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Upper-Income Taxpayers Plan for Hike

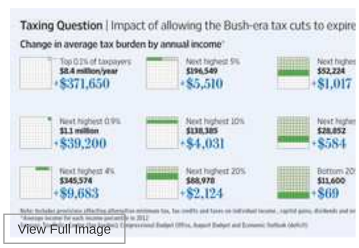
By GARY FIELDS

Arch Brown has converted his traditional retirement accounts into plans with better tax advantages. Andrew Ahrens has been buying gold and silver and selling stocks. Archie Anderson might speed up the sale of two equities himself. Mike Henry is considering selling timber.

The four are among a growing group of high-income taxpayers who assume they will see higher taxes next year, no matter what Congress does to address the expiring tax cuts from the George W. Bush administration. More than four months before the expiration date, they are making plans to mitigate any impact.

Mr. Brown, a Tucson, Ariz., businessman, said he is working on the assumption that "the tax rates for people like me who have income over $250,000 will go up."

The maneuvering ahead of Dec. 31 has confounded traditional tax preparations and spawned feverish activity among higher earners, a trend reported by tax planners and financial advisers across the country.



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Michele Knight, of Knight Accounting and Technology in Colorado, said she is fielding numerous questions from people who want to know the tax implications of starting a small business. She is advising them to create limited-liability partnerships, one way to organize a new company that might have more favorable tax rates for some. Others are interested in learning about changing their retirement accounts.

Jim Kirby, a tax partner with PMB Helin Donovan LLP in Dallas, estimates that 70% of his clients are calling about the potential tax increases.

"The third quarter is coming around, and people are getting concerned about what they should do to mitigate tax increases next year," he said, adding that he is hearing a lot from clients with property to sell.

Greg Rosica, a tax partner with Ernst & Young's Personal Financial Services practice in Tampa, Fla., said the looming increases were turning tax planning around 180 degrees. The pattern is normally to defer income until the following year, ever in hopes of avoiding or lessening the tax on it. Now "with higher income and capital-gains taxes [in store], it's accelerating income," he said.

It isn't clear exactly what will happen to the Bush tax cuts. President Barack Obama and most Democrats in Congress want them extended only for households with less than $250,000 in income and individuals making less than $200,000 a year. Republicans and a small group of Democrats say the cuts should continue for everyone. One option would see current tax rates extended for a shorter period, such as a year.

Then there's the default, if Congress can't reach agreement: Everyone's taxes will rise. Should the cuts be discontinued for the top two income brackets, the rate would go from 33% to 36% and from 35% to 39.6%. With the election season beginning, and a rancorous political environment, few would bet against the possibility of inaction.

Mr. Ahrens, of Ahrens Investment Partners in Lafayette, La., said 90% of the investment advice his firm is now giving centers on taxes. The firm is advising clients on how to defer income well beyond next year—for example, in annuities and retirement accounts, for when a client may have less income to tax—or bring it into the current tax year.

The investment manager is taking his own advice, in a number of ways, "to avoid the tax freight train coming our way." In April, among other steps, he "pulled out of equities and moved into hard assets like gold, silver and land." He said he will take other steps once the tax code is clearer.

Mike Henry, of Henry Wealth Management in Natchez, Miss., said he is trying to move up income that would normally be carried over into the next year. One idea is to sell timber growing on 500 acres of land he owns in Louisiana. He is considering that option even though timber prices have been dismal because of the prolonged downturn in housing construction.

Waiting for a better price on timber next year is "speculative at best," he said. "Even if the price does go up on timber, that increase will likely be eaten up anyway by the tax increases," Mr. Henry said. He said he is looking at other possibilities as well, including cutting back on his work hours and reducing his income.

"This is not tax evasion," he said. "This is year-end planning."

Mr. Brown, the Tucson businessman, said he converted his retirement accounts this year to Roth IRAs. With a Roth, withdrawals can be tax-free if certain conditions are met, while withdrawals from a traditional IRA are taxable. Anyone converting to a Roth must pay income tax upfront on any previous pretax contributions and earnings being moved into the new account.

Mr. Brown said he decided to convert and pay the tax this year, at the existing rates, in anticipation of what he thinks will be higher rates next year. It could save him thousands of dollars in tax payments, he said.

"I'm taking advantage of what I think will be the lowest tax rate for me in many years, and that's this year," he said.

It is hard to determine how many people are converting to Roth IRAs for this reason, however. While conversions are up this year, this was also the first year in which taxpayers earning more than $100,000 annually could take advantage of the Roth, so some people might have converted even without the threat of tax increases next year.

One frequently discussed option is stock sales. Mr. Anderson, president and chief executive of Options and Choices Inc., a Colorado data-integration and software-services company, said he has looked at a couple of equity holdings in his stock portfolio and decided he might sell them this year rather than waiting, as he was planning to do.

Capital-gains taxes, currently set at 15%, are set to rise. Treasury Secretary Timothy Geithner has said they should rise to 20%. Without congressional action, they will be treated as regular income and will be subject to a taxpayer's top marginal rate.

"As it gets on toward the end of the year," said Mr. Anderson, "I'll be thinking about those things more."

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