

# Planning for tax increases

A period of economic weakness is not generally a good time for a major tax increase. However, increased income taxes have already been legislated for 2011, when tax cuts enacted under President Bush will expire. Some in Congress have argued that these tax cuts should be allowed to expire for upper-income taxpayers, while others believe that these breaks should be extended to everyone. But without some Congressional action, which now appears unlikely, the fact is that the following changes will go into effect:

- the 10% and 25% tax brackets will disappear, so that middle income folks will be covered by the 15% and 28% brackets;
- the top tax bracket will elevate from 35% this year to 39.6%;
- the lowest tax rate on capital gains will jump from 0% to 10%;
- the highest tax rate on capital gains goes from 15% to 20%;
- the preferential tax treatment for dividends will be lost, so the top tax rate will more than double, to 39.6% from this year's 15%;
- the marriage penalty tax returns;
- phase-outs for itemized deductions and personal exemptions will return.

The interplay of these changes will have different impacts upon different families. For example, for a family with income of \$30,000 and projected federal income tax of \$400 in 2010, there could be a jump of over 100%, to \$878, because of the loss of the 10% tax bracket and marriage penalty relief. Family income of \$50,000? Expect a jump from \$2,763 this year to \$3,878 next year.

Higher income families face higher dollar tax increases, though the percentage increase is less dramatic. A family with \$500,000 income and no itemized deductions (admittedly, an unusual situation) would see their tax liability grow from \$136,208 in 2010 to \$158,801 in 2011, according to one published estimate.

All things being equal, if tax rates are going up in the future one should accelerate income to take advantage of the lower rates today. If one is sitting on large portfolio gains, for example, it may be wise to realize some gains this year to lock in the lower tax rates, especially if one is expecting continuing share appreciation.

All things are not equal, however. The financial markets remain quite volatile, and there are signs that the rate of economic growth is declining. In fact, some observers are worried about another recessionary dip. Although tax considerations and tax efficiency are important in

portfolio management, they generally should not be a primary driver of buying and selling decisions.

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