Taxing Decisions in an Uncertain World

By Robert W. Wood

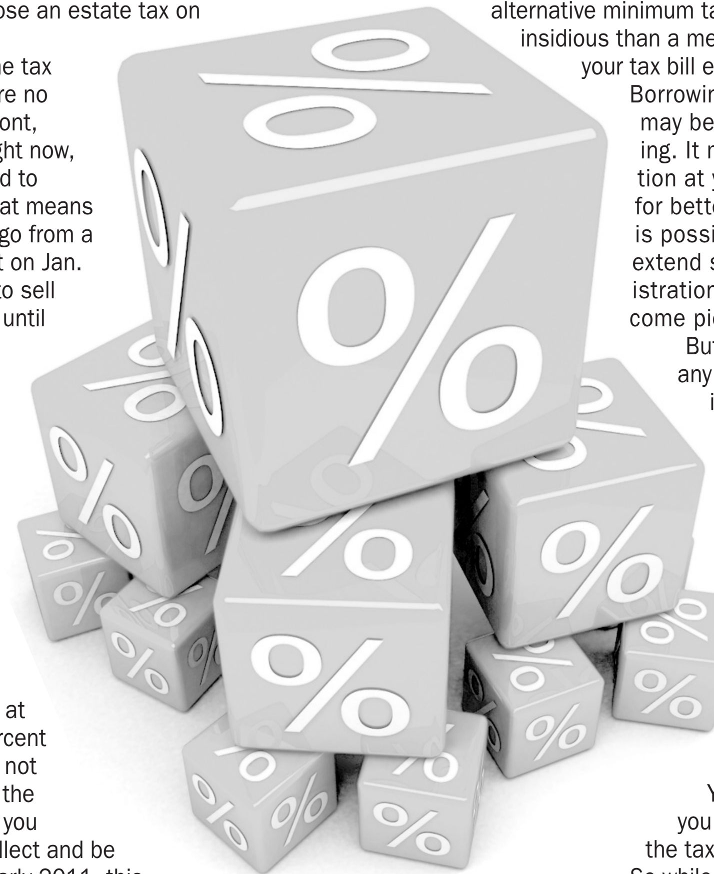
Tax law is ever changing, so learning new laws, regulations and strategies is a never-ending part of being a tax lawyer. For 30 years, I've enjoyed that. Yet I also like the constancy of knowing that some things are virtually set in stone. For example, one of the precepts of tax planning suggests you should never pay a tax today you can legitimately pay tomorrow. Deferral, in other words, is important and rarely should be ignored.

Robert W. Wood is a tax lawyer with Wood & Porter (www.woodporter.com) in San Francisco. The author of more than 30 books including "*Taxation of Damage Awards & Settlement Payments*" (4th Ed. 2009 www.taxinstitute.com), he can be reached at wood@woodporter.com.

Similarly, tradition suggests you should accelerate tax deductions, claiming them as early as you can. Paying a big bill on Jan. 1 that you could legitimately pay Dec. 31 just doesn't make sense from a tax viewpoint. You should try to push off income into the future, and to accelerate deductions simultaneously. That is just common sense. Yet these days many people are scratching their heads wondering if these traditional notions are changing.

Congress has been mired in the sausage-making that is tax policy for some time. There's no sign we'll know anytime soon exactly what's to come. On the estate tax front, with our current 2010 hiatus in the estate tax, we don't even know exactly how 2011 deaths will be taxed. People who had the misfortune (but considerable tax omniscience) to die in 2010 may skate by without *any* federal estate tax. They include Texas oil billionaire Dan Duncan and San Francisco real estate tycoon Walter Shorenstein. I'm betting there will be litigation raising constitutional issues if Congress tries to retroactively impose an estate tax on 2010 deaths.

The Bush legacy cuts on the income tax side may be less obvious, but they are no less significant. On the income tax front, some things are clear — as mud. Right now, the so-called Bush tax cuts are slated to expire at midnight Dec. 31, 2010. That means your federal capital gain tax rate will go from a high of 15 percent now to 20 percent on Jan. 1. That will encourage some people to sell assets right now, rather than waiting until January.



Even worse, many dividends (so-called qualified dividends) are currently taxed at 15 percent, but will be taxed at up to 39.6 percent come January. Unlike choosing to sell an asset now versus in January, most taxpayers will have little control over whether companies pay dividends or when they do it. That makes these changes especially maddening.

On the ordinary income front, your federal income tax rates now top out at 35 percent, but will climb to 39.6 percent as of the New Year. That spread may not be enough to cause you to disregard the usual "defer income" mantra. Still, if you have the ability in your practice to collect and be taxed on money now rather than in early 2011, this might be the year to do it.

In fact, these rate increases are only a portion of the new changes in the tax law you'll need to factor into your situation. Starting in 2011, the so-called marriage penalty gets worse, as do the phase outs, which often means that miscellaneous itemized tax deductions and personal exemptions don't end up garnering any benefit. Like the alternative minimum tax, these stealth provisions are more insidious than a mere rate hike. In fact, they can increase your tax bill even more precipitously.

Borrowing a term from the medical field, this may be an awfully good time for watchful waiting. It may not be a cure, but more information at your disposal almost always makes for better decisions. Speaking of waiting, it is possible after all that Congress will act to extend some of the legacy of the Bush administration. It might come wholesale, or it might come piecemeal.

But that doesn't mean you can count on any of it, or that you should not be crunching numbers and meeting with your tax adviser now. These may not be big and interesting legal issues, but they can sure matter. For example, if you know a sale of an investment will produce a $400,000 gain, figure (or have your accountant or financial planner figure) what the tax result will be in 2010 versus 2011.

Depending on the type of investment, you may or may not have full control over the timing of the sale. Yet there are often steps you can take to accelerate or delay a closing. You shouldn't make a decision which way you want it to come out without considering the tax ramifications of such a transaction.

So while crunching numbers is no one's idea of fun, this may be the most "number-crunchingest" year in recent memory. Do some of it today. And as you keep one hand on your calculator, keep the other on your television remote or mouse and follow Congress. Come tax time, you'll be glad you did.

This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.

The so-called Bush tax cuts are slated to expire at midnight Dec. 31, 2010. That means your federal capital gain tax rate will go from a high of 15 percent now to 20 percent on Jan. 1.