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Tea Leaves And Tax Moves In 2010

I'll bet you thought your government would decide by now what tax rates would apply for the rest of this year and into January. Hey, who needs to plan, right? Most of us do, of course, and it's frustrating that Congress can't seem to break free of its tax paralysis to get this addressed.

Happily, it's possible that there could be a 2 year extension of the Bush rates, though it's a long way from soup yet. Current suggestions are that even some Democrats are now in favor of the move. Yet a key issue will be whether the extension applies to upper income earners. See Senate Tax Showdown. One for all, all for one extensions would clearly be best, but whatever they do, as Macbeth might admonish, do it quickly!

Sometimes inaction is a type of action of its own. The best example was the estate tax. The last estate tax legislation—a type of band-aid bill—was passed way back in 2001. It called for gradual reduction in the estate tax each year until December 2009, no estate tax at all in 2010, followed by a return to 2001 law in 2011! That sounds insane. Yet part of the 2001 compromise was that *everyone* knew some type of legislative compromise would be worked out between 2002 and 2009.

That *seemed* plenty of time to iron out differences between Republicans and Democrats. No one could imagine the insanity of no estate tax in

2010, or of a return to 2001 rates and exemptions in 2011, undoing all of the reductions that occurred between 2002 and 2009. I would have bet my net worth that Congress would *never* let this happen. Oops, at least I didn't bet!

With several billionaires already having died in 2010, the fisc is losing out on big dollars. Given such inefficiency, perhaps it shouldn't be quite so surprising that Congress can't get its act together to help John Q. Citizen figure out whether he should sell assets in 2010 or wait until 2011. After all, there's no constitutional right to know tax rates in the future.

Here's where we are in making tax sausage right now.

> **<u>Capital Gain?</u>** The top 15% expires December 31, 2010. It pops to 20% the next day. So while the right price and investment considerations should dominate, sell in December vs. January if you can. Of course, the 15% rate could still be extended. Maybe only for some and not for all. We'll see.
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> As the months roll on and we keep our eyes on Congress, one of the unanswered questions is how many people will sell appreciated assets in 2010 because they fear tax increases. There are some indications that some advisers are touting selling now. See Tax Unknowns Drive Business Moves. Some such sales may involve the tax tale wagging the dog.
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> There will doubtless be some sales in which the seller says "I really wasn't going to sell, but if I'm ever going to sell I'd better sell now." The decision may go beyond the *whether* to sell decision, but may impact *how* to sell too. For example, there will be some installment sales where a seller is paid over multiple tax years. Ordinarily, the seller would pay tax over time (the installment method). Does it makes sense to elect out of the installment method and pay all the tax now? Perhaps, but that can be risky.
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> In general, I believe economics not taxes should control most decisions, but there is an inevitable mix afoot, especially this year.

Dividends. Qualified dividends (for that definition, click here) are taxed at only 15%, but only through December 31, 2010. In January they jump to 39.6%. So more clearly than with anything else, take them now if you possibly can. If you have a family company and control the timing of dividends, see your tax adviser and lawyer today.

Income Tax Rates. While not as dramatic or obvious as either the capital gain or dividend rate shifts, regular old tax rates are going up too, from a high of 35% in 2010, to 39.6% in 2011. That can hurt. More important, though, are what these rates don't tell you. Personal exemptions are phased out again in 2011, as are itemized deductions.

These phase-outs don't apply in 2010 due to the Bush tax cuts, but they'll kick in again in 2011. If you have a single income above $170,000, or joint above $255,000, beware. Your effective tax rate may actually climb significantly above the stated 39.6% come January. Quite appropriately, many call these "stealth taxes," since their rate effect is hard to pin down.

Charitable Giving. While there's no big change, the environment is uncertain. President Obama actually proposed cutting back on the deductions upper income taxpayers receive for charitable contributions (limiting the benefit to 28%). To me this seems unlikely, but if you have big plans for charitable giving, you may be better off doing it in 2010 rather than facing more uncertainty. Conventional wisdom would suggest your deduction would be worth more in 2011 when rates will be higher, but conventional tax planning this year is well, unconventional. For more, see Making Tax Decisions In Limbo.

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