BUILDING WEALTH IN CHANGING TIMES

The Solari Report

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Your Taxes in 2013

with Chuck Gibson & Melanie Pelayo

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C. AUSTIN FITTS: Let's talk a little bit about the fiscal cliff and your goals. It's very important before the end of the year. Are there going to be changes in the tax code? And again, we don't know for sure what's going to happen. But if there's going to be possible changes that could impact you, we want to make sure you understand what they are so that you have time before the end of the year to speak with your CPA or tax preparer – if you do your own taxes, take the time to sit down and look at this before the end of the year.

We also want to make sure that in your 2013 budget you have prepared for the fact that there is likely to be additional taxes one way or the other. Forewarned is a good thing, and that's the goal tonight, to give you the background you need to sit down and then take some time to look at your unique situation and see what, if anything, you can do to make sure you're prepared for what's going to come. And again, I just want to say that each person listening tonight has their own unique situation. We're going to be speaking generically, but before you take action or assume something's true, you really do need to consult with an expert that understands your unique situation.

Joining me tonight is Chuck Gibson, who's not a stranger on The Solari Report. We did a great equity markets overview recently, and then before that we did a "View from Silicon Valley" overview of the technology trends that we expect to impact the equity markets. The next equity overview is coming up on January 18th, 2013. That's one you don't want to miss.

Chuck is the President of Financial Perspectives, and he's my partner and a managing member of Sea Lane Advisory. And also joining us is our powerhouse, Melanie Pelayo who works with Chuck as a Certified Financial Planner and manages the Sea Lane Investment Committee for us. She's also licensed as an enrolled agent, but doesn't practice. Melanie – I'm just going to tease her now – happens to be very smart. And from my point of view, she has an encyclopedia capacity for remembering the complexities of financial planning, which was one of the reasons I was delighted when she and Chuck said that they would join me this evening.

Let me just note that we're also going to be covering a fair amount of ground tonight, and I'm going to take extra time because it's important that we not race too much and go into the details where appropriate. So Chuck and Melanie, are you with us?

CHUCK GIBSON: I am. Good evening, Catherine.

C. AUSTIN FITTS: Good evening.

MELANIE PELAYO: Hi, Catherine. It's Melanie. Good evening.

C. AUSTIN FITTS: Hi, Melanie. Okay – take it away, Mel. I'm going to start with you: taxes and the fiscal cliff. Can you give us an overview?

MELANIE PELAYO: Sure. I'm actually going to be referring to Chart 1 when I start this, and so if you guys can take a look at that – when you look at the fiscal cliff, there are actually two elements of the fiscal cliff. There's the tax increases, which is of most concern to most individuals, and then the spending cuts portion of it. And all told, the fiscal cliff's impact would be to decrease the GDP by $650 million according to the Congressional Budget Office. In absent legislative action, the tax impact in that is going to be around $500,000.00, which for households is going to average almost $3,500.00 each, which is approximately 25 percent above what they would be without the fiscal cliff going into place.

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C. AUSTIN FITTS: So you mean – you mean $500 billion.

MELANIE PELAYO: Yes – excuse me – $500 billion.

C. AUSTIN FITTS: $500 billion – okay.

MELANIE PELAYO: Yes $500 billion. And absent legislative action, as Catherine mentioned earlier, the most tax cuts that were enacted in the Bush era are going to expire as of January 1, 2013. And for most households, the two biggest increases are going to be from the expiration of those tax cuts and then also the expiration of a temporary payroll tax cut that's been enacted for the past two years.

C. AUSTIN FITTS: Just walk us through Chart 1 and show us how big the Bush era tax cuts are relative to the other possible changes.

MELANIE PELAYO: Sure. So if you look at Chart 1, you'll see that in terms of the expiration of Bush tax cuts, that is supposed to have an impact of $180 billion in terms of decreasing the GDP, and that's coming directly out of workers' or individuals' pockets. And in terms of the Bush era tax cuts, there's really five areas that we're discussing when you think about that. One that most people are aware of, of course, is the marginal income tax brackets.

For the marginal income tax brackets, what you're going to see is that instead of the current rates, which are at 10 percent on the low end and 35 percent at the high end, without any action those are going to increase by 5 percent so that it's 15 percent at the low end and as high as 39.6 percent. The second of most interest is usually the capital gains tax, and the capital gains tax currently for anyone who is in the 10 percent tax bracket they actually pay no long-term capital gains taxes, and anyone above the 10 percent marginal rate pays a 15 percent rate on their long-term capital gains.

With no changes occurring, in 2013 that will increase to 10 percent for those in the bottom tax bracket and increase to 20 percent for those anywhere above – at that point it would be a 15 percent tax rate. Next would be the qualified dividends – currently qualified dividends are taxed at a 15 percent rate, and if nothing happens in 2013 those would go back to being taxed at ordinary income tax rates. So they would go – they would also be taxed at those higher income tax rates that would be put into effect in 2013.

