It’s Time to Think about Year-End Income Tax Planning, As Higher Income Tax Rates Are on The Way

Client Advisories

07.17.2012

With the Bush Tax Cuts set to expire at the end of the year, and with the ObamaCare taxes set to kick in at the same time, the next six months may be the last time we see federal income tax rates as low as they are.
Capital Gains. The 15% federal tax rate on long-term capital gains is set to rise to 20% beginning January 1. The new 3.8% federal tax on net investment income (for singles with modified AGI in excess of $200,000; $250,000 for joint returns) is also to go into effect then. As a result, the federal tax on capital gains is set to jump from 15% to 23.8% for many people at the end of the year.

Add state income taxes into the equation, and it won’t be surprising to see an overall tax rate of 30%+ on capital gains.

Planning thoughts. Should the Company or the Property be sold this year? Should some of those stocks which have run up in value over the past year or so be sold before year-end?

Dividends. We’ve had the good fortune of a limited 15% federal tax rate on dividends the last several years, but that’s about to change as well. Dividends will not only go back to being taxed as ordinary income in 2013, but they, too, will become subject to the new 3.8% tax on net investment income (as will interest income).

Planning thought. Maybe it makes sense to pay dividends or collect interest prior to January 1, 2013? This is an opportunity to distribute the accumulated profits of a C corporation at rates we may never see again.

Ordinary Income. Speaking of ordinary income, the federal rates on ordinary income (i.e., income items such as compensation, interest, net rents and retirement income) are scheduled to increase from their current high of 35% for the highest income earners to the 39.6% rate that was in effect several years ago.

Add in the new 3.8% tax on net investment income and state income tax rates, and there are going to be some who pay as much as a 50%+ tax on their dividends and interest income.

Employment Taxes. The higher wage earners and self-employeds are about to see a higher tax on the fruits of their labor: (i) the self-employment tax is set to rise from 2.9% to 3.8% of self-employment income in excess of $200,000 ($250,000 for joint filers); and (ii) the 1.45% employee component of the FICA tax is about to go up to 2.35% for wages in excess of $200,000 ($250,000 for joint returns).

Planning thought. If possible, maximize those year-end bonuses before January 1.

Of course, all of this is subject to change after the November elections. Nothing is a certainty any more when it comes to Congress and taxes, but if a substantial transaction is something under consideration, getting it done before the end of the year will avoid the uncertainty.

If you have questions or concerns, please contact a member of Archer's Tax Group in Haddonfield, N.J., at (856) 795-2121, in Philadelphia, Pa., at (215) 963-3300, or in Hackensack, N.J., at (201) 342-6000.

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