New American

Written by Bob Adelmann on November 5, 2012

Tax Moves Being Dictated by the Fiscal Cliff

Small business owners, some of whom have spent their lifetimes building their businesses, are unloading them before the end of the year in order to save taxes. With taxes on capital gains increasing by almost 60 percent on January 1, Bert Wolf decided to sell his compressed-gas business, Acetylene Oxygen Company in Harlingen, Texas. It wasn't in his plan to sell, but the offer from Praxair, and the uncertainty about what Congress might, or might not, do during the upcoming lame-duck session to avoid the fiscal cliff, made it too good to resist: "It just made more sense for me to take my chips off the table and go do something else." Besides, the increase in taxes is so onerous that, if he had decided to keep the business, it would take him "at least 3 or 4 more years [of building the business] to achieve the same after-tax sales dollar."

The current capital gains tax rate is 15 percent, but in January it is scheduled to increase to 20 percent, plus the ObamaCare tax of 3.8 percent added on top brings it to 23.8 percent, a jump of 58 percent. Even if a lame-duck Congress extends the present rate of 15 percent, there is no conversation in Washington about repealing the ObamaCare tax, so at best capital gains taxes will increase by 25 percent after the first of the year.

John Emerick, one of the owners of IM Solutions LLC, an online marketing company that focuses on the legal profession, calculated that if they waited to sell until 2013, it would cost him $1 million out of his share:

> It was pretty clear to us that it made more sense for us to pull the trigger early. For me — I'm 49 — I'm thinking I might not earn that much for the rest of my life. The earnings for the rest of my life would be equivalent to the tax I'd be paying by waiting until 2013.

George Lucas, the founder and chairman of Lucasfilm, best known for developing the *Star Wars* and *Indiana Jones* franchises, no doubt did the math and decided to sell his company to the Walt Disney Company last month for $4 billion. Mark Calvey from the *San Francisco Business Times* calculated that Lucas saved at least $200 million in taxes on the deal compared to waiting until after the first of the year to close on the sale.

Nearly every major financial journal is cranking up end-of-year tax-saving strategies, including *Kiplinger* and *Barron's*, in their efforts to assist people of means — even modest means — to avoid, defer, or minimize the fiscal cliff's impact. *Kiplinger* suggests converting a traditional IRA to a Roth, maxing out contributions to a 401(k) plan, and accelerating income into 2012 rather than deferring it into 2013.

Barron's says that even financial advisers are getting on board: Get out while the getting is good. It's more a matter of how to rather than whether to. One adviser suggests selling stocks that have significant taxable gains all at once, and then buying them back after the first of the year. Another says sell a little at a time, but be sure to get out no later than December 14, to allow all trades to settle correctly. *Barron's* also points out that after the first of the year, dividends (currently taxed at the 15-percent level) will be subject to the same rate as ordinary income. That could boost taxes on dividends to nearly 40 percent, depending on the taxpayer's income tax bracket.

But there's another alligator in the water: the Alternative Minimum Tax (AMT), designed originally only to reach high-income earners. But with inflation pushing middle-income taxpayers into ever higher levels — called bracket creep — selling a lot of stock could trigger the AMT, which could negate much of that strategy.

Luxury home owners are also making the decision to unload before the fiscal cliff. Teke Wiggin at *Fox News* wrote that million-dollar home sales are up nearly 25 percent from a year ago, while the average selling price has actually dropped 12 percent. This reflects the nervousness that new buyers are experiencing when making an investment that large in an economy faced with so much uncertainty. This reflects the reality: government intervention and its consequences that inevitably follow. Buyers are waiting for prices to come down enough to compensate for the additional risk, while sellers are putting their high-end homes on the market but are willing to cut the price just to get out before the end of the year to avoid the impending increase in taxes.

None of these calculations would be necessary in the absence of government intervention through its crazy-quilt tax code.

Even those who are being forced to "short sell" their homes — where a lender agrees to sell a property for less than it is owed by the homeowner — are about to discover another nasty surprise after December 31: The tax break that allows them to avoid paying income tax on the forgiven debt goes away on that date.

Case in point: When Jeff Shingledecker put his home up for a short sale last April, he sold it for $105,000, leaving him with $118,000 in unpaid loan debt. When the bank forgives his debt, under the Mortgage Forgiveness Debt Relief Act of 2007, he won't have to report that $118,000 as income. After the first of the year, however, others forced into a short sale situation will get a shock: Any forgiven mortgage debt on primary residents, according to the IRS, will be considered taxable income. They will receive a 1099-C from the bank, and so will the IRS, showing the cancelled debt, and the resulting taxable income. In Shingledecker's case, in his tax bracket, the forgiveness by his bank would have cost him $29,000 in additional taxes.

What's exasperating about the tax code and its uncertainty is the amount of time and effort people spend trying to make decisions to reduce their income tax liabilities when that time and effort could and should be spent trying to provide better products and services to their customers and consumers. Then any decision to sell would be made on the basis of what serves the owners of the capital best in their circumstances rather than trying to navigate the ever-increasingly complex, and onerous, tax code.

Photo:Fiscal Cliff via Shutterstock