And finally also there not only are going to – are they going to increase your tax rates; they are also going to reduce some of the deductions that are allowed. So if you itemize deductions, currently there were no caps to that itemized deduction; you could deduct as much as you wanted. But with the 2013 coming back will be a cap on certain itemized deductions depending on your adjusted gross income. And then also in that same place there will be a phase out that will be implemented for the – the personal exemption rate.

C. Austin Fitts: Right.

Melanie Pelayo: And then finally also within the Bush era tax cuts, the really big onerous portion is the expiration of the estate tax changes. And with the estate taxes, what you see is, again, you're going to increase the top rate. Currently, it's at 35 percent; it will go up to 55 percent. And there is currently an estate tax exemption of a little over $5 million. It's $5.12 million, and if nothing happens that's going to decrease by $1 million – oh, excuse me – decrease to $1 million. So it's actually essentially a decrease of $4 million that you're going to be losing.

And also with that, there's something that's called "portability," which means that if you are a surviving spouse, and your deceased spouse didn't use all of their estate tax exemption, currently you're able to actually use whatever they didn't use during their estate tax planning or figuring and use that in your total at the end of your life so that, in essence, you could exempt up to $10 million at the end of the second spouse's life. And finally, with the estate tax and the gift tax, they're right now actually a unified tax, so at this point in time the gift tax exemption is also at $5 million. That would reduce back down to $1 million as well.

C. Austin Fitts: So you're looking at higher ordinary income rates, then higher rates on capital gains and investment income and higher estate. It could hit an individual in a whole number of different places and particularly could really hurt somebody who's dependent on investment income. Let's just look at a little perspective here. If I've been living on investment income, then I've been watching my yields come down

tremendously on my fixed income investment, my purchasing power come down because of the debasement, and some of my capital gains are coming from inflation, not really from real gains.

You know, they're nominal gains, but I'm getting taxed on the nominal dollars. So this could be a real squeeze on a lot of individuals.

MELANIE PELAYO: Yes, very much so.

CHUCK GIBSON: Yes, and this only includes the Bush era tax cuts. We haven't gotten to the rest of this yet. You could see how onerous this could be. I don't know how it's not going to affect virtually everybody in some form or another.

C. AUSTIN FITTS: Right. Okay, Mel, anything else on the Bush tax cuts?

MELANIE PELAYO: Well, there was one thing that I did want to mention in terms of the capital gains, because I know a lot of your listeners might own actual tangible assets. And in terms of tangible assets, the capital gains rate has actually not changed on that; it's always been 28 percent, and it will continue to be 28 percent. So there hasn't been really any change in that regard.

C. AUSTIN FITTS: Right – that we know of.

MELANIE PELAYO: Yes.

C. AUSTIN FITTS: Anything's possible!

MELANIE PELAYO: Very true.

C. AUSTIN FITTS: As far as we know, the taxes on precious metals have been onerous, and they're going to continue to be onerous.

MELANIE PELAYO: Yes.

C. AUSTIN FITTS: If you look at the amount of money in terms of budgets –

and I would say that the Bush tax cuts are the biggest pot on the table right now of any of the things we're going to discuss. So let's turn to the expiration of the payroll tax decrease.

Melanie Pelayo: Sure. What happened was in 2010, President Obama declared what we call a holiday on two percent of Social Security Payroll Tax for the employee. So the employee used to pay 6.2 percent into the Social Security Fund out of their take-home pay, and in 2010 it got decreased to 4.2 percent. And so absent any extension on that, the Social Security tax that workers will have to pay will go back to 6.2 percent as of January 1, 2013. And the impact is an immediate reduction in your take-home pay.

"Absent any extension on that, the Social Security tax that workers will have to pay will go back to 6.2 percent as of January 1, 2013. And the impact is an immediate reduction in your take-home pay."

Chuck Gibson: If you wanted to put that into perspective, the average household takes in $ 50,000.00 a year, in and around that area. That means that they're going to have another $1,000.00 in taxes.

C. Austin Fitts: Right – just for this item.

Chuck Gibson: Yes, just from this specific item. So it's like $1,000.00 in taxes, $1,000.00 in less take-home pay and $1,000.00 towards less living expenses.

C. Austin Fitts: Right. Okay – next step is the expiration of the alternative minimum tax patch.

Melanie Pelayo: Yes. Everything that we've talked about so far is actually something that will affect tax year 2013. With the alternative minimum tax patch, this is actually an immediate impact on this current year, 2012, potential tax impact. The alternative minimum tax system was originally created to initially ensure that high-income payers paid some minimum of tax regardless of their deductions and exemptions and credits. And what Congress usually did was institute a patch, year over

year that would increase the deduction that people could take on figuring out what the alternative minimum tax would be because originally it was not indexed to inflation.

