# Higher taxes are inevitable

## Smart investors should take steps to prepare for that eventuality.

Amid all of the financial and economic uncertainty in the world today, there is one sure thing: Your taxes are going to go up. You can take that to the bank.

Even before the kabillion-dollar bailout proposed by Washington, the federal government was spending $400 billion more every year than it was taking in. Figure in aging baby boomers signing up for Social Security – and a few years after that, Medicare – and there's no way to start closing that chasm other than by raising taxes.

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Even George H.W. "Read My Lips" Bush saw that writing on the wall and raised taxes during his presidency.

"Congress will raise taxes regardless of who wins the presidential election," said Janine Racanelli of **J.P. Morgan Private Bank.**

The good news about all the bad news is that it offers taxpayers a little bit of time to prepare. Here are some actions to take before the end of the year:

- **Sell losers.** If you haven't done it yet, this is a good time to dump any stocks or mutual fund shares that you have lost money on. You can cancel out any capital gains on winning investments with the losses you reap and use an additional $3,000 of losses to offset ordinary income.

If you have bigger losses than that, they will carry forward and offset your income in 2009 and beyond, until you've used up all of your losses. Caveats: Do not buy back the same securities you sell within 30 days of selling them, or you will not be able to deduct the losses. And don't bother doing this in your retirement account; you can't take those losses.

- **Sell winners too.** If you have a big gain in a stock you want to sell, this might be as good a time as any to do that. Capital gains rates are as low as they have been in 30 years, and there is some pressure to increase them.
- **Reposition your portfolio.** You can use the current climate and the capital loss rules to move high tax investments into your retirement account and take low tax investments out, suggests Christopher Parr, with advisory firm Financial Advantage Inc. in Columbia, Md. He calls investments like real estate investment trusts and bond funds "tax-ugly" because they throw off high, fully taxable dividends. Sell them while they are beaten down if you hold them in taxable accounts, he said. Then buy similar investments (or wait 31 days and buy the same fund back) in your IRA or 401(k).
- **Feed tax-free plans first.** If you have a health-care savings account, make your maximum annual contribution to that before you salt money away in a tax-deferred IRA or 401(k) plan. Think seriously about putting more money into your Roth IRA, even if it means putting less in your tax-deferred IRA or 401(k) plan. By the time you retire, your tax rate on money coming out of those tax-deferred accounts could well be higher than they are now.
- **Consider investing in municipal bonds.** They are currently paying their highest rates in six years. With local and state governments facing their own deficits, they will be raising taxes too. A triple tax-free muni fund – one that exempts its interest from federal, state and local taxes – can be a good bet for those in high tax brackets. To figure out if it's worth it for you, you can use the calculator at the TIAA-CREF Web site, **www.tiaa-cref.org/performance/mutual-funds/tax-yield/index.html.**
- **Look at the advantages of converting your tax-deferred IRA into a Roth IRA.** You'll pay income taxes on that, but if you are having a bad year, that could limit the blow in two ways. If your personal earnings are down, your tax rate could be lower now than it will be in the future. And if the investments in the account are beaten down, your tax hit on them will not be as high as if you had waited for them to recover, and then made the move.
- **Watch that space.** Once Washington starts writing tax legislation, ideas will be flying all over the place. A McCain tax increase will look different from an Obama tax increase. On Nov. 4, you can pick your poison.

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