Tax Update (Long View)

Most tax changes set to take effect in 2012 are marginal, but 2013 is a different story.

"MORE THAN 60 income tax provisions are scheduled to expire at the end of 2011," says Mitchell A. Drossman, national director of U.S. Trust's Wealth Planning Strategies group. "With Congress mandated to find ways to reduce the biggest deficit in our history, there is some uncertainty as to whether these provisions will be extended before year end, simply allowed to expire, or be reinstated next year but made retroactive to the beginning of 2012. Even so, only a few of these provisions are relevant for most wealthy investors." (See below.) Indeed, the meaningful changes seem likely to unfold in 2013.

"That's when the Bush tax cuts are set to expire and income tax rates rise. At that time, itemized deductions would once again be partially phased out, the estate tax exemption will drop precipitously and the estate tax rate will jump," Drossman says. "We will also see the beginning of a new healthcare surtax in 2013. That will mean a 3.8% tax on certain investment income and a tax of almost 1% on wages above a specified threshold."

FEW OF THE LAPSING PROVISIONS ARE RELEVANT FOR WEALTHY INVESTORS.

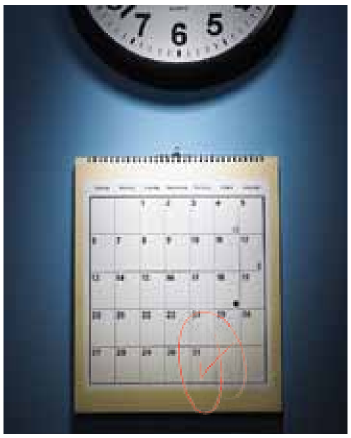
Between now and 2013, expect "lots of talk about tax changes, tax increases and tax reform," Drossman says. "The President's American Jobs Act of 2011, which initially failed to pass in October, will likely be addressed on a piecemeal basis and may include an extension and enhancement of the payroll tax holiday. The Congressional bipartisan 'supercommittee' could consider controversial revenue-raising measures, such as the limitation on itemized deductions for high-income taxpayers and altered tax treatment for so-called carried interest. The supercommittee is set to vote and make recommendations by November 23, 2011, but ultimately passage of such tax changes is far from certain. Meanwhile, the President, the Republican presidential candidates and Congress all are talking tax reform, both corporate and individual. Yet despite the increasing political momentum in favor of reform, many experts view tax reform as too complicated to be tackled by the end of 2012."

What does this mean for investors? Plan for what we know, not what might happen. "The end of this year and next year will present taxpayers with tactical and strategic decisions. Tactically, taxpayers may want to take advantage of expiring tax provisions. Strategically, taxpayers should begin thinking about whether to sell securities now or later, exercise compensatory stock options now or later and make gifts to charities or beneficiaries now or later," Drossman says. Here are his comments on three lapsing provisions:

AMT Patch. "A temporary increase in the Alternative Minimum Tax exemption — often called 'a patch' — was extended for 2010 and 2011. If Congress does not extend the patch, the AMT exemption for 2012 would return to earlier, lower levels. If that happens, many more people — 34 million in total, by some estimates — could be subject to the AMT tax next year."

Charitable IRA Rollover. "This temporary provision allows individuals aged 70½ and older to transfer funds from an IRA to qualified public charities without recognizing the withdrawal as taxable income, but without taking a charitable deduction, either. If there is no extension, income tax will have to be paid on those withdrawals."

Payroll Tax Holiday. "The portion of the Federal Insurance Contributions Act (FICA) tax that goes to Social Security was reduced temporarily in 2011 from 6.2% to 4.2%. With no extension, the higher rate returns in 2012." CA



capitalacumen.com

QR CODES

The image above is a QR (quick response) bar code. Use your smartphone and the QR codes in this issue to access additional articles and video commentary from U.S. Trust. It's easy. First, open your QR reader (available from your online software resource, or "app store"). Then, point the phone's camera at the pattern. That's it — technology will do the rest.

OPPOSITE PAGE, FROM LEFT: ALBERTO INCROCCI/GETTY IMAGES, FRANK VAN GROEN/GETTY IMAGES; THIS PAGE: MARK HOOPER/GETTY IMAGES