And so a lot of people that weren't necessarily considered the high-income earners were getting caught in this trap because of some of the deductions that they were able to take on their taxes and then they had to put back into as preference items in figuring out their alternative minimum tax. So if nothing happens, the current deductions that you're able to take are $74,450.00 for joint filers and $48,450.00 for any other filer. And that will be reduced to $45,000.00 for joint filers and $33,750.00 for any other type of filer. It's a huge decrease in terms of the deductions that you can take to figure out the alternative minimum tax.

CHUCK GIBSON: I don't know if anybody of your listeners or those that understand it can understand the impact, but this is – from a magnitude standpoint, this is the largest I think that could hit people that aren't aware of it. The way the alternative minimum tax works is it's two taxes. Basically, you have to file two sets of taxes, or you calculate two sets of taxes: your normal rates on how they want you to, and then you have to do another calculation – it's a separate calculation for the alternative minimum tax.

And whichever is higher, that's what you have to pay. But – okay, so that doesn't sound so bad; but what is bad is that the starting rate on alternative minimum tax I believe is 20 percent. Right, Mel?

MELANIE PELAYO: Yes.

CHUCK GIBSON: Okay – so if you do it your – if you fall within the alternative minimum tax guidelines, and you have, for example, $50,000.00 of taxable income, you're – if you do it the ordinary way, you might only fall in the 10 or 15 percent tax bracket. But with the alternative minimum tax, you will now rise to a 28 percent tax bracket. So you can do the math. That's a minimum of a 13 percent increase on your taxes on $50,000.00 or whatever your income is. And it's unbelievably onerous and very surprising if you're not aware of it, because I've gone through that and

lived through it.

And you think you've planned your taxes really well, and you've got everything proportioned appropriately, and you're going to hopefully get a little bit back on your return when you file them, and you find out you owe – in my case, it was tens of thousands of dollars. And especially because it's going to take effect at the end of this year, people need to be really prepared for this.

C. AUSTIN FITTS: But it's going to be retroactive.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: So it will affect your 2012 filing that is due in April.

CHUCK GIBSON: Yes.

C. AUSTIN FITTS: So that means it affects your estimated in January as well.

CHUCK GIBSON: Yes, it does.

MELANIE PELAYO: Yes.

C. AUSTIN FITTS: Yes. One of the things that struck me when I – when you and I – when we – the three of us went through this the other day is I almost felt like this was sort of a "get California" tax, because I just came back from being out there with all of you in San Francisco area, and – I live in Tennessee, which is a state that has no income tax. So I have no deduction – I have no state income tax deduction because I have no state income tax. And I have three properties here in Hickory Valley, and my combined city and county property taxes are $500.00 a year, which in San Francisco, I don't think anybody in your area can conceive of property taxes of $500.00 a year.

On just this one property, I have a barn, I have orchards, I have a garden, I have acreage, I have a house, I have big trees. And this property alone is $250.00 for the year. So when it comes to a state with no income tax and

very low-cost housing compared to a very high-cost area like San Francisco, the AMT could – if you have significant state income tax deductions and mortgage deductions, it could be very painful.

Chuck Gibson: Absolutely. In addition to that – and I know this isn't a part of the fiscal cliff because it's – but it is a tax issue. Next year, because we voted in for the tax increase for state taxes, our tax rates are going from a top level of 10.3 percent to 13-plus. So we'll be the most taxed state in the union. So this is in addition to the increases in the federal taxes that we're all talking about here.

C. Austin Fitts: Right. Okay – on that cheerful note – let's go through the additional impacts.

Melanie Pelayo: Okay – the additional impacts – and I'm just going to take these in order in terms of their monetary value on the chart. The mandatory spending cuts are those cuts that Catherine referred to in terms of the mandatory cuts that are going to happen if they're – if Congress and the President don't agree on an actual spending cut package that is going to pass. And so that's going to be immediate as of January 1, 2013. The other expiring provisions are a set of tax deductions that are actually more geared towards businesses that are called "extenders."

Usually what happens is Congress will extend those packages year over year. And most of them, like I said, affect businesses like R&D deductions that are available. Actually for individuals, the biggest thing would actually be for certain credits for education expenses that are currently given to individuals. But if they don't extend them, those are going to go away. The Affordable Care Act – now that is the surtaxes that are going to be hitting people that make $250,000.00.

There's actually two different ones that are going to be put in place in 2013. The first is actually a 0.9 percent surtax on any income – so this is income – of somebody who makes more than $ 250,000.00, and that's going to be paid – it's part of increasing the Medicare portion of your Social Security and Medicare taxes that are charged out of your income. Instead of just paying 2.9 percent for – or actually the employee and the

employer split 2.9 percent, anyone who makes $250,000.00, any income over $250,000.00 will have to pay an extra 0.9 percent on that income.

