The Boston Globe Business

With tax rules set, the time to plan is now

By Lynn Asinof | GLOBE CORRESPONDENT FEBRUARY 10, 2013

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A woman picked up tax forms at the JFK Federal Building in 2004. There are now lots of ways for taxpayers to get tripped up as they navigate the new income thresholds.

After a long, frustrating period of tax uncertainty, people can now make tax planning decisions with a much greater degree of confidence. For some, that's good news; for others, it's a challenge.

Passage of the American Taxpayer Relief Act earlier this year means those with less than $200,000 in modified adjusted gross income — $250,000 for those married filing jointly — escape virtually all of the new taxes, phase-outs, and rate increases that

became effective in January and will affect 2013 income tax returns. For those in higher brackets, however, there are a variety of income thresholds that will trigger new provisions and create new headaches.

“There is a lot of confusion,” says Jeff Pirner, a district manager with H&R Block in Boston. People are still trying to figure out the impact of the tax legislation, he said. Moreover, there are lots of ways for taxpayers to get tripped up as they try to navigate the new income thresholds.

That makes tax planning critical. “You may want to do tax planning on a quarterly or semi-annual basis if you expect to have a change in income,” says Pirner. “You want to make sure you are optimizing your opportunities.”

With the 2012 tax filing season underway, that return you are working on is a good starting place for your 2013 planning. It offers a snapshot of current finances, allowing you to make projections in areas affected by the new tax rules. To help get you started, here’s a rundown of the issues you need to think about while pondering the law’s new income thresholds, taxes, and tax rates.

If your modified adjusted gross income is below $200,000 — or $250,000 for married filing jointly — the most significant tax pain will come from higher payroll taxes. For the past two years, taxpayers got a tax holiday that cut the payroll tax by 2 percentage points. Now the tax has reverted to 6.2 percent, which means someone earning $50,000 will get $1,000 less take-home pay in 2013.

Those with higher incomes will face not only new taxes, but also limits on potentially valuable tax breaks. There’s the 0.9 percent Medicare tax on *earned income* above [illegible] new 3.8 percent [illegible] *l gross income* over the $200,000 individual or $250,000 married-filing-jointly threshold. And finally, *adjusted gross income* over $250,000 for individuals — $300,000 for couples filing jointly — triggers the phase-out of personal exemptions and itemized deductions such as mortgage interest, state income tax, and home office deductions.

Once *taxable income* exceeds $400,000 for individuals or $450,000 for couples filing jointly, tax rates start to go up. The top marginal income tax rate jumps to 39.6 percent, up from 35 percent last year, while the top tax rate on capital gains goes to 20 percent from last year’s 15 percent.

That means many taxpayers will be looking closely at their income levels, considering ways to stay below those key thresholds. “You never want to let the tax tail wag the dog, but it’s a good idea to make decisions with one eye towards tax considerations,” says Dana Levit, a fee-only financial adviser with Paragon Financial Advisors in Newton.

One strategy: Be sure to make the most of tax-advantaged savings opportunities by maximizing contributions to 401(k)s, 403(b)s, and IRAs funded with pre-tax dollars. This year, new inflation adjustments are increasing contribution limits to a variety of retirement plans by $500. That means people can now contribute $5,500 a year to their IRA, while those over age 50 can take advantage of the “catch-up” limit which is now $6,500. Likewise, the annual limit on 401(k) plan contributions is now $17,500, up from $17,000.

Health savings accounts and flexible spending accounts — which are also funded with pre-tax dollars — may also make a difference, particularly when combined with other strategies.

These include paying close attention to where you hold different kinds of assets, says John Sweeney, executive vice president at Personal and Workplace Investments, a unit of Fidelity Investments.

Assets that are likely to produce taxable income, including taxable bonds and high-turnover equity mutual funds, might be better kept in a tax-advantaged account like an IRA or 401(k), he says. Tax efficient investments such as growth stocks that will be held for a long time may be better in taxable accounts.

Municipal bonds may become more attractive since interest paid here is generally exempt from federal and sometimes even state income tax. Other considerations include closely monitoring the timing of portfolio sales that could trigger capital gains and using capital losses to offset capital gains when appropriate. “Investing for an after-tax return can be much more complicated,” says Sweeney, noting that Fidelity is seeing more inquiries from people interested in tax-managed investing.

Now that Congress has made permanent the $5 million estate and gift tax exemption — which adjusted for inflation is $5.25 million per person in 2013 — people will be able to tackle their estate planning with greater confidence as well, said Robert Lepson, vice president of financial planning at Braver Wealth Management in Needham.

In Massachusetts, remember that the exemption limit is much lower. The state's estate tax kicks in after the first $1 million.

Go $1 over that amount, however, and taxes are owed on the entire estate, not just the amount exceeding the exemption.

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