Abstract: Despite its name, the Tax Cuts and Jobs Act didn't cut all types of taxes. It left several taxes unchanged, including the 3.8% tax on net investment income (NII) of high-income taxpayers. This brief article defines the NII tax and urges you to explore strategies for reducing it if you must pay it.

Planning for the net investment income tax

Despite its name, the Tax Cuts and Jobs Act (TCJA) didn't cut all types of taxes. It left several taxes unchanged, including the 3.8% tax on net investment income (NII) of high-income taxpayers.

You're potentially liable for the NII tax if your modified adjusted gross income (MAGI) exceeds $200,000 ($250,000 for joint filers and qualifying widows or widowers; $125,000 for married taxpayers filing separately). Generally, MAGI is the same as adjusted gross income. However, it may be higher if you have foreign earned income and certain foreign investments.

To calculate the tax, multiply 3.8% by the lesser of 1) your NII, or 2) the amount by which your MAGI exceeds the threshold. For example, if you're single with $250,000 in MAGI and $75,000 in NII, your tax would be 3.8% × $50,000 ($250,000 - $200,000), or $1,900.

NII generally includes net income from, among others, taxable interest, dividends, capital gains, rents, royalties and passive business activities. Several types of income are excluded from NII, such as wages, most nonpassive business income, retirement plan distributions and Social Security benefits. Also excluded is the nontaxable gain on the sale of a personal residence.

Given the way the NII tax is calculated, you can reduce the tax either by reducing your MAGI or reducing your NII. To accomplish the former, you could maximize contributions to IRAs and qualified retirement plans. To do the latter, you might invest in tax-exempt municipal bonds or in growth stocks that pay little or no dividends.

There are many strategies for reducing the NII tax. Consult with one of our tax advisors before implementing any of them. And remember that, while tax reduction is important, it's not the only factor in prudent investment decision-making.