The second portion of that Affordable Care Act is actually a hit on investment income. So if anyone makes over $250,000.00 in investment income – and that's interest, dividends and capital gains, etcetera – anything that's above $250,000.00 will be charged a surtax of 3.8 percent. And that's going to go toward what they call the "Medicare Contribution Fund," which is going to help pay for things that were passed within the Affordable Care Act.

"That's going to go toward what they call the "Medicare Contribution Fund," which is going to help pay for things that were passed within the Affordable Care Act."

C. Austin Fitts: Okay.

Melanie Pelayo: And then the Emergency Unemployment Benefit – that is the expiration of unemployment – extensions of unemployment benefits. It's going to go back to its original 26 -week maximum. And then finally, just reduce stimulus spending – that's pretty self-explanatory in terms of they're just going to reduce the amount that they're going to be spending in terms of stimulus.

C. Austin Fitts: Now, we got a question on whether or not the Emergency Unemployment Benefits were going to expire – whether they're going to be renewed or not. And the answer is, "I don't know." If you look at where the economy is right now, that's one of the things that is – would be most damaging to the economy – not to continue those. But I think it's – if you look at what the politics are right now, it's surprisingly easy for those to go one way or the other because there's so many controversial issues at hand. I didn't know, Chuck, if you had any other comments on those.

Chuck Gibson: Not really. I just am concerned that this – you know, you're the expert on politics, and you can tell by Melanie speaking she's the expert on taxes. I just expect this to be the start – because we have this – from a political standpoint, there's so much uncertainty. But what we do

have in certainty is we have a rising deficit and a budget that is completely out of control. And the only way you're going to be able to keep that at least somewhat under control is to print money and to raise taxes.

If anybody thinks that this is going to be the end of tax increases, I think that they need to reconsider that, because this is going to be in our future in some form or another. This is going to continue to squeeze the working person.

C. Austin Fitts: Right. We've just gotten a whole series of questions. So let me go back a little bit to the house one. "Dear Catherine, rent versus buy – first home in San Francisco – my wife and I are considering the purchase of our first home in the San Francisco Bay Area. We hope to find one along with a mortgage payment, taxes and insurance that will not exceed 25 percent of our monthly gross income and still leave about 12 to 15 percent of our budget free for discretionary spending or emergencies.

I work as a skilled trades person and do not feel very concerned about losing my job or finding work if I do. I'm having a challenging time trying to discern if renting would still be a better option if the economy tanks and unemployment goes up in 2013 like everyone expects. Thanks in advance for your thoughts." Okay – so since we've been talking about – here's what I would say. And Chuck, you jump in after me. I think it's very important to see which way the tax provisions go and what they do to real estate in the San Francisco Bay Area.

My feeling is the economy in San Francisco is going to be relatively very strong, and housing prices will be strong there. So I would be careful to not want to get shut out of the market, but I'd love to see what happens in terms of the tax provisions and things like the alternative minimum tax and what it's going to do to your 2012 and pro forma 2013 taxes. So I would make sure you've penciled this all out before you decide on what you're going to do and how you're going to do it. So Chuck and Melanie, what would you say?

Melanie Pelayo: I think one thing that we are always talking about,

especially with buying and the mortgage interest – that's something that's on the table, definitely, for either rationing down in terms of the deductibility and everything else. You really have to think about that in terms of – whether – when you're actually doing the planning – that it may go away; it may not. So it's definitely an uncertainty that you have to figure when you're thinking about that particular purchase.

CHUCK GIBSON: And I want to add into that that it's especially important when you're on either coast, because the cost of housing is such a dramatic portion of people's expenses that if you make a minor mistake and it's only ten percent of your income, and they take away the deductibility of your mortgage expense, then it's not so bad. But if you're stretching it, and you're at the limit of 25 to 30 percent where you're allowed to get a loan, you make a minor mistake, and they take away that deduction from you, it can mean the difference between, "I have to get the heck out of my house now because I can no longer afford it."

It doesn't give you a whole lot of latitude to be able to have any errors or any downside or any slowdowns in income.

C. AUSTIN FITTS: Another good question I should have asked in the beginning – but this is a good one – "Do private practice tax preparers now 'work for the IRS'? I remember hearing you say that they are now of far more accountability. Where does an honest, hardworking taxpayer go for good advice? Can you comment?" That's – if you look at the provisions related to enforcement, the – to me, from my point of view, the fundamental relationship between somebody preparing taxes or giving tax advice vis-à-vis the IRS has changed.

