PERSPECTIVE

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Straighten your tax posture

By Robert W. Wood

Tax issues are on everyone's mind even more than usual — they seem to be driving the presidential election and there's great fear about increases. In reality though, whether Gov. Mitt Romney or President Barack Obama wins the election, there will be tax increases next year. In fact, you are *already* paying higher taxes in 2012, as will become painfully clear at tax return time in 2013.

That makes this a particularly tax-centric year-end. Lawyers and all others in business should be thinking of ways to improve their tax postures. Principles of traditional tax planning suggest that you should never pay a tax now you can pay later, that you should defer income into the future when you can, and that you should accelerate tax deductions.

Accelerating deductions can be as simple as paying for items this year, not next, and making large deductible purchases now. Subject to limits, you can even prepay for some 2013 items now. But don't forget the Alternative Minimum Tax (AMT) which is already back to its pre-Bush era tax cut heights. All the discussion about tax rates does not explain the AMT.

The AMT was enacted in 1969 to catch huge and unusual tax deductions — things like drilling expenses from oil deals. But gradually the AMT expanded to cover almost everything. You compute regular tax and AMT and pay whichever is higher.

In 2010, Congress "patched" the AMT to keep it somewhat manageable after the commissioner of the Internal Revenue Service practically begged Congress to fix it. But this patch only the covered 2010 and 2011 tax years. Of all the "extenders" that will probably not be passed this year, arguably the most vital is the AMT.

For most of us, the practical dollar effects of AMT are far more than a mere 15 percent and 20 percent capital gain rate spread, or between a 35 percent and 39.6 percent top rate on ordinary income. Plus, the AMT is hard to handicap. You can't eyeball your income or expenses and know how it will hit you. The AMT is the best example of a stealth tax.

In fact, a recent report by the Congressional Research Service states that 30 million people — roughly one-fifth of all U.S. taxpayers — will be hit by the AMT in 2012. That is *this* year, not next. Want more sobering numbers from the Congressional Research Service?

* 1997: 605,000 taxpayers, about 1 percent of all taxpayers, paid AMT.

* 2009: 3.8 million taxpayers, 2.7 percent of all taxpayers, paid AMT.

* 2012: Over 30 million taxpayers will pay AMT or have AMT limits on tax credits.

* 2020: 58 million taxpayers will be hit by AMT.

It remains possible that Congress — not the president — will pass an AMT patch by the end of 2012 and that it will be retroactive to Jan. 1, 2012. But experts don't expect it.

As if this doom and gloom about AMT were not bad enough, there's the capital gain tax. It is common knowledge that the 15 percent rate on long-term capital gain expires Dec. 31. Compared to the AMT problem for 2012, at least we have the 15 percent rate until Dec. 31.

Will it be extended as it was two years ago? Perhaps, but experts say it's unlikely. That means in just a few months you will pay 20 percent on long-term gains, right? Not quite.

Under the Affordable Care Act, known as Obamacare, starting Jan. 1 capital gain incurs an additional 3.8 percent Medicare tax for single filers with incomes over $200,000 and married joint filers with incomes over $250,000. That means long-term rates jump from 15 to 23.8 percent — the highest rate since 1997. Capital gain rates can apply to personal as well as investment or business property, but the rules still seem unfair to many.

You must report all gains (except for certain limited personal residence relief). If your long-term gains exceed your long-term losses, you then can subtract your short-term losses to determine your net capital gain. However, you can deduct only $3,000 of capital losses against ordinary income on a joint return or $1,500 if married filing separately. That makes capital losses particularly painful and often unused for years.

Could the 15 percent rate be extended into 2013? Perhaps, but the president cannot do so without Congress. Even if Congress extends the 15 percent rate, it won't change the 3.8 percent surtax post-Dec. 31. That means an 18.8 percent rate if the 15 percent is extended and 23.8 percent if it is not. Romney promises he would repeal Obamacare and its 3.8 percent surtax, but even if he is elected that still would require Congress.

Besides, even if Congress passes a tax extender (which most experts do not expect) it could come very late in the year. Some say this: you may want to grab the 15 percent rate now. That could mean selling a residence, vacation home or investment property. But economics should take precedence over taxes. Depending on economic conditions and other factors, an unsatisfactory sales price may offset any tax savings.

What to do this year-end? There's no easy answer. Perhaps now more than any other year in recent memory taxpayers and their advisers should do projections and tax calculations. Prepare *pro forma* returns using software or see your accountant to try to handicap the taxes you pay before you take action.

For lawyers and other businesses that can selectively time income, run the numbers based on the best data you have to try to make informed decisions. This year more than most, you shouldn't just wait until the end of the year and let the chips fall where they may.

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