PERSPECTIVE

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Year-End Tax Tips

By Robert W. Wood

This has to go down as one of the strangest year-ends on record. First, we have the so-called fiscal cliff, comprised of an incredibly long list of expiring tax breaks (including the Bush Era tax cuts). What's more, at least some tax increases in 2013 are certain. The phase-out of deductions and credits will hurt, but it's the expiring 15 percent capital gain rate that generates the most buzz.

After December 31, 2012, the best rate on long-term gains jumps to 20 percent. Yet that's not the whole story, since capital gains incur an additional 3.8 percent Medicare tax starting January 1, 2013. This 3.8 percent add-on tax hits single filers with incomes over $200,000 and married joint filers over $250,000. Thus, for many, long-term rates leap from *15 percent to 23.8 percent* at year-end, the highest capital gain rate since 1997.

Even with that rate jump, alternative minimum tax (AMT) is a bigger problem, and one that is harder to plan around. If you haven't seen how AMT works, you should run some numbers — and prepare to be shocked. A recent Congressional Research Service report (RL30149) included a grim timeline of how AMT is darkening our national map. Congress' two-year extension of limited AMT relief in 2010 covered only 2010 and 2011.

As you worry over the state of the economy and your likely tax bill, here are some last minute ideas. Cashing in on investments at 2012 tax rates can be good business. More than a few people observed that George Lucas had superb timing with his 2012 sale to Disney. A 15 percent capital gain rate is attractive, and may never return.

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Of course, don't let taxes blind you to economics. However, if you can cash in and it makes sense for you to make a sale, do it. You may be selling a business, real estate, or stock. If you have a big gain, selling this year might be smart. On the other end of the spectrum, if you have clear losers in your portfolio, consider selling them too.

You can use capital losses to absorb capital gains with no limit. If you run out of capital gains, you can only deduct $3,000 of additional capital losses and you'll have to carry over the balance. Ideally, you should try to time dispositions to affect as much as you can. However, holding on to clear losers that may only keep declining in value may not be smart from a tax or an investment perspective.

Another idea is to bunch or to accelerate deductions. There can be considerable math involved in this, especially if you don't use a tax return software program. A precept of tax planning is to claim deductions in the year when you get the most bang for your buck. Usually that means earlier rather than later, but not always.

You may also want to make charitable contribution deductions before this year-end, especially in light of the possibility such deductions may be cut back next year. Another prime deduction for Californians is state income taxes, since California taxes are among the highest in the nation. Fortunately, they are deductible for federal income tax purposes.

If you can, figure out how much in California tax you are likely to owe in April of 2013 for the 2012 tax year. If you pay your California taxes in December 2012, you can deduct them on your 2012 federal income tax return. If you wait until April to pay, you can't deduct them until you file your 2013 federal tax return in 2014. The same idea works with your local property taxes, too.

While accelerating deductions usually makes sense, the bunching idea is not to take deductions if they will create problems. A prime example is AMT. Too many large deductions at one time can trigger the AMT. This issue can make it better to delay some payments into 2013. If you don't always itemize, bunching can make sense so you get maximum advantage in the year in which you do itemize.

Whatever you do, try to plan ahead. If possible, run some numbers, since often that is the only way to tell what benefit you will reap from paying in 2012 or 2013. It is hard to eyeball the value of deductions and almost impossible to handicap your exposure to AMT. Get some tax return preparation software and experiment — you might be surprised how much you'll learn.

Alternatively, turn to a good accountant who can run the numbers for you. But whatever you do, don't wait until Dec. 31 to start planning. And this year-end in particular, be careful out there.

Robert W. Wood *is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 With 2012 Supplement www.taxinstitute.com), 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.*