Starting in 2014, higher-income individuals may be hit with a new 3.8 percent Medicare surtax on all or part of their net investment income.

“Investment Income” includes the following sources of income:

- Gain from selling assets held for investment -- including gain from selling investment real estate and the taxable portion of gain from selling a personal residence.
- Gross income from dividends.
- Gross income from interest (not including tax-free interest such as municipal bond interest).
- Gross income from rental activities.
- Gross income from royalties.
- Gross income from annuities.
- Gross income and gains from passive business activities

Gains and Income from Businesses: In general, gains from selling assets used in a business in which you actively participate are apparently outside the definition of net investment income and are therefore exempt from the Medicare surtax.

Grouping of Active and Passive Business Activities

Historically, profitable business activities, whether those business interests were classified as material participation businesses or passive-activities were taxed the same. Starting in 2013, business income stemming from a passive activity is subject to the 3.8 percent net investment income tax (NIIT).

Due to the change in tax treatment, the regulations are allowing taxpayers a one-time opportunity to regroup multiple business activities: This opportunity enables the taxpayer to reevaluate the grouping of business activities on their tax return, and potentially can be used to minimize passive business income exposed to the new NIIT. An evaluation should be done to determine if it is possible to group multiple activities into a single “appropriate economic unit,” By doing this a taxpayer’s hours of participation in one entity can extend to another business. This causes the combined income to be considered active business income not subject to the NIIT.

The ability to group multiple business activities may enable a taxpayer to accelerate losses, but they should consider the potential consequences carefully and adhere strictly to the new reporting requirements. Once activities have been grouped, they generally cannot be regrouped unless there is a material change to facts and circumstances that has rendered the original grouping inappropriate.

Business owners that have interests in multiple business ventures will want to sit down with their tax advisor and evaluate the possibility (long term and short term) of a revised grouping election.