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MEDICARE PREMIUM BASED ON FEDERAL ADJUSTED GROSS INCOME IN 2007

With all the attention given to the Medicare prescription drug plan, the huge surcharges that will hit many seniors have been lurking in the background. Upper-income seniors will pay considerably higher Medicare Part B premiums beginning in 2007 and the definition of “upper-income” may surprise you.

Calculating the Increase

Taxpayers with a modified 2005 AGI (adjusted gross income) exceeding \$80,000 for single, or \$160,000 for married filing joint, will pay an income-related monthly adjustment for their Medicare Part B premiums in 2007.

Modified AGI for this purpose is 2005 federal AGI plus:

- Tax-exempt interest;
- Excluded savings bond interest used to pay for educational expenses;
- Excluded foreign-earned income;
- Income derived from sources within Guam, American Samoa, or the Northern Mariana Islands; and
- Income from sources in Puerto Rico.

Taxpayers who file as head of household or qualifying widow or widower will be treated as single for purposes of the Medicare premium surcharge.

A taxpayer who files an amended tax return that reduces federal AGI may request a re-determination from SSA of the surcharge amount. Also, the law provides for re-determination based on a major life-changing event.

Here are some additional key points:

- Additional premium is due even if the beneficiary did not sign up for prescription drug coverage.
- The provision that limits Medicare premium increases to the amount of Social Security (or Tier 1 railroad retirement) cost-of-living adjustments does not apply.
- The IRS will provide information to the SSA for purposes of determining the surcharge.
- SSA will notify Medicare beneficiaries of the increase at the end of 2006 (no accrual date has yet been set).

See Example 6-1.

Married Couples

Because the surcharge applies to each premium, a married couple will actually pay double the surcharge if both are Medicare beneficiaries.

See Example 6-2.

EXAMPLE 6-1: Ron, who is single, is a Medicare beneficiary with modified AGI of \$125,000. His Medicare Part B Premium is \$88.50 per month in 2006. So, if you apply the monthly adjustment to his 2006 premium, in 2007 he will pay a monthly premium of \$117.97.

In reality, Ron's 2007 premium will be even higher because his base premium will increase in 2007 and his adjustment will be based on that increased base premium.

EXAMPLE 6-2: Sharon and Bill are married and both have Medicare. Their 2005 income is as follows:

Pension	\$100,000
Social Security	\$22,000
Tax-exempt interest	\$30,000
Rental income	\$40,000

Their federal AGI is \$158,700. However, their modified AGI for purposes of the Medicare surcharge is \$188,700. Their surcharge is 13.3%, which is applied to each of their premiums. So, in effect, their additional cost will be \$23.54 x 12 months, or \$282.48 per year based on 2006 Medicare premiums.

2008-9 Premiums Will Have Larger Increases

In 2008 the monthly adjustment percentage will be twice the 2007 amount, based on 2006 modified AGI. In 2009, the percentages will triple and be based on 2007 modified AGI. The threshold amounts will be adjusted annually for inflation.

Beneficiaries Can Contest

Determinations

The SSA will determine which beneficiaries are subject to the increased premiums based on information provided by the beneficiary and the IRS. Affected beneficiaries will receive a letter notifying them of the adjustment at the end of 2006. The letter will explain the additional amount of their Medicare Part B premium, and any related changes in the amount of their monthly Social Security benefits (or railroad retirement or civil service annuity payments).

If a beneficiary disagrees with the SSA's determination, or would like to request a re-determination based on a later year because of changed circumstances (death of spouse, retirement, divorce, etc.), he or she will have 60 days after the receipt of the notice to appeal the initial determination.

Tax Planning

Tax planning will affect the Medicare premium. The rate of return of tax-exempt income will decrease for higher-income taxpayers. Tax-exempt interest already increases AGI for purposes of Social Security taxability, and now tax-exempt interest can also push a client into a higher Medicare premium.

In an extreme example, a single taxpayer with \$100 of tax-exempt interest could be pushed up a Medicare surcharge bracket, which will wipe out that income. See Example 6-3.

The cliff thresholds make tax planning to those levels an important part of the plan. While it is difficult to hit an exact income figure in tax planning, hitting the target is more important

now than ever.

EXAMPLE 6-3: Jon has federal AGI of \$199,950 in 2005. He also had \$100 in tax-exempt interest on a bond he purchased late in the year. His Medicare premium is \$88.50 per month. Because his modified AGI for purposes of the Medicare surcharge is \$200,050 his premium surcharge is \$64.87 per month, or \$778.44 per year. His net return on the bond is (\$65.23)! Without the bond income, his surcharge would only be \$47.17 per month, or \$566.04 per year. So, the bond is creating a \$165.23 annual surcharge increase.

MEDICARE: The Social Security Administration will administer the surcharge based on information received from the IRS.

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