But my attitude is it's – you know, obviously, you want to find somebody who is trustworthy and who is competent. And my feeling is – you know, what I always say to my tax preparer is, "Look, I don't – I'm not interested in pushing the line. I want to make sure I'm absolutely impeccable in terms of how I report," and that's what you always want to be. Mel, you're an enrolled agent, so what would you add to that?

MELANIE PELAYO: You know, I don't actually practice in terms of helping

people actually file their taxes. And in general, really it does come down to finding someone that you can trust. And if you can find someone that you can trust and that you have a good working relationship with, then at least you have somebody that does have that knowledge base and is keeping up with the information that you may not necessarily have the time or the inclination to keep up with.

C. Austin Fitts: Okay – so before we go onto actions we can take, I did want to point everyone to Chart 3 – I'm sorry, Chart 2 up on the both the webinar software, and it's up on the blog if you can't access it through the webinar. What I did with our producer is we got the tax collections from the IRS website since the mid '90s so that you could see the level of tax collections. And what you'll watch is that the collections rose in most categories as the economy sort of bubbled through 2000, and then in recent years have been coming down.

And it's not too hard to look at the numbers and see – sort of see what the pinch is. One thing I would note is much of the debate around the fiscal cliff is what will the individual taxes be, and the discussion has been relatively quiet on corporate taxes. And if you look at the historical collections, what I would say is corporations' share of carrying the load has been flat or dropping, and I think – and we'll talk about this in the wrap-up in next year.

One question is, "Is this the right way to frame it, or do corporate taxes need to be on the table, too?" And I, of course, would say yes. So now, Mel, let's turn to what can be done to mitigate the impact of the fiscal cliff, if anything, or any of these tax changes? So let's just start to talk through what are people's options given what we think may happen?

Melanie Pelayo: Well, the main theme really is that at some point or another, tax rates, if nothing happens, are going to rise. And so if that's the case, really, you have to take advantage of lower rates before they potentially increase next year. And there's a couple ways that you can do that. One potentially is to realize capital gains. That means if you have built-in gains of some of your positions, it might be a good time to actually think about selling those out, because right now if you sell them

this year – by the end of this year, they'll be taxed at a maximum 15 percent long-term capital gains rate.

And if you do it next year it's going to go up by 5 percent to that 20 percent rate.

C. Austin Fitts: Right – but that's if it's in a regular account; not an IRA or retirement account.

Melanie Pelayo: Exactly – and again, I have to also remember that it doesn't apply to the tangible assets unless a Passive Foreign Investment Rule [PFIC] applies. Another potential thing that clients can do is actually do Roth conversions because Roth conversions in this case, if it makes sense, where money's not needed immediately due to the five-year waiting period, it's a way to do that Roth conversion now. Of course, that money that you convert into a Roth is going to be taxable in this year, but at this year's rates, which are going to be lower than potentially next year's rates, that money that you do convert into a Roth when it becomes available for qualified distributions, it's going to be currently available to you tax-free.

"Another potential thing that clients can do is actually do Roth conversions because Roth conversions in this case, if it makes sense, where money's not needed immediately due to the five-year waiting period, it's a way to do that Roth conversion now."

Of course, that could change in the future, but with current laws it will be tax-free once it becomes a qualified distribution.

C. Austin Fitts: I just wanted to note, I put a link in the subscriber space in the blog post to an article you wrote or a blog post you wrote on Roth conversions. But you might just want to go over very simplistically what is a Roth conversion.

Melanie Pelayo: Okay – so a Roth conversion is when you convert a traditional IRA – so that's an IRA that you have been contributing to and have been able to deduct contributions to. And that money is usually – it grows tax-deferred like it does in any type of Roth. So you haven't

actually been paying any taxes on any of the gains and/or dividends that have been built into that particular account. And what happens is if you convert it, you take that money and put it into a Roth IRA, and the amount that you convert into a Roth IRA becomes taxable in the year that you do the conversion.

So you pay taxes on it now so that when you go out to take it later, it continues to grow tax deferred, but once you're able to make qualified distributions because of Roth rules, Roth are – you're able to take money out of Roth IRAs on a tax-free basis. You don't pay any taxes on it at that point in time, because you paid them when you converted the IRA into a Roth.

C. Austin Fitts: Right – at a lower rate.

Melanie Pelayo: Another option is if you have two types of accounts – one a taxable account and the other – some sort of tax-deferred account like an IRA, you may want to shift dividend paying stocks into the tax-deferred account, because if nothing changes, dividend – the amount of income tax that you have to pay on dividends is going to go up to ordinary income rates from where they currently are now at 15 percent. So if you don't want to pay that extra tax next year, it may be a good time to again realize some capital gains if you have some gains on your dividend paying stocks, and then potentially buying them back in your tax-deferred account so that when they pay your dividends in the coming years, they're going to be tax deferred.

