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MANAGING YOUR TAXES

Brace for impact

Taxpayers should get ready now for 2013 increases

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SPECIAL TO THE BUSINESS JOURNAL

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Douglas Becker, shareholder and senior tax attorney at Otten Johnson Robinson Neff + Ragonetti in Denver, says, "Upcoming tax increases will make the small business owner less able to expand and hire more people."

The expiring Bush tax cuts coupled with new tax legislation could cause both business and individual taxpayers to see a major jump in their federal taxes starting in 2013.

While tax law is strongly affected by politics, including the 2012 presidential election, the existing tax structure is the law right now. Tax professionals say taxpayers should get ready now for increases scheduled to go into effect in 2013 and beyond, rather than hoping they won't happen if there's a change in the White House.

After the election, though, there may be pressure on whoever wins to keep taxes low to sustain the U.S. economic recovery.

"So many things are changing. … Business people should be planning for increases now," said Adam Cohen, partner and tax attorney at Denver law firm Holland & Hart LLP.

"Businesses looking to sell, or to sell a significant investment asset that's not liquid, should do it now," said Joe Bertsch, partner and tax specialist at Ehrhardt Keefe Steiner & Hottman PC of Denver.

Businesses likely to be hard hit by the tax hikes include relatively small, closely held companies, experts say. Such firms make up 90 percent of U.S. businesses.

"Tax legislation over the last five years has encouraged small business to invest and hire," said Douglas Becker, a shareholder and senior tax attorney at Denver law firm Otten Johnson Robinson Neff + Ragonetti PC. "But now they're getting mixed messages from Congress. Upcoming tax increases will make the small-business owner less able to expand and hire more people."

Cleantech companies such as Danish wind-turbine manufacturer Vestas Wind Systems A/S, which has multiple Colorado operations, also might feel the effect of tax changes. The federal wind tax credit expires at year-end, and that deadline already has prompted layoffs at wind companies, according to the

INCREASES: Health care tax adds to tally

American Wind Energy Association.

But tax professionals think the credit could be renewed. “That credit has expired on and off again for the last 20 years,” Cohen said.

A major cause of anticipated tax increases is the end of tax cuts enacted during President George W. Bush’s administration, via the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of May 2001, and the 2003 Jobs and Growth Tax Relief Reconciliation Act. The cuts were expected to save taxpayers more than $1 trillion.

The 2001 law increased tax exemptions for individuals, and lowered taxes on income from dividends and capital gains. The later legislation, which strengthened and accelerated parts of the EGTRRA, lowered individual income tax rates as well as those for capital gains, dividends and estate tax.

Individual income tax cuts ranged from dropping the 15 percent tax bracket down to a new 10 percent bracket, and lowering the tax paid by the top bracket from 39.6 to 35 percent. That tax cut was scheduled to sunset at the end of 2010, but was extended through the end of 2012.

“It has been estimated that repealing the tax cuts for the top bracket could raise upwards of $700 billion over the next decade, and only impact 2.5 percent of U.S. taxpayers,” said Denver wealth manager Dickson Griswold, president of Highwater Wealth Management LLC. “This is appealing to deficit-reduction proponents.”

The federal government faces a budget deficit of roughly $1 trillion a year for the next several years, according to the Congressional Budget Office.

The capital gains tax rate, which mostly affects high earners, dropped to 15 percent as part of the tax cuts, but is slated to return to 20 percent. Some tax experts think an increase in that rate will put a damper on investment by relatively wealthy taxpayers, particularly in real estate, but others disagree, saying the planned increase isn’t that big and the new rate won’t be as high as it’s been in the past.

“Under Reagan, the capital gains rate was still 28 percent,” Becker said.

People in upper tax brackets also may be affected by an impending drop in estate and gift tax exemptions.

This year, the estate/gift tax exemption inched up to $5.12 million from $5 million in 2011 at a 35 percent tax rate, but is scheduled to go back down to $1 million in 2013.

At the top of new laws that will affect taxpayers is the 2010 Patient Protection and Affordable Care Act — the health reform effort nicknamed “Obamacare” — which goes into effect in 2014 and adds a 3.8 percent tax on the lesser amount of investment income or gross income of $250,000 or more. Under this law, fewer itemized deductions will be allowed as well.

Whether the upcoming tax increases are good or bad depends on perspective, tax experts say.

“If you’re the government, you’re looking at paying down the deficit,” Cohen said. “If you’re a taxpayer, you’re looking at your pocketbook.”

A RUNDOWN ON TAX INCREASES

Here are some of the tax boosts individuals and businesses may see starting in 2013, as federal tax laws currently stand.

- **Income tax** — The top tax rate for people earning more than $175,000 will go back to 39.6 percent from 35 percent.
- **Itemized deductions** — Currently deductions are limited to expenses that are more than 7.5 percent of adjusted gross income, but starting in ’13, that rate rises to 10 percent.
- **Unearned income tax** — Affects individuals earning more than $200,000 a year ($250,000 for families) by adding a 3.8 percent tax on interest, dividends and capital gains next year.
- **Capital gains tax** — Scheduled to return to 20 percent from 15 percent.
- **Medicare tax** — Slated to increase to 2.35 percent of pay in 2013 from 1.45 percent. Self-employed rate will go up to 3.8 percent from 2.9 percent.
- **Social Security tax** — Returning to 6.2 percent rate from a temporary drop to 4.2 percent for employees. The business rate of 6.2 percent never changed and is expected to stay the same.
- **Estate/gift tax exemption** — Both exemptions were $5 million in 2011, with a tax rate of 35 percent, but drop to $1 million this year. In 2013, current exemption may remain, but the tax rate may go up.

Source: DBJ research