

## Multi-Year Tax Considerations

There is an old saying that goes, “Make hay while the sun shines.” While this proverb originated for farmers, the same philosophy should be considered when examining your finances. After waiting through most of 2010 for the tax uncertainty to be resolved, on December 17, 2010, the Tax Relief Act of 2010 was finally signed into law and at least for now, rules are in place once again. However, with a U.S. tax code more than 3.4 million words in length and a presidential election looming in the near future, you can expect that nothing will stay the same for long. In light of the tax and estate laws in force today, what should you be considering for 2010 and beyond? In other words, for what situations should you consider “making hay”?

**Roth Conversions** – Many people took the opportunity to convert Traditional IRAs to Roth IRAs in 2010 when the income restrictions on conversions were eliminated. Along with the elimination of the income restrictions came a special opportunity for 2010 conversions: the option of taking the entire conversion amount into income for the 2010 tax year or splitting the income from the conversion over the 2011/2012 tax years. Now that tax rates for 2011 and 2012 are law, it is probably wise to revisit which taxation option will be the most advantageous regarding those 2010 conversions. This situation is indeed one where a multi-year strategy needs to be considered given that the specifics of your income may vary significantly over these years; this may result from a pending retirement, a job loss or change or other taxable income situation.

**Roth Do-Over** – Remember that conversions from 2010 can be re-characterized, or undone, up to the tax filing deadline plus extensions (i.e. October). This option gives taxpayers the opportunity to effectively back out of a taxable situation if their converted dollars have lost value or if their financial situation has changed drastically and they are unable to afford the tax associated with conversion.

**2011/2012 Tax Years** – Although the newly enacted law clearly defines the income tax rules for 2011 and 2012, don’t assume that these are cast in stone. An act of Congress created them and a similar act of Congress could change them. If you have the ability to influence the timing of large taxable events, the next two years might be an ideal time to do so.

- **Roth conversions** continue to be permissible regardless of income levels. The difference now is that all conversion income is taken into account for the actual tax year associated with the conversion. You should still be discussing with your advisors whether conversions make sense for your particular situation, remembering that this is not simply a tax consideration but also a planning consideration.
- The **3.8% Medicare excise tax** will come into play beginning in 2013 for taxpayers with high Adjusted Gross Incomes (AGI), resulting in an additional layer of taxation on investment income. It is also expected that overall income tax rates will be higher beginning in 2013. Therefore, if you are anticipating a large taxable event in the next few years, such as the sale of property at a taxable gain or a large Roth conversion, the best course of action may involve accelerating the taxable event into 2011 or 2012 if possible. Although ordinary income events like Roth conversions are not directly affected by

2013's excise tax, they may boost your AGI to levels where your investment income is hit with the additional tax. The best course of action is to involve your advisors in multi-year planning for these events to look at the best overall strategy for your situation. We are still in a very low tax environment, and realizing gains and paying the associated taxes now may be very favorable to the taxation alternatives of the future.

- **Make the most of savings opportunities** as they present themselves. If you are back on the bonus track at work, plan for it and use it wisely. If you receive a raise this year, increase your savings to match the salary increase. Remember the lessons of 2008 and don't ratchet up your lifestyle to unmanageable levels; live below your means to help protect your future.
- If you do nothing else positive in 2011, take the opportunity to **squirrel away a 2011 gift from the government**. Congress granted employees and the self-employed a salary increase for this year by decreasing the employee portion of the FICA tax to 4.2% of salary, applied to a maximum of \$106,800. That means that 2% more of your salary is showing up in your paycheck; do yourself a favor and boost your savings by this amount immediately. It is a painless way to pay yourself first.

**Estate and Gift Taxation.** No one ever expected us to go through almost the entire year without estate taxation laws in place for 2010, but that is exactly what happened. Although the new laws are again temporary, known amounts now exist: the exclusion amount has been set at \$5 million per person with a maximum federal estate tax of 35%. There are some new provisions, including the portability of a spouse's unused exclusion amount, lifetime gifting levels of \$5 million and return of the basis step-up provision. Now is the appropriate time to have your estate documents reviewed to ensure that in light of these new laws they still address your specific desires for transfers at death. Increased lifetime gifting may also be a consideration for some families.

Despite the fact that tax legislation was signed into law in December of 2010, the taxation landscape will continue to be a moving target. So how does "Make hay while the sun shines" apply to you? You should consider that there may be tax opportunities today that are worth evaluating and discussing with your advisors. You should check in with your estate attorney to review how the newly enacted legislation affects your documents. Finally, you should always be reviewing your personal financial landscape from a comprehensive viewpoint, to ensure that all the pieces of your financial life are working together in the best way possible toward your desired future.

Regards,  
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