

Preparing for Upcoming Tax Changes

Sometimes when you're right, you're right.

A couple of months ago I wrote about the pending Fiscal Cliff and suggested that the media (and the markets) would focus on it once the election was over. Sure enough, the day following the election several major newspapers, including the Wall Street Journal and The New York Times ran prominent stories about the Fiscal Cliff. The stock market also took notice, with the Dow Jones Industrial Average posting its largest decline in both points and percentage for the year on Wednesday, November 7th.

Until a deal for addressing the Fiscal Cliff is agreed upon that the stock market is very possibly going to move significantly on every press conference, news release or rumor related to it. Sometimes you can literally watch it happen in real time.

Last Friday the four congressional leaders took a break from their meeting on the Fiscal Cliff to step outside and address the media. As they each took a turn at the podium and talked about “constructive discussions” and “progress” the stock market literally turned from negative on the day to positive. Just imagine what could happen if there would be a deal? Or, on a scary note, if there isn't?

While there are lots of rumors floating around about what a potential deal could entail, there are some things that the election results can tell us about what to expect – and what you may want to do because of it.

First of all, we know that taxes on net investment income will be going up, at least for those in higher tax brackets, but very possibly for everyone.

Currently capital gains are capped at a 15% federal tax rate. On January 1st a provision of the Patient Protection and Affordable Care Act (often referred to as Obamacare) will take affect that adds a 3.8% surcharge on net investment income over \$200,000 for those filing single or \$250,000 for those filing jointly. Most people assume that this won't apply to them but keep in mind that selling a business, a family farm or even a second home could all be captured under these new rules.

In addition, President Obama has stated that he would like to see the 15% long-term capital gains tax rate go up to 20% for everyone and for those earning above \$250,000 he would like to see long-term capital gains taxed at ordinary income tax rates, plus the 3.8% surcharge.

If a “fix” is not agreed upon the Alternative Minimum Tax (AMT) is, according to Bloomberg, slated to spread to 21.7 million households, up from 4 million this year. Falling under AMT can be a very unpleasant surprise and can limit existing deductions in unexpected ways, among other things.

While there are many opinions on how raising taxes could effect people's ability to spend and their incentive to invest and take risks with their capital – and the resulting impact that could have on the economy – the reality is that some increase is almost certain to occur.

So as we head into the final month of the year I suggest that you review your investment and tax situation as you normally would to determine if any year end moves are appropriate, but this time with perhaps a different focus.

In prior years in the last weeks of December I would review my client's holdings to determine if there were any taxable losses that could be realized to offset gains or a portion of their ordinary income (subject to annual limits). This year I will be looking to see if there are any appreciated holdings that we may want to sell and, if so, placing the sales before year end so the gains will be taxed at current rates. I suggest you consider reviewing your investment portfolio for these reasons as well.

In addition, if you are considering a sale of stock, a business, a piece of real estate or any other investment asset you may want to consider expediting the process and completing the sale before year end – especially if the sale will push your income above \$250,000.

And, while tax planning should be something everyone incorporates in their savings and investment strategy, the upcoming changes put an exclamation point on the importance. Review your current holdings and strategy and discuss it with your investment and/or tax advisor if you use one.

With changes on the horizon, a little planning can potentially save a lot.

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