CORAMANDEL WEALTH MANAGEMENT

The Taxes Are Coming…*Back*!

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Paul Revere is most remembered today as the nighttime messenger who, just before the battle of Lexington, warned of the British troop movement. He rode at midnight on April 18 (morning of April 19) 1775, from Boston to Lexington, to warn John Hancock and Samuel Adams about the British Army's movement. Historians say that Revere could not actually shout the famous phrase attributed to him, "The British are coming! The British are coming!" because the mission depended on secrecy and the countryside was filled with British subjects. The Massachusetts Historical Society, in accounting for Paul Revere's famous ride, claims that he actually shouted, "The regulars are coming!" and this was understood as a warning that the British were moving.

As the year 2010 is starting to wind down, a battle cry that could be made famous for this year would be "The taxes are coming! The taxes are coming!" However, a more accurate saying could be, "The taxes are coming back!" Many temporary tax cuts that were enacted in 2001 and 2003 are scheduled to expire on December 31, 2010. Starting on January 1, 2011, unless Congress decides to extend certain tax cuts or make new changes, there will be increases in some income tax, capital gains, and estate tax rates and rules.

With all of the uncertainty surrounding this situation, this may be a good time to review your investment portfolio to see if your current plan will hold up in the future. Starting in 2011, tax rates that were in effect prior to 2001 are scheduled to return. Specifically, the top income tax rate will go back to 39.6% and the special low 10% bracket will be eliminated. There have been discussions this year over making some potential changes or extensions of the current conditions. However, as of the date of this article, nothing has been passed.

Five Notable Tax Increases Scheduled to Return on January 1, 2011

Unless Congress decides to extend tax cuts or make new changes, income tax rates, capital gains taxes, and estate taxes are scheduled to revert back to what they were in 2001 on 1/1/2011. Here are five changes that you should be aware of:

1. The top federal tax rate will rise from 35% to 39.6%.
2. The 10% federal tax bracket will expire and revert to 15%.
3. The maximum long-term capital gains tax will rise from 15% to 20%.
4. The tax rates on qualified dividends will increase from 15% to ordinary income tax rates (which could be as high as 39.6%).
5. The estate tax exemption will move from $3.5 million in 2009 and unlimited in 2010 back to $1 million in 2011.

info@CoromandelWealthMgmt.com

Phone: 781.728.9001

Also, the tax rate reductions for long-term capital gains and dividends are scheduled to expire in 2010. Specifically, in 2011, the maximum long-term capital gains tax rate will go back to 20% from its current 15%.

Another adjustment to think about is the taxation of dividend income. Starting in 2011, dividend income (other than capital gains distributions) will change from being taxed at 15% to being taxed at ordinary income tax rates (once again dividend income will be taxed at your highest marginal tax rate). This means that in 2011 you could pay as high as 39.6% federal taxes on qualified dividends.

As if things weren't bad enough, the estate tax will be revived. For those who die after 2010, the estate tax will return with a $1,000,000 exemption and a 60% maximum rate (includes 5% surcharge). Currently, there is no Federal estate tax for those who pass away during 2010.

Some other smaller changes for 2011 include an adjustment in the child tax credit. Specifically, the credit of $1,000 per eligible child will be reduced to $500 after 2011. Also, after December 31, 2010, none of the child tax credit will be refundable to taxpayers if their earned income is more than $12,550.

How will marginal tax rates rise in 2011?

At present, the marginal tax rates are 10%, 15%, 25%, 28%, 33% and 35%. If Congress doesn't act by the end of 2010, tax brackets for 2011 will reset to 15%, 28%, 31%, 36% and 39.6%.

Here are the current 2010 tax rates and the scheduled 2011 tax rates.

2010 Individual tax rates

Tax Bracket	Married Filing Jointly	Single
10% Bracket	$0 - $16,750	$0 - $8,375
15% Bracket	$16,750 - $68,000	$8,375 - $34,000
25% Bracket	$68,000 - $137,300	$34,000 - $82,400
28% Bracket	$137,300 - $209,250	$82,400 - $171,850
33% Bracket	$209,250 - $373,650	$171,850 - $373,650
35% Bracket	Over $373,650	Over $373,650

2011 Individual tax rates

Tax Bracket	Married Filing Jointly	Single
15% Bracket	$0 – $70,040	$0 – $35,020
28% Bracket	$70,040 – $141,419	$35,020 – $84,872
31% Bracket	$141,419 – $215,528	$84,872 – $177,006
36% Bracket	$215,528 – $384,860	$177,006 – $384,860
39.6% Bracket	Over $384,860	Over $384,860

These are just some of the changes that 2011 will bring to taxpayers. Once again, our question is: has someone taken a look at your personal situation to make sure that you are prepared for these changes? January 1, 2011 could prove to be a day of reckoning for many taxpayers.

If you look ahead to the year 2013, the potential tax environment could get even more confusing. As part of the new Health Care Bill that was passed by Congress earlier this year, a new 3.8% Medicare surtax is scheduled to be assessed starting January 1, 2013. This new surtax will be on or the lesser of "net investment income" or the excess of "modified adjusted gross income (MAGI)" over the threshold amount. For purposes of this calculation, currently "net investment income" is defined as the sum of gross investment income over allocable investment expenses. This "investment income" (for the purpose of this 3.8% surtax) includes: interest, dividends, capital gains, annuity income, rents, royalties and passive activity income. Currently it does not include distributions from IRAs or qualified plans.

This surtax can take the top tax bracket of the 39.6% up to 43.4%. It can also take the top capital gains tax of 20% to 23.8%.

Earlier this year President Obama's office presented a new proposal for 2011 tax rates that differs from both the current and scheduled rates. According to an *ABC News* February 2010 press release following this topic, when discussing the President's tax bracket plan, a Senior Administration official told reporters that "the sounds you hear are the sounds of hard choices being made."

That same logic should apply to taxpayers. Now is the time to review your personal tax situation to prepare for these changes.

While the tax situation may take some time to settle, we still should plan on reviewing and preparing for the upcoming changes.

Some good questions to ask yourself now are:

- **How will the change in tax rates affect my current investments?**
- **How will the change in tax rates affect my total tax?**
- **Are there things I can do to prepare for these pending changes?**
- **Is my estate best positioned for the return of the estate tax?**

This is a time when a tax return, estate plan, and investment portfolio review by a qualified financial advisor can prove to be helpful.

For those readers who are not currently clients of ours, we invite you to schedule a *complimentary* appointment with our office to see if we could potentially improve your tax situation. Please call our office at: (781) 728-9001 to schedule your appointment today.

For both clients and friends of our practice, as we stated in the beginning of this article, ***"The taxes are coming…back!"*** We look forward to keeping you updated as this process continues.

About Coromandel Wealth Management

Coromandel Wealth Management is a Lexington, MA financial advisory and investment firm that offers a full range of financial planning and investment advisory services. We provide individuals and families with objective advice and customized financial plans that enable them to meet their goals.

If you would like a copy of this article sent to someone else who would benefit from this information, please contact Coromandel Wealth Management at: (781) 728-9001.

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Coromandel Wealth Management wants to offer you a **complimentary, one-hour, private consultation at absolutely no cost or obligation to you.** To schedule your financial check-up, please call us at: (781) 728-9001.

Coromandel Wealth Management
15 Muzzey Street
Lexington, MA 02421

Phone: 781.728.9001
info@CoromandelWealthMgmt.com
www.CoromandelWealthMgmt.com