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Are you financially prepared for 2013?

Personal Finance

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Washington spent this year delaying decisions on a number of major economic policy issues until after the election. Now lawmakers must grapple with their unfinished business, in particular a confluence of expiring and impending policies referred to collectively as the "fiscal cliff."

As it stands, there will be major changes in tax rates next year unless a compromise is reached. The changes affect income taxes, investment taxes and estate taxes.

The maximum marginal income tax rate for ordinary income will increase from 35 percent to 39.6 percent. The maximum tax rate for long-term capital gains will increase from 15 percent to 20 percent for individuals. Dividends will cease to be taxed at capital gains tax rates and will again be taxed at ordinary income tax rates, which are as high as 39.6 percent.

The "marriage penalty" relief, which provided more advantageous tax brackets for married couples, will expire, meaning that the standard deduction for married couples will cease to be calculated as double of the amount available to individuals.

The changes would not only affect high earners.

Currently taxpayers in the 10 or 15 percent tax brackets pay no tax on qualified dividends. This will no longer be the case. Also, income currently taxed at 10 percent will be taxed at 15 percent and income currently taxed at 25 percent will be taxed at 28 percent.

The payroll tax cut that was enacted in 2011 and 2012 will expire. This tax cut reduced individual's payroll tax by two percentage points on income up to $108,000. Also, the expiration of the "marriage penalty" will affect taxpayers in all tax brackets.

As a result of all these possibilities, some investors are wondering whether they should realize long-term capital gains in 2012 at the lower rates.

While traditional wisdom holds that investors should defer the payment of taxes, if you are planning to sell an asset in the near term, you should consider triggering the gain in 2012 to take advantage of the lower rates while they are still in effect.

You may even wish to consider "resetting" the basis of assets that currently have a low basis for income tax purposes.

It may be possible to sell the asset and immediately buy it back, thus triggering a capital gains tax at the lower current long-term rates and establishing a new cost basis. This strategy only applies to sales that trigger gains and would not be appropriate if you plan to hold the asset until your death because of the unlimited step-up in basis at death.

Also, discuss with your financial adviser whether it makes sense to convert a traditional IRA to a Roth IRA. When you convert to a Roth IRA, the converted amount of your traditional IRA will be taxed as ordinary income in the year of conversion at the income tax rates in effect on the date of conversion. Accordingly, triggering the income in 2012 at this year's lower tax rates may make a Roth conversion more compelling.

Prior to 2010, the amount of itemized deductions a taxpayer could claim was reduced for taxpayers with adjusted gross income over a certain threshold. This limitation on itemized deductions was repealed in 2010, but the repeal is only in effect through 2012.

Also in 2013, under the Affordable Care Act, the medical expense deduction threshold will increase to 10 percent of adjusted gross income from the current 7.5 percent. Because of these changes to itemized deduction rules next year; it may make sense to accelerate tax deductions to 2012. Consider paying for unreimbursed medical expenses or property tax in 2012 rather than in 2013.

The gift tax exemption is $5.12 million per person for 2012 and is scheduled to revert to $1 million per person in 2013.

You may want to consider utilizing a substantial portion or even all of your gift tax exemption by making a gift to your family members, in order to remove the value of the gifted asset, plus future appreciation, from your estate. There are many strategies to utilize your gift tax exemption and it is critical to engage your tax advisers and attorneys as soon as possible to take action in 2012.

While there is bipartisan consensus in Washington for mitigating the negative impact of going over the "fiscal cliff," there will likely be significant adjustments made to revenue policy during the current lame duck session and into 2013. However, the laws in place right now offer us direction on certain safeguards we can take immediately to protect assets and investments from excessive tax exposure. If there ever was a year-end to consult with expert financial advisers and tax planners, 2012 is it. NHBR

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