Tax tips to avoid a hit this year

By Lynn Asinof Globe Correspondent,November 24, 2013, 12:00 a.m.

The stock market is up, federal tax rules have changed, and some popular tax breaks are about to expire. That means taxpayers could be in for some big surprises when they file income tax returns in April. Those looking to lower their 2013 tax bills, however, still have a month to take advantage of some year-end tax strategies that could make a difference.

Among those in for the biggest sticker shock are upper-bracket taxpayers who face a variety of new taxes and rate hikes. Ditto for same-sex spouses, who will be filing federal taxes as married couples for the first time. Combine those two categories, and the tax bill may be startling.

“The difference was $10,000,” said Newton-based financial planner and CPA Dana Levit after running one client’s 2012 numbers under the new 2013 rules. “They were shocked.”

For those in the lower-income brackets — less than $200,000 of modified adjusted gross income if filing single or $250,000 if married and filing jointly — year-end planning will largely focus on charitable giving, management of investments, and making use of expiring tax breaks, including home energy tax credits and teacher classroom-expense deductions, Levit says.

Record stock prices, for example, mean that investors looking to lock in gains may want to sell appreciated stock. Moreover, with the stock market continuing its upward march, investors are likely to find their portfolios more heavily invested in equities than they may have realized.

That makes it a good time to sell some stock-market winners and put the proceeds into either fixed-income instruments or investments that have been out of favor.

But before thinking about taking gains or selling to rebalance, investors in all brackets should consider how such sales will increase their tax bill. For example, investors may want to harvest portfolio losses to offset any taxable gains. Or perhaps they can do their rebalancing within tax-sheltered retirement plans, where these sales have no tax implications.

Such strategizing is particularly important to those in upper-income brackets. Last year's tax-law changes created a variety of income thresholds, each triggering new taxes, higher rates, or loss of tax breaks. But each threshold is calculated differently. That means any taxpayers whose income puts them close to one of these new thresholds needs to pay close attention.

"Think about doing a tax projection for 2013 and beyond to make sure you are not going to be bumping into these new limits," advises Levit. These limits include:

■ A new 0.9 percent Medicare tax on earned income above $200,000 or $250,000 for those married filing jointly.

■ A 3.8 percent Medicare surtax on net investment income for those with modified adjusted gross income over the $200,000 individual or $250,000 married-filing-jointly threshold.

■ A phase-out of personal exemptions and itemized deductions, which is triggered when adjusted gross income exceeds $250,000 for individuals or $300,000 for couples filing jointly.

■ Higher tax rates, which go into effect once taxable income exceeds $400,000 for individuals or $450,000 for couples filing jointly. The top marginal rate jumps to 39.6 percent, from 35 percent for 2012, while the top tax rate on capital gains goes to 20 percent from 15 percent.

Juggling these isn't easy, and even the experts say they have a hard time keeping it all straight. "It's complicated," says Beth Gamel, a fee-only financial planner and managing director at Argent Wealth Management in Waltham, noting that different strategies may be needed to avoid each of the thresholds.

For example, to stay below the 0.9 percent Medicare-tax trigger, taxpayers may want to defer bonuses or postpone the exercise of company stock options. You can't avoid this tax by making contributions to IRAs, 401(k)s, or other such retirement plans. But those contributions can be used to dodge the threshold on the new tax on net investment income, since they reduce modified adjusted gross income.

Of course, investors looking to avoid the net investment income tax can opt to delay any securities sales that would put them over limit. Or they can give those shares to family members in lower tax brackets instead of giving cash.

All these techniques work for people trying to hold on to personal exemptions and itemized deductions. Taxpayers worried about phase-outs of these tax breaks, the net investment income tax, and higher tax brackets may want to shift some assets to municipal bonds, which are not counted in calculating these thresholds.

Whatever the strategy, Gamel suggests that people take action soon. Arranging a charitable donation of appreciated stock, for example, can eliminate capital gains taxes on those shares, but it can't be arranged overnight.

The expiring 10 percent tax credit on up to $5,000 of energy-efficient home improvements may prompt a homeowner to install a new storm door or add insulation before year end, says Jeff Pirner, master tax adviser and a district manager with H&R Block in Boston. One caveat: Homeowners only qualify if they haven't already used up their credit in past years. Then, too, teachers, who are slated to lose their annual $250 above-the-line deduction for unreimbursed classroom expenses, might want to purchase school supplies before year-end even if they aren't needed until 2014, he says.

Finally, those over age 70½ who are charitably inclined need to act soon if they want to meet the year-end deadline for making contributions of up to $100,000 directly from their IRA to an IRS-qualified charity and eliminate all income taxes on the withdrawal.