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Sept. 10 (Bloomberg) -- Wealthy Americans have the price of a BMW convertible riding on the outcome of the Congressional battle over tax cuts set to expire this year.

A married New Yorker earning about $1 million in income, with an additional $50,000 in capital gains and $5,000 in dividends may pay about an extra $45,300 in federal income taxes, $2,500 in capital gains and $1,230 on dividends if Congress doesn't extend the 2001 and 2003 tax reductions scheduled to end Dec. 31, says Alan Dlugash, a partner at Marks Paneth & Shron LLP, a New York-based accounting firm. That's about a $50,000 hit, he said.

"These are very large tax increases," said Dlugash, whose typical client has a net worth of $5 million to $10 million. His example assumes a taxpayer in the top bracket without deductions such as mortgage interest on a home or charitable donations.

An estimated 315,000 U.S. taxpayers earn more than $1 million, according to the Joint Committee on Taxation. In 2011, federal income tax rates for the highest earners will go to 39.6 percent, up from 35 percent, and capital-gains rates will increase to 20 percent from 15 percent, unless Congress acts. Dividends, currently taxed at 15 percent, would be taxed as ordinary income with rates as high as 39.6 percent.

Deficit Woes

President Barack Obama has proposed ending tax cuts enacted during the presidency of George W. Bush for families making more than $250,000 and raising capital-gains and dividend rates to 20 percent for those same earners. Congress is scheduled to return to Washington next week. "We hope to consider tax cuts in this upcoming work period," said Regan Lachapelle, a spokeswoman for Senate Majority Leader Harry Reid, a Nevada Democrat, in an e- mail.

Obama said Sept. 8 that the country can't afford to extend tax cuts for the wealthiest Americans because of the deficit. Proponents of keeping the lower rates for all income levels such as Senate Republican leader Mitch McConnell of Kentucky have said raising taxes will slow job creation and limit consumer spending. A BMW Z4 Roadster convertible, for example, has a starting price of $46,000, according to the website of the manufacturer, Bayerische Motoren Werke AG.

'Vulnerable to Hysteria'

The uncertainty over taxes means some individuals are "vulnerable to hysteria" and financial advisers who urge them into unnecessary or unwise transactions, said Clint Stretch, managing principal of tax policy at Deloitte Tax LLP in Washington.

The total federal income tax owed on about $1 million for a New York City resident would be about $323,000, up from $278,000 if the tax cuts expire, Dlugash said. That figure doesn't include an estimated $125,000 in local government levies, he said.

Nine states raised their personal income tax rates last year to as much as 11 percent, according to the Washington-based Tax Foundation, a research group. California's top rate is 10.55 percent on income above $1 million. That's why Alfred Peguero, personal financial services partner at PricewaterhouseCoopers LLP in San Francisco, is already formulating tax projections through 2012 for clients who have $50 million to $5 billion.

"If we want to get really scary we go to 2013," said Peguero. Starting that year, there will be a 3.8 percent additional tax on unearned income such as capital gains and dividends, to help fund health reform Congress passed in March.

Handful of Options

Taxpayers in top brackets have a handful of options for softening the impact on their wallets, said Joseph Spada, managing director of Summit Financial Resources in Parsippany, New Jersey.

"Accelerate any income you can into this year at the 35 percent highest marginal rate," said Spada, whose average client has $25 million. "If you have a choice, get your bonus in December, rather than January, and move deductions into 2011. Most people make charitable donations at the end of the year. Push it to January."

Executives may elect before year-end to delay some of their expected 2011 salaries through non-qualified deferred compensation plans, said William MacDonald, chief executive officer of the Retirement Capital Group, an executive benefits consulting firm based in San Diego. The plans generally allow employees in a firm who make more than $150,000 to defer a portion of their salaries and up to 100 percent of their bonuses until a future date, such as retirement, when they may be in a lower tax bracket, MacDonald said.

Deferred Risk

The deadline for deferring 2011 bonus compensation ended in June for most workers, MacDonald said. Executives can still delay some of next year's salary to offset taxes, he said.

Workers using such plans need to keep in mind that there's a risk in deferring pay if their company goes bankrupt, because the employee would be considered an unsecured creditor, said Spada.

Retirement accounts are another way to plan around rising taxes, said Jonathan Forster, national chair of the wealth management group of Greenberg Traurig LLP who works in the law firm's McLean, Virginia, office. Those considering converting their traditional individual retirement account to a Roth IRA should do so this year, said Forster. While the rules permit the taxes owed to be split in 2011 and 2012, individuals may be better off choosing to pay the full bill in 2010 to lock in lower rates, he said.

Tax-Free Distributions

Distributions from Roth IRAs are free from income taxes with no minimum required withdrawals, and investors may pass any remaining balances on to heirs, Forster said.

As for capital gains, those thinking about selling an appreciated asset such as a business or real estate should try to complete the sale this year, said Dan Zucker, a partner at the law firm of McDermott, Will & Emery LLP in Chicago.

Municipal bonds are generally exempt from federal taxes as well as state and local levies for residents in most states where they're issued, making them attractive to high-income earners, said Dan Yu, a director at EisnerAmper LLP's personal wealth advisory practice group in New York.

Tax-exempt munis due in 8 years to 12 years were yielding an average of 2.67 percent in August, according to Barclays Capital indexes. That's equivalent to a 4.42 percent taxable-bond yield for the highest earners, if the top federal income tax rate goes to 39.6 percent.

Investors should stagger the maturities of their municipal bonds from 2 years to 10 years with an average duration of no more than 5 years because of the potential for rising interest rates, and they should research the bonds' credit quality due to stress on government budgets, Yu said.

“With our deficit, taxes aren’t going down in our future, they’re going up,” said Clifford Caplan, president of Neponset Valley Financial Partners, an advisory firm based in Norwood, Massachussetts. “It doesn’t matter if you’re Democrat or Republican.”

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