WebCPA™

November 12, 2012

Obama Victory Leads to Fast Tax Moves by Wealthy Before 2013

By Margaret Collins

(Bloomberg) The race is on for wealthy Americans to save on taxes before Jan. 1.

President Barack Obama's re-election means his administration will push to let tax cuts enacted during the George W. Bush era expire for high earners, as scheduled, at year-end. Obama wants to increase the top federal income tax rate to 39.6 percent from 35 percent, boost rates on long-term capital gains to as much as 23.8 percent, and shrink exemptions from estate-and-gift taxes.

"If you have to put a movie title on what's going to happen from now until the end of the year it would be: 'The Fast and the Furious,'" said Jeff Saccacio, a personal financial services partner at New York-based PricewaterhouseCoopers LLP. "The wise, smart people are preparing themselves for a sunset of the Bush tax cuts."

Wealthy investors have about a month and a half to examine their investment gains and losses left over from previous years, as well as to consider ways to move income into 2012 and transfer assets to heirs, Saccacio said. Now is the time to start running the calculations, he said.

"Acceleration of investment income is clear," said Elda Di Re, partner and personal financial services area leader for Ernst & Young LLP in New York. "If anyone was planning on realizing a gain in the next two to three years on either securities or real estate, there's a considerable amount of money to be saved."

The Standard & Poor's 500 Index, which is up 64 percent since Obama took office in 2009, lost 2.4 percent yesterday to 1,394.53, its lowest level since August.

Capital Gains

An investor who sells $100 of stock with a cost basis of $20 in 2012 would see proceeds-after capital gains taxes-of $88, according to an analysis by J.P. Morgan Private Bank. Next year, if Congress doesn't act, earnings from the sale would drop to $80.96 if rates rise to 23.8 percent. That means the stock price would need to rise by at least 9 percent for an investor to be better off selling in 2013.

Investors shouldn't accelerate sales of securities just to avoid a higher tax rate, said Saccacio, who is based in Los Angeles. They should consider how long they planned to hold stocks and whether they need to rebalance. Those who decide to sell at current capital gains rates can re-invest in the securities if they remain attractive without violating so-called wash-sale rules under the Internal Revenue Service code that apply to stocks sold at a loss, he said.

Bonuses, Dividends

Closely held businesses that have a choice to pay bonuses or dividends in 2012 or 2013 should do so before year-end, said Joanne E. Johnson, wealth adviser and managing director at New York-based JPMorgan Chase & Co.'s private bank unit. The tax rate on dividends may jump to as much as 43.4 percent next year from 15 percent now with the expiration of Bush-era tax cuts and levies set to take effect from the health-care law.

Employees who have a choice to receive their bonus this year should do so and consider exercising stock options that are set to expire, she said.

While the election provided some clarity, wealthy taxpayers still must be prepared for the unexpected before Dec. 31, Johnson said. "We don't know what the compromises are going to be," she said.

Fiscal Cliff

Democrats maintained control of the U.S. Senate in the election results last week as Republicans kept their majority in the House of Representatives. That ensures continued resistance to Obama's determination to raise taxes for the wealthiest Americans in the effort to reduce the U.S. budget deficit.

Lawmakers may have to address the so-called fiscal cliff of tax increases and spending cuts that would start in January if Congress doesn't act in a lame-duck session set to begin this month.

House Speaker John Boehner told reporters last week that Republicans are "willing to accept new revenue under the right conditions." He cited ideas Democrats already have rejected: restructuring entitlement programs and relying on revenue generated by economic growth from a tax-code overhaul.

Some tax-rate increases scheduled to take effect next year don't depend on fiscal-cliff negotiations, said Di Re of Ernst & Young. The 2010 health-care law, which Republican presidential candidate Mitt Romney had vowed to repeal, applies a 3.8 percent surtax on unearned income such as realized capital gains, dividends and interest in 2013 for married couples making more than $250,000 and individuals earning at least $200,000.

Payroll Tax

The law also increases the Medicare payroll tax levied on wages by 0.9 percentage points for high earners.

Wealthy taxpayers with large carryover losses remaining from 2008 and 2009 may not want to rush to sell securities before year-end, Saccacio said. They may have enough losses to offset future gains even with higher tax rates, he said.

When capital losses exceed gains, the extra generally can be deducted on individuals' tax returns and used to reduce other income, such as wages, up to an annual limit of $3,000, according to the IRS. If the total loss is more than the cap, the unused portion may be carried over to following years.

The Obama victory also may lead some millionaires who were hesitating to take advantage of current rules on gifts to fund trusts they've set up, said Linda Beerman, manager of the wealth strategies group at Atlantic Trust. The firm is the private wealth-management unit of Atlanta-based Invesco Ltd.

Estate Tax

Legislation enacted in 2010 raised the lifetime estate-and- gift-tax exclusion for 2011 and 2012. This year individuals can transfer up to $5.12 million-or $10.24 million for married couples-free of estate and gift taxes. Those levels are scheduled to expire at the end of 2012 and Obama wants to set the estate tax threshold at $3.5 million while dropping the gift-tax exemption to $1 million as it was in 2009.

"People are really rushing here at the end to take advantage of it," Beerman said.

Wealthy families should consider setting up trusts under current rules that can benefit grandchildren or future generations and set them up in states such as Delaware, which let the entities exist in perpetuity, said Johnson of JPMorgan. The Obama administration has proposed curtailing the benefits of such trusts as well as limiting discounts taken when transferring illiquid assets in its most recent budget proposal.

Decisions about making charitable contributions this year are more complicated, Beerman said. While deductions for donations probably will be more valuable next year if rates are higher, limits on itemized deductions for those with higher incomes are scheduled to be reinstated next year, she said.

"They need to start crunching some numbers," PwC's Saccacio said of wealthy taxpayers. "This year, year-end tax planning takes on a heightened significance given the fact that we're going to have this jump in rates next year unless we have an 11th-hour adjustment."

license.copyright.net/user/viewFreeUse.act?fuid=MTY3OTU4NTU%3D

©2012 Accounting Today and SourceMedia, Inc. All rights reserved.. Permission granted for up to 2 copies. All rights reserved. You may forw ard this article or get additional permissions by typing http://license.icopyright.net/3.8414?icx_id=64622 into any w eb brow ser. Source Media and WebCPA logos are registered trademarks of Source Media . The iCopyright logo is a registered trademark of iCopyright, Inc.