And then finally, the other thing in terms of estate taxes and estate planning, when appropriate really you could consider accelerating a gifting plan. And the one thing you have to remember with that, of course, is that any gift is irrevocable. And so you have to really make sure that it's appropriate for your situation.

C. Austin Fitts: Right – that one I find is one of the trickiest to decide because if you gift it to make sure you get the exemption under tax law, at the same time there are real issues about diminishing your own flexibility.

MELANIE PELAYO: Correct.

C. AUSTIN FITTS: Because it may turn out you need that money.

MELANIE PELAYO: Exactly.

C. AUSTIN FITTS: That one can be – yes, that one can be a tricky one. I'd hate to gift everything and then wake up tomorrow and discover they hadn't dropped the exemption after all.

MELANIE PELAYO: Yes – very true.

C. AUSTIN FITTS: One more question in from Los Angeles – a real estate question – "Is the mortgage interest deduction related to owner property or investment property?"

MELANIE PELAYO: It usually applies to owner property. It can be in some cases in terms of deduction – the mortgage interest can be deducted on investment property as well. But it's usually falling into an actual deduction based on the property itself.

C. AUSTIN FITTS: Right. So it's a project deduction, not a general deduction.

MELANIE PELAYO: Yes

C. AUSTIN FITTS: The other thing I would like to mention is that when you look at the feasibility – or the attractiveness of working longer hours to make more money versus doing more for yourself, I have to admit that the more taxes rise, the more attractive it is to not generate the revenues, but instead use the time to do things that significantly lower your expenses. So depending on your — Chuck, you have some things to add, and I know we have Chart 3 that you wanted to describe, which is fascinating.

CHUCK GIBSON: Well, the one thing I did want to make sure that one of the other topics that we – I think we skipped over with regards to what somebody can do to help mitigate these changes – Mel, did you mention

the fact that you should be pulling in revenue into this year if at all possible. So if you have the ability to recognize revenue in 2012 rather than 2013, I think that's another thing you can do. It's kind of like picking your tax hit this year or pulling the revenue this year so it gets taxed at a lower rate.

MELANIE PELAYO: Yes, right.

C. AUSTIN FITTS: And in fact, we had a question – let me just read it. "I'm a freelance consultant. I'm on the verge of receiving a large check for a project that I have done for a U.S. company. I could either get the payment now before the New Year or after the New Year. Since you forecast taxes are going to rise next year, would you recommend that I hold the payment until next year or the other way around?"

CHUCK GIBSON: Well, nobody can tell the exact situation and how this thing is actually going to play out with Congress and the President. But I would take the revenue now. That's what I'm doing, personally.

C. AUSTIN FITTS: Right – and some of it depends on what their other – you know –

CHUCK GIBSON: Yes.

MELANIE PELAYO: The other situations are – yes.

C. AUSTIN FITTS: Yes, their other situation –

CHUCK GIBSON: Right.

C. AUSTIN FITTS: See, I have the advantage that none of you all have. I have a lifetime of tax loss carry forwards. So it's a different situation.

CHUCK GIBSON: Can I just add one other thing before we jump into Chart 3, because, for me, this is about what can be done. And part of what can be done for me is managing expectations. And I don't remember – I think you mentioned one of your listeners – I think it was about the question in

housing in San Francisco – you know, they were expecting projected growth in 2013. Well, actually, I went to a couple of the government websites, and their projection for growth in 2013 is nine tenths of one percent.

"What I want to do is just set an expectation for what people should potentially expect if this thing goes through."

So what I want to do is just set an expectation for what people should potentially expect if this thing goes through – so what we've done is we've quantified this, and we've said, "This potential impact – the $650 million of all of these tax increases and exemption, deductions, etcetera, has an effect of approximately 4.7 percent of GDP." So if you take a look and if we only grow nine tenths of one percent, and you have the potential of taking out 4.7 percent, you do the math, and it works out to be a 3.8 percent contraction. So what does that mean?

I'm just trying to put this in context. Please don't take it like I'm predicting this, but if you use 2008 – 2009 as a reference point, we had a 3.1 percent contraction during that period of time, and we all saw what happened to investment assets, whether they be stocks or bonds or gold, precious metals, our homes – all of those things. Now, I don't think that's going to happen. It's a completely different scenario, but we don't know what's going to play out here. So again, my point is to manage expectations, and that is a potential outcome as far as I'm concerned.

C. Austin Fitts: Right – now we have a series of questions on IRAs and 401Ks that I want to turn to. And I've watched some of the – I know the President's proposal had one proposal to encourage 401Ks for small businesses, and we've seen that proposal floating around in various conditions. If you look at the negotiations that are going on, they're going on right now at things that generate much more immediate revenues for the budget.

