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MP&S TAX ALERT: WHAT THE FISCAL CLIFF DEAL MEANS FOR YOUR TAXES

After much contention and negotiation, President Obama and Congress finally came to agreement on legislation to address the "fiscal cliff" — a combination of higher taxes and forced spending cuts scheduled to go into effect in 2013. While the American Tax Relief Act (ATRA) simply extends the deadline for the spending cuts, it does prevent income tax rate increases for all but approximately the top 2% of taxpayers.

ATRA also extends other income tax breaks for individuals and businesses and addresses the alternative minimum tax (AMT) and the estate tax. It doesn't, however, extend payroll tax relief. So taxpayers with earned income will see a Social Security tax rate increase of two percentage points.

Here's an overview of some of the act's key tax law changes.

Individual income taxes

ATRA makes permanent the 2012 ordinary-income tax rates, ranging from 10% to 35%. But, beginning in 2013, taxpayers with taxable income that exceeds $400,000 (singles), $425,000 (heads of households) or $450,000 (married filing jointly) will be subject to the top pre-2001-tax-law marginal tax rate of 39.6% on taxable income in excess of the applicable threshold.

In addition, the act allows the scheduled 2013 return of the limits on certain itemized deductions and the personal exemptions to take place. For these limits, it sets income thresholds of $250,000 (singles), $275,000 (heads of households) and $300,000 (married filing jointly).

On the long-term capital gains front, ATRA makes permanent the 2012 rates of 0% and 15%. But, beginning in 2013, taxpayers with taxable income that exceeds $400,000 (singles), $425,000 (heads of households) or $450,000 (married filing jointly) will face the pre-2001-tax-law long-term gains rate of 20%.

The act also makes permanent long-term capital gains treatment for qualified dividends. This means, however, that taxpayers with taxable incomes exceeding the applicable income thresholds may face a rate increase from 15% to 20% on qualified dividends. But they'll avoid the significantly larger increase that would have applied if such dividends had been allowed to return to being taxed at ordinary-income rates, as had been scheduled for 2013.

ATRA also makes some changes that will affect taxpayers' 2012 tax bills: It revives AMT relief, making it not only permanent, but retroactive to Jan. 1, 2012. Without such relief, many more taxpayers could have found themselves owing AMT when they filed their 2012 tax returns.

Finally, the act extends (also in some cases retroactively to Jan. 1, 2012) various other tax breaks for individuals, such as:

- The deduction for state and local *sales* tax in lieu of state and local *income* tax,
- Various child- and education-related credits and deductions, and
- The ability of taxpayers age 70½ or older to make a direct tax-free rollover from an IRA to charity.

Extensions of certain home and energy-related breaks may also benefit individual taxpayers.

Estate taxes

Under ATRA, estate taxes also will increase somewhat in 2013, but not as much as they would have without the legislation. For 2013 and future years, the top estate tax rate will be 40%. This is a five percentage point increase over the 2012 rate, but significantly less than the 55% rate that was scheduled to return for 2013.

The estate tax exemption will continue to be an annually inflation-adjusted $5 million, so for 2013 it will likely increase slightly from the $5.12 million 2012 exemption. This will provide significant tax savings over the $1 million exemption that had been scheduled to return for 2013.

Businesses

If your business is a partnership, limited liability company or S corporation, the income tax law changes discussed here may have a major impact on your business. But whether it's a flow-through entity or C corporation, it could benefit from the extension of various tax breaks for businesses, such as:

- Bonus depreciation,
- Enhanced Section 179 expensing,
- Accelerated depreciation for qualified leasehold, retail and restaurant improvements,
- The Work Opportunity credit, and
- The research and development credit.

Extensions of certain energy-related breaks may also benefit businesses.

How will you be affected?

We've provided only a broad overview of the tax impact of the fiscal cliff deal. The act includes other provisions that may affect you or your business.

It's also important to keep in mind some other tax increases going into effect in 2013, namely the additional 0.9% Medicare tax on wages exceeding certain levels and the new 3.8% Medicare tax on some or all net investment income if modified adjusted gross income exceeds certain levels. This could have a major impact on your 2013 tax liability.

If you have questions about how the various tax law changes may affect your situation, please contact us.

COUNTING DOWN THE DAYS TO OUR NEW NYC HEADQUARTERS

Marks Paneth & Shron is delighted to announce the opening of our new midtown Manhattan headquarters. Effective January 21, 2013, our new address will be:

685 Third Avenue
New York, NY 10017

Our telephone, fax and emails will all remain the same.

We look forward to serving you from our new state-of-the-art offices.

MP&S TAX PLANING GUIDE

To facilitate ongoing access to the latest tax rules and regulations, MP&S offers an online tax guide that is updated on an ongoing basis.

FOR MORE INFORMATION

If you have questions about anything you read in this Alert or in the MP&S tax guide, please contact a MP&S tax advisor or Steven Eliach, JD, LLM, the Principal-in-Charge of the MP&S Tax Practice, by phone at 212.503.6388 or by email at seliach@markspaneth.com.

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