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Lynn's Top Five: What will YOU do if Your Favorite Tax Benefits Disappear?

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Everywhere you turn you hear about major tax reform coming our way. And by reform, may I clarify by saying "increases?" Let's talk about five likely candidates and what you should be doing now to be prepared.

1) Deduction for Interest on Your Home Mortgage: Already limited to $1,100,000 (an oversimplified statement --- check with your tax advisor for clarification), we hear increasing rhetoric from Washington D.C. about severely limiting this write off now, and phasing it out completely in years to come. Not a big deal to US taxpayers living in less expense geography, but to those of us in the Bay Area, a potential financial disaster. What can you do now? First, refinance your home, if you can, to the lowest possible rate you can get with no fees, no points. Second, be sure you can afford your payments if there are no tax deductions. For some, this means paying down the mortgage, for others it might mean stretching out the mortgage pay back terms. Going forward: don't buy a home and take out a mortgage if you can't afford the payments in full without any tax breaks!

2) Repeat after me: My Gross Pay is NOT my TRUE Income! Your take home pay is reduced from your gross pay by all sorts of things: federal and state taxes, FICA, SDI, benefit plan payments, deferred retirement plans, etc. Using a tax program such as Turbo Tax or meeting with your tax advisor and CFP(r), figure out what your true annual take home pay is. Compare that to your annual after tax spending. Oh, and just to be safe, assume that you'll take home 5% less because Congress is talking about increasing income taxes across the board. Learn to live within this new amount ---in the meantime invest the difference!

3) Investment Income will be Taxed at Higher Rates in 2013: Right now most taxpayers pay a very preferential rate on capital gains and investment income such as qualifying dividends. These are part of what's called the "Bush Tax Cuts." At the end of 2012, these benefits are due to expire. Additionally, there's likely to be another surtax on most investment generated income to pay for what's being termed as "Obama Care" --- a national health care initiative. It's time to be sure you can afford these extra tax hits and that your portfolio is properly positioned for these major changes. On the one hand, don't throw away great investments just because they'll be taxed at higher rates --- so will everything else. But do be prepared and use this as an opportunity to rethink your holdings before the stampede that's sure to happen next year when everyone else realizes that investment tax changes are coming up soon, too.

4) Rethink your Long-Range Financial Planning Calculations: Whether you do this yourself, or work with a CFP (r), it's time to dust off your plan and build in higher tax rates into your future planning. This is the time to see if there are potential problems on your financial planning horizon, and make mid-course adjustments. What's the most important ratio to think about in your planning? It's how much left after your assumptions for investment rate of return, inflation and taxation. If that net number is higher than 1 - 3%, I strongly recommend you go back to the drawing board! Like a good scout, be prepared!

5) National Sales Tax --- a U.S. VAT: Another possibility from Washington. Your Congressmen and women are leaving no stone unturned in finding ways to raise revenue. As you do your long-range planning, factor into your budget the possibility of a national sales tax of 3 - 5%, the range. It could happen, if not across the board, on certain products.

What to do? Be calm, don't panic, but do not delay refocusing your financial viewpoint. Where appropriate embark upon defensive planning tactics to protect your life journey and that of your family from overly optimistic planning. You may find that this type of long-range vision results in you living not only with your means now and in the future, but also finding a way to pay down debt faster than you thought while bolstering savings and building more fun into your future. I applaud you on this journey!

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