I don't think IRAs or 401Ks have been at the top of anybody's list in Washington. So they're kind of down on the list. But we have a series of questions of, one, would you start to take money out of IRAs now, or would you put money into IRAs given what's going on? And I'll just kick

this of, because I think everybody has a different opinion. But what I find is it's very unique to the individual situation. And what I try and encourage people to do is simply not have all their eggs in any basket, including the IRA basket. And certainly if you're – if you have a lot in IRA, you ought to take – at a minimum, take a look at the Roth conversion.

Mel did a great little piece, and it's up. You can link to it from the links in the subscriber area. I would suggest you take a look at it. But I would invite both of you to kick in because, as you know, I have a terrible prejudice on this having said, "Never again being slammed by the government on my 401K." But I find it's very unique to the individual. So I have a hard time always answering this question generically. But let me kick it over to each of you.

MELANIE PELAYO: Well, unfortunately, I was actually going to say the same thing, which is it is going to be unique to the person's situation. The one thing you have to remember is that it is the potential that you're going to tax – taxes are going to increase. A way to try to mitigate that could be to do one of two things, which is take some money out and realize some gain – realize that income now or contribute more. But it's – it really is going to be up to the individual's situation.

C. AUSTIN FITTS: It's very interesting – at the subscribers' luncheon in Murfreesboro, we got a request to do a show on self-directed IRAs. And the theory was if I use my IRA to do private venture or small business investment, it will be sufficiently illiquid that the government can't take it or force me to sell it and put it in an annuity. So as a lover of liquidity, it was very upsetting to hear, but the idea of putting it in something illiquid is becoming increasingly attractive. We also got a question from somebody saying, "Would you suggest I put my IRA into a self-directed IRA – into something quite illiquid – because then I can not wake up and find that the treasury has determined that it has to go into an annuity?"

CHUCK GIBSON: I have a feeling, though, Catherine, if that comes about, and they really do need the money, they're going to find whatever way that

they need to to make those illiquid things pretty liquid if they need the money that bad.

Melanie Pelayo: Yes.

C. Austin Fitts: I agree.

Chuck Gibson: But one thing I just wanted to add, and I'm not going to parrot what you guys said because you're I think both spot on. My only comment would be is that when people are planning for retirement and, while this is an adjunct issue, the best thing you can do is to take a look at your position, and you want to go into retirement with a good balance of money between your IRA and non-IRA funds. So to answer that question, would I contribute going forward?

Yes, all those concerns about taxes and confiscation and whatever you want to call it – but I would also take into account that if I'm in balance and I have most of my assets in non-IRA funds, then I would – me personally – I can't tell everybody else what to do – but I would want to continue to contribute to my IRA. If the converse is true, I would probably forgo giving up the tax deductibility and just take it – pay the taxes on it and go find another home for it.

C. Austin Fitts: Right, and that's why I think it's very unique to the individual situations. Okay – well, Chuck, you want to just describe Chart 3, because I thought it was fascinating?

Chuck Gibson: Yes, I think this is an interesting chart in the sense that – so if you look at the top line – the black line there, that's the total tax received as a percentage of private GDP. So that – you could see that trend is – you could draw a trend line, and it's actually moving upwards. But the green line, which is a total – it's an annual revenue growth of GDP is actually going down. So our GDP is going down, but the tax receipts from the private sector are going up.

For me, what that's saying to me is they're squeezing – you know, more and more money is being taken away from the private sector in the form

of – in the form of taxes.

C. Austin Fitts: Right – and that's what we've seen is the economy. In my opinion, the government's behaved in a series of ways over the last 20 years that shrinks the pie, and now it's coming back to bite them because the pie is shrinking, and it's hurting their tax receipts, and now they want a bigger piece of the pie. And the reality is what we need to do is get out of that spiral, and whatever we do we need to reengineer in a way that makes the pie bigger.

So it's not just a matter of balancing the budget. It's balancing the budget of the whole economy, not just the government. So the Sheriff of Nottingham cannot solve this problem alone; we need Robin Hood.

Chuck Gibson: And Little John.

C. Austin Fitts: And Little John – you're right. Okay – so before we close, any other points that you would like to make?

Chuck Gibson: None for me.

Melanie Pelayo: None for me, either.

