Capstone Comments

A forum for communicating information about the management of assets

Q:

A:

With all this uncertainty, can I still do tax planning?

As the New Year is rapidly approaching, tax planning should be in full swing. Unfortunately there is such uncertainty with the looming Fiscal Cliff that many don't know how or if to proceed with any year-end planning. Unless Congress reaches an agreement by December 31, tax rates on wages and investments will rise, the exemption from the estate tax will shrink, and dozens of tax breaks will disappear. According to Kiplinger's, without a compromise, nearly 90% of Americans will pay higher taxes next year. The average household's tax bill could increase by $3,500 according to an analysis by the Tax Policy Center (Kiplinger' Personal Finance, "Year-End Tax Moves for 2012").

With such a high level of uncertainty we felt it was important to provide some topics you may want to discuss with your tax preparer. The following are three types of general tax strategies that may help:

<u>Tax Avoidance:</u> The use of certain types of investments that produce an economic return that is not subject to taxation. The best example is the tax-exempt security such as a municipal bond. Interest received is generally exempt from federal taxation and in certain situations, exempt from state taxation.

<u>Tax Reduction:</u> Deductions and credits are used to reduce income tax. Some investments and charitable gifting result in a reduction of your current overall tax obligation. Contributions to certain forms of retirement accounts such as Traditional IRAs, SEP IRAs, 401(k) plans and so forth have the effect of reducing your total taxable income.

<u>Tax Deferral:</u> An investment that grows in value over time, but whose growth in value is not recognized for current tax purposes. Growth stocks or mutual funds that don't pay a dividend, for example, may result in increased value that is only recognized for tax purposes at some future point in time – when they are sold. Investments that are held in a retirement account are tax deferred. Interest, dividends, and capital gains build up over time, but are taxed when funds are distributed from the account.

We recommend that you discuss these and other strategies with your tax preparer that is familiar with your current tax situation. We are happy to join you in those conversations, if you feel it would be of benefit.

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