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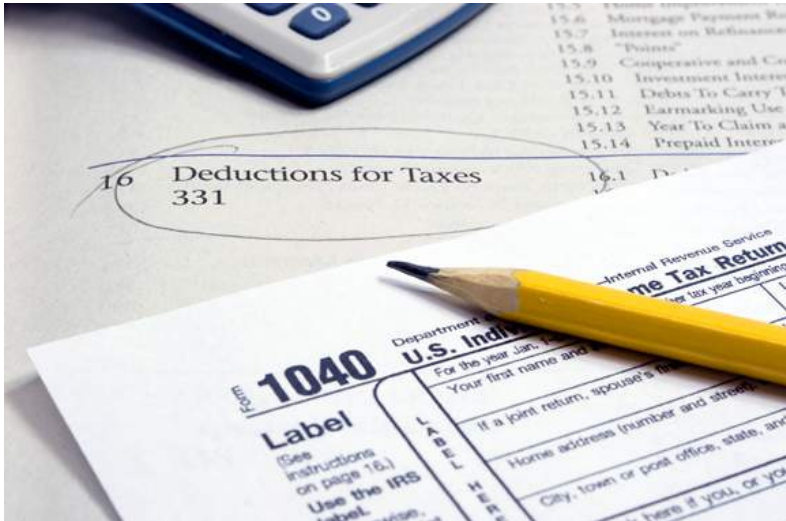


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Tax breaks for the well-off likely to be cut off

Deficit pressures leave little room for further extensions of tax cuts in 2013, retirement policy expert says

By **Darla Mercado**
May 3, 2011 2:18 pm ET

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As Congress attempts to trim back the nation's deficit, advisers and their clients should brace for a less-generous tax set-up in 2013.

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While legislators in Washington are making budget trimming a priority this session, the real action will take place in 2013, James Delaplane, a partner at Davis and Harman LLP, said during a presentation today at the InvestmentNews Retirement Income Summit.

"We may have some preliminary steps but the real action is likely to come in 2013, and you'll see a macro effort to deal with the reform of the tax code," he said. "At some point, action is going to be forced onto the policy makers. I think it's just a matter of time before the grand deficit reduction legislation happens."

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The tax deal that President Barack Obama struck with Congress last fall bought investors some time on the treatment of capital gains and dividends. However, the extensions of those cuts are set to expire at the end of 2012. Unless Republicans are able to gain control of the House, Senate and the presidency in 2012, the tax cuts probably won't be extended, Mr. Delaplaine predicted.

"If Obama weren't looking forward to 2012, he wouldn't have struck that tax deal," he said. "Presuming the economy is more solid and the deficit pressures are starker, then that's a recipe for tax cuts not being extended."

As a result, income tax rates on higher

earners will likely rise in 2013, and the capital gains rate is unlikely to remain at its current level. (Which states would be the max taxed for HNW individuals? [Click here to see one research group's estimates of the five states where the wealthy would be hit hardest.](#))

Meanwhile, tax incentives for retirement savings are no longer safe from cuts.

The Bowles-Simpson deficit reduction commission proposed capping tax-deferred savings in defined-contribution plans to the lesser of \$20,000 or 20% of income in an attempt to shore up the nation's budget. The commission didn't specifically comment on the treatment of tax-free inside build-up for life insurance and annuities, but it may be limited in some way, Mr. Delaplaine said.

"The political push-back won't be small, but every sacred cow is taking its nicks," he said.

Mr. Delaplaine warned advisers that the Federal Reserve is expected to reach the federal debt ceiling in the next two weeks, which means Congress will have to vote on raising the cap. That would mean the Fed will bump up against that limit sometime in August. Congressional freshmen are likely to push back against that move unless they get some substantial agreements to slash government spending, Mr. Delaplaine said.

"We are entering a high-stakes effort here, and even the president knows that some reforms have to accompany the debt ceiling vote or it won't go through," he said.

Mr. Delaplaine recommended that advisers tell their clients that this discussion is going to be tough and that the markets may not react favorably.

"It's going to get down to the last minute, and it won't be what the Treasury will prefer or what the markets want," he said. "Put on your seatbelts."

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