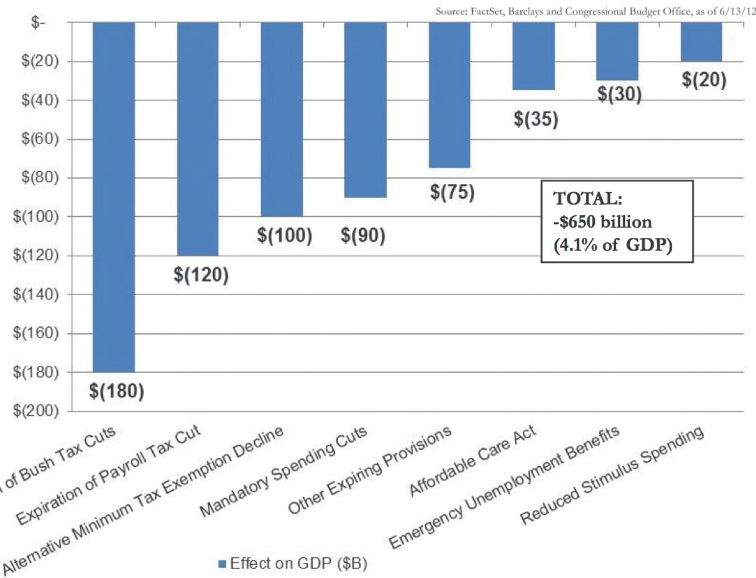
C. Austin Fitts: Okay – well, today is December 6th. If you're going to do something, it's good to do the transactions before the very end of the month. Hopefully, this will give subscribers about two weeks to look at their own unique situation and talk to the appropriate people in your life, and if there are any transactions to be done, hopefully do it before the end of the year. Chuck and Melanie, thank you very much.

As I said, Chuck's going to be back with us for the equity overview on January 18th, and we're looking forward to that. Mel and Chuck, have a great evening. And again, thank you very much.

Chuck Gibson: You, too.

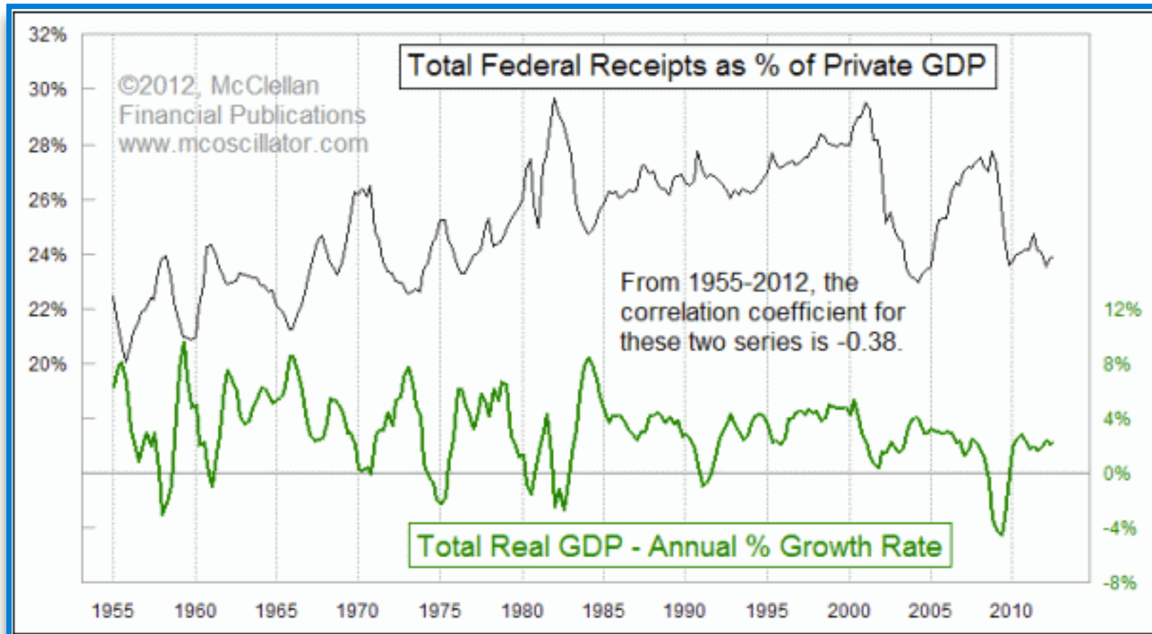
Melanie Pelayo: Thank you, Catherine.

CHUCK GIBSON: Talk to you later.



U.S. Annual Tax Collections (In Billions)

Year	Business Income Tax	Individual Income Tax	Employment Tax	Estate and Gift Taxes	Excise Tax	Net Collections
1995	157	590	464	15	43	1270
1996	171	656	491	17	40	1376
1997	182	711	526	20	43	1482
1998	188	808	553	24	44	1617
1999	182	855	595	28	56	1717
2000	205	978	634	29	53	1900
2001	149	971	676	28	50	1875
2002	145	828	684	26	50	1732
2003	128	757	692	22	50	1650
2004	185	763	714	25	52	1739
2005	273	880	766	25	55	1999
2006	351	994	810	28	55	2238
2007	368	1118	838	26	46	2396
2008	301	1060	877	29	49	2316
2009	130	854	855	23	45	1908
2010	180	814	820	19	45	1878
2011	175	1006	176	7	47	1999



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