deductions taken on line 40 of Form 1040.
- They don't reduce NII because only properly allocable deductions paid or incurred to produce the income can be deducted for NIIT purposes and the charitable deduction is not a cost of producing the income.
- The Income tax charitable deduction can be used to reduce the NIIT on charitable lead annuity trusts (CLATs).

### Example

Individual IRC §170 Deduction		Trust - §642(c) Deduction	
Wage Income	\$260,000	Interest Income	\$100,000
Interest Income	\$100,000	Dividend Income	\$50,000
Dividend Income	\$50,000	MAGI	\$150,000
MAGI	\$410,000	Less: Charitable Deduction	(\$150,000)
Less: Threshold Exemption	(\$250,000)	AGI	\$0
Subtotal	\$160,000		
Lesser of Excess over Threshold or NII	<b>\$150,000</b>		
NII Tax at 3.8%	\$5,700	NII Tax at 3.8%	\$0