

FEDERAL NET INVESTMENT INCOME TAX AND THE WEALTH PROCEEDS TAX PROPOSED BY S.282

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OUTLINE – NIIT AND WPT

- What is the Net Investment Income Tax (NIIT)?
- What is the Wealth Proceeds Tax (WPT)?
- Comparison of NIIT and WPT

WHAT IS THE NET INVESTMENT INCOME TAX?

- Effective Jan. 1, 2013. (Health Care and Education Reconciliation Act of 2010).
- Purpose. Help fund healthcare reform (Affordable Care Act).
- History. The TCJA eliminated the individual mandate to require healthcare coverage but kept the NIIT.
- Surtax. Is applied in addition to income tax.

WHAT IS THE NET INVESTMENT INCOME TAX?

Policy Reasoning

Tax Disparity: Earned income from work is often taxed more than passive income from investments.

Progressive Tax Policy: High-income households tend to have these types of income.

Source: [Institute on Taxation and Economic Policy](#)

26 U.S.C. § 1411

Tax Base of the Net Investment Income Tax

A tax of 3.8 percent applies to the **lesser** of:

Net Investment Income

OR

Amount that MAGI exceeds certain thresholds

26 U.S.C. § 1411

Tax Base of the Net Investment Income Tax

Net Investment Income

- capital gains (no matter how long you held the asset)
- dividends (payments made by corporations to shareholders)
- taxable interest (earnings from savings, bonds, and other investments)
- rental and royalty income (rent: income from real or personal property; royalty: income from intellectual property)
- passive income from investments (dividend stocks, bonds, high-yield accounts, other investments that create income without active involvement)
- business income from trading financial instruments or commodities (trading securities for short-term gain)
- taxable portion of nonqualified annuity payments (financial instrument issued by insurance companies to “grow money” – funded with after-tax contributions so only distributions are taxed)

26 U.S.C. § 1411

Tax Base of the Net Investment Income Tax

Net Investment Income

Does not include:

- wages
- social security benefits
- unemployment pay
- qualified retirement plan withdrawals (401(k) or IRA)
- traditional defined benefit plan or retirement plan annuity
- deferred compensation plans
- interest from municipal bonds or funds
- income from the sale of your primary home
- life insurance
- active business income

26 U.S.C. § 1411

Tax Base of the Net Investment Income Tax

MAGI (modified adjusted gross income)

In this case, MAGI is:

- AGI + the foreign earned income exclusion (but accounting for deductions not allowed because of the exclusion)
 - Individuals living abroad may exclude up to \$130,000 of foreign wages in 2025.
- For individuals with no excluded foreign income, MAGI will be the same as AGI.

26 U.S.C. § 1411

Tax Base of the Net Investment Income Tax

MAGI Thresholds for NIIT

Single - \$200,000

Married Filing Jointly - \$250,000

Married Filing Separately - \$125,000

Note: The federal thresholds were enacted in 2013 and do not inflate.

Note: Both the NIIT and WPT apply to the income of trusts and estates but that is not a focus of most of this presentation for the sake of clarity and time.

3.8 PERCENT TAX APPLIES TO THE LESSER OF: NET INVESTMENT INCOME OR AMOUNT THAT MAGI EXCEEDS CERTAIN THRESHOLDS

Example:

\$50,000 in net investment income and MAGI of \$300,000 (single filer;
\$100,000 over threshold)

Net investment income (\$50,000) is less than the amount of MAGI over the threshold (\$100,000).

Tax applied to the lesser: 3.8 percent of \$50,000 is \$1,900 in tax due.

Proposed Wealth Proceeds Tax

Adapts the federal NIIT to Vermont law as a surtax on a similar tax base.

A tax on certain types of income that is in addition to income tax.

Does not directly tax the value of a taxpayer's wealth, such as real and personal property, stocks, and other assets.

PROPOSED 32 V.S.A. CHAPTER 149

WEALTH PROCEEDS TAX

A tax of four percent applies to the **lesser** of:

Wealth Proceeds (net investment income with several adjustments)

OR

Amount that MAGI exceeds certain thresholds

Note: Tax imposition is tied to Vermont taxable income, but tax liability is calculated using federal MAGI. Referencing Vermont taxable income only serves to decrease the number of taxpayers subject to tax.

PROPOSED 32 V.S.A. CHAPTER 149

TAX BASE FOR WEALTH PROCEEDS TAX

Net Investment Income

Increased by:

- income from state and local obligations outside VT (exempt under federal income tax but states usually tax this and are legally allowed to tax it)
- gains from qualified small business stock excluded under federal law
- gains from investments in opportunity zones excluded under federal law
- capital gains from the disposition of property held in a trade or business and not subject to NIIT
 - NIIT applies to gross income from passive activity and trading financial instruments or commodities, but the WPT would also include gains from the disposition of property for any trade or business.

PROPOSED 32 V.S.A. CHAPTER 149

TAX BASE FOR WEALTH PROCEEDS TAX

Net Investment Income

Increased by (continued):

- any amount of gain not subject to NIIT from the disposition of a partnership interest or S corporation stock
- net unrealized appreciation in securities of an employer corporation in certain retirement accounts (such as when an employer sets up a trust for an employee and contributes stock – any appreciation in stock value would be taxed under the WPT even though it is exempt under NIIT)
- wealth proceeds from an incomplete gift nongrantor trust that would be subject to federal income tax if the trust was a grantor trust

PROPOSED 32 V.S.A. CHAPTER 149

TAX BASE FOR WEALTH PROCEEDS TAX

Net Investment Income

Decreased by:

- Income from U.S. obligations (bonds, certificates of indebtedness, Federal Reserve notes, Federal Reserve bank notes, Treasury notes, gold certificates, etc . . .).
- Any amount exempted from state taxation by U.S. law (rare situations).

Comparison: NIIT and WPT

*for individuals – estates and trusts may have some differences

NIIT	WPT
Imposition based on MAGI threshold.	Imposition based on MAGI threshold.
Applies to several forms of investment income.	Applies to all of the same investment income as NIIT, except
	Excludes relatively small items of income federally preempted.
	Includes several items of investment income exempted or excluded from the NIIT.
Excludes wages and traditional retirement income.	Excludes wages and traditional retirement income.
Applies to individuals, estates, and trusts.	Applies to individuals, estates, and trusts.
3.8 percent rate.	4 percent rate.

Trusts and Estates

- Some clarifications are needed in the bill language regarding how to calculate tax for trusts and estates.
- If the GA wants to follow the federal approach, tax would be calculated as the **lesser** of:

Undistributed Net Investment Income
OR

Excess AGI over a certain amount (VT's highest bracket, a set amount of AGI, or something else)

CONSIDERATIONS AND DECISION POINTS

- Some clarifying language is needed in the imposition section.
 - No need to use Vermont taxable income as imposition thresholds when tax is calculated using MAGI.
- Include all the proposed investment income additions?
 - Additional administration for the Vermont Department of Taxes.
 - Seek testimony regarding the additions that are crucial to prevent tax avoidance?
- Vermont allocation. Difficult for Vermont to tax investment income from assets that are not located in Vermont.
 - This issue does not exist for a federal tax.