Tax Planning for the Coming Capital Gains Tax Rate Increases for Individuals

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It appears to be a pretty safe bet that the tax rate on Long Term Capital Gains (LTCG) , like the gain from the sale of a typical business, will be higher in 2013 and future years compared to the favorable 15% LTCG rate for individuals that we enjoy now. The scheduled expiration of the Bush tax cuts, and the budget proposals recently submitted by the President call for an increase in the Federal LTCG to 20 %. However, the 3.8% surtax contained in the 2010 Affordable Health Care Act will actually make the LTCG rate for 2013 and future years 23.8%, an increase over the 2012 rate of 58.6%.

The following table illustrates the impact of the tax rate increase on the sale of a business yielding a $10 million LTCG:

	2012	2013
LTCG Rate	15%	23.8%
Tax on Sale	$1,500,000	$2,380,000

At the present time it is very uncertain how this tax rate increase will be applied to installment sales realized prior to 2013.

IMPACT ON YOUR SECURITIES PORTFOLIO:
Investors should sit down with their investment advisors prior to the end of the year in order to determine if it makes sense to recognize some of the long term capital gains that one may have in their portfolio. To a certain extent, this decision may depend on how long one plans to hold the investment. For example, if the expected holding period is 3 years, the investment would have to appreciate an additional 15% per year just to offset the increase in the LTCG rate.

Unlike the rules related to sales of investments at a loss, there are no wash sale rules that apply to recognized capital gains. One can repurchase the investment sold at a gain immediately. This will give the investor a fresh start basis that will reduce the future capital gain on the sale that would be taxed at the higher, future LTCG rate.

Hopefully, by the end of the year, after the November elections, we will be able to make a more educated guess as to where the LTCG tax rate is headed.

Note: The President's budget proposals of 2/14/12 do not contain the 30% AMT rate on taxable incomes over $1 million, nor do they contain the provision for a 5% surtax on taxable income over $1 million.

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