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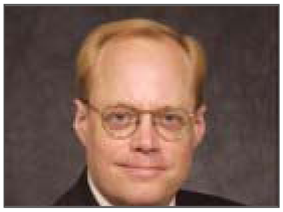

Robert W. Wood

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Year-End Tax Planning Despite The Cliff

Taxes (Photo credit: Tax Credits)

With the fiscal cliff and its double whammy of expiring tax breaks and spending cuts, this has to go down as one of the strangest year-ends on record. Tax cuts are expiring including the 15% capital gain rate. After December 31, 2012, the best rate on long-term gains jumps to 20%.

Yet capital gains incur an additional 3.8% Medicare tax starting January 1, 2013. It hits single filers with incomes over $200,000 and married joint filers over $250,000. Thus, long-term rates jump from 15% to 23.8% at year-end, the highest rate since 1997.

As for Alternative Minimum Tax (AMT), a Congressional Research Service report (RL30149) reveals a grim timeline. Congress' two-year patch in 2010 covered only 2010 and 2011. See 30 Million Taxpayers Face Alternative Minimum Tax Right Now. But as you worry over the state of the economy and your likely tax bill, here are some last minute ideas.

Cashing in may make sense since the 15% capital gain rate may never return. George Lucas had superb timing with his sale to Disney. See Like A Jedi, Sell A Business, Real Estate Or Stock This Year. You might sell a business, real estate, or just some stock.

Conversely, consider selling losing investments too. You can use capital losses to absorb capital gains with no limit. Beyond that you can only deduct $3,000 of additional capital losses. You'll have to carry over the balance. But retaining clear losers that may only decline further in value may not be wise, especially if you are selling some assets at a gain.

Another idea is to accelerate or bunch deductions. There can be considerable math involved if you don't use a tax return software program. Try to claim deductions when you get the biggest benefit. Usually that's earlier, but not always.

One prime deduction is state income taxes. Figure out approximately how much in state taxes you will owe in April of 2013 for the 2012 tax year. If you pay them in December 2012 you can deduct them on your 2012 federal tax return. If you wait until April, you can't deduct them until you file your 2013 federal return in 2014.

Accelerating deductions usually makes sense, but you may not want to take deductions if they will create problems like AMT. If you don't always itemize, bunching payments together can make sense so you get maximum advantage in years when you do itemize.

Whatever you do, plan ahead and run some numbers. It is hard to eyeball the value of deductions and almost impossible to handicap your exposure to AMT. If you experiment with tax return preparation software you might be surprised how much you'll learn.

Alternatively, turn to a good accountant who can run the numbers for you. This year-end in particular, be careful out there.

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.