How Do You Spell Taxmeggedon?

In recent months, you may have heard the ominious and odd term "taxmegeddon." And, if you're like me, you may have asked yourself, how does one spell taxmegeddon? A quick Internet search provides no consensus. Taxmeggeddon is as varied a term as it is off the wall, but it is, unfortunately, very real.

No matter how you spell it, taxmegeddon is coming to a theatre near you.

There are two major reasons why almost all taxpayers will feel the wrath of taxmegeddon. First, the Bush tax cuts are set to expire at the end of this year causing income tax rates to increase in 2013 for most individual taxpayers. Currently, rates for individual taxpayers are 10, 15, 25, 33 and peak at 35 percent. Long-term capital gains and most dividends are taxed at 15 percent. Without further legislation, if the Bush tax cuts expire, individual taxpayers will see income tax rates increase to 15, 28, 31, 36 and 39.6 percent, long-term capital gains rates increase to 20 percent and dividends will be taxed at the higher ordinary income tax rates.

Secondly, those taxpayers deemed "high income" will also begin to pay for the Affordable Care Act (Obamacare). High income is defined as modified adjusted gross income (MAGI) of $200,000 for individuals, $250,000 for joint filers and $125,000 for married filing separate taxpayers. These taxpayers will pay a 3.8 percent surtax on the lesser of net investment income or MAGI in excess of the applicable threshold. Investment income includes interest, dividends, annuities, royalties, rents and income from other passive activities. Investment income does not include distributions from retirement plans such as IRA's.

The following chart outlines the top tax rates with best and worst case scenarios for high income taxpayers in 2013:

	Current Top Tax Rate	2013-Current Rates Expire	2013-Current Rates Extended
Long-Term Capital Gains	15%	23.8%	18.8%
Dividends	15%	43.4%	18.8%
Interest Income	35%	43.4%	38.8%
Estate Taxes	35%	55%	35%
Estate/Gift/GST Exemption	$5.12 mil	$1 mil	$5.12 mil

Even with all the uncertainty, there are a few simple steps that everyone can consider to mitigate possible tax rate increases:

- Tally your assets. Along with retirement plan balances, home values, and brokerage accounts, be sure to include the value of life insurance that you own. You may be surprised to find that your estate is larger than you anticipated.

- Review your investment portfolios. Pay special attention to any capital gains and losses. With capital gains rates almost certain to go up, recognizing gains in 2012 may be preferable to waiting until next year. Conversely, consider deferring capital losses into 2013 when they may be more valuable. However, tread carefully before incurring substantial gains that you would not otherwise take just to take advantage of the 15 percent rate. Capital gains are treated as income for the Alternative Minimum Tax (AMT) and recognizing large gains can have unintended AMT consequences.

- If you are planning to convert a traditional IRA to a Roth, doing so this year may offer additional savings compared to next year when income tax rates may be higher.

For those higher earning individuals and those with substantial assets (above $5 mil), consider utilizing all or a portion of the currently available (and historically high) $5.12 mil gift tax exemption. Assets anticipated to appreciate in value may be particularly good candidates for gifting programs. Remember that gifting techniques can be as simple as forgiving an outstanding loan. The techniques increase in complexity depending on the goals of the donor and assets involved.

The best course of action may be to outline now those changes that would be appropriate if current tax cuts expire at year-end but wait for clarity before making substantive changes. Every individual's family and tax situation is unique so it is extremely important, to consult with qualified tax and legal advisors, especially if you are a high earner or have substantial assets.

We at TCO also stand ready to work with you and your advisors as you establish or modify your financial plan, whether it be investment planning or estate and/or gift planning.

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