Law Offices of
JOHN M. CLYNE, JR.
A Professional Association

John M. Clyne, Jr.
Admitted NJ Bar; C.P.A.
LL.M. in Taxation
Jclyne@clynelaw.com

Daniel M. Brownstein
Admitted NJ and PA Bars; C.P.A.
Dbrownstein@clynelaw.com

Regina Garrido
Admitted NJ and NY Bars; C.P.A.
Rgarrido@clynelaw.com

8 Ridgedale Avenue
Cedar Knolls, NJ 07927
Phone: (973) 993-9767
Facsimile: (973) 993-0848

SUMMIT OFFICE:
490 Morris Avenue
Summit, NJ 07901
Phone: (908) 598-8888
Please Reply to Cedar Knolls

Joseph D. Sullivan
Of Counsel
Admitted NJ and NY Bars
josephd.sullivan@att.net

July, 2012

Re: The Affordable Care Act and New Tax Rates

Dear Clients and Friends and Colleagues:

On June 28, 2012, the U.S. Supreme Court ruled that the mandate that individuals purchase health insurance is constitutional under the taxing power of Congress. While the Court's ruling placed certain limits on the expansion of Medicaid, in general, it affirmed the constitutionality of the Affordable Care Act (the "ACA" which is sometimes referred to as "Obamacare").

On the horizon, the Bush-era tax cuts - the lower tax rates in effect for most of the past decade - are scheduled to expire at the end of 2012. This January 1, 2013 tax increase event has been referred to as "Taxageddon." In general, Republicans believe that the Bush-era tax cuts should be extended for <u>all</u> taxpayers, and Democrats believe the tax cuts should be extended <u>only</u> for the middle and lower income taxpayers.

The fate of Bush-era tax cuts likely will be decided by a "lame-duck" Congress convening after the Presidential election. This will consist of the current gridlocked Congress - a Republican-led House and Democratic-led Senate - regardless of the election results. President Obama will still be in office at the end of 2012: he will have been re-elected (in which event he will likely feel newly empowered to propel his policies) or, if not re-elected, he will be a lame-duck president who, in theory, will be free to do what he thinks is right without regard to political fall out.

Given the short time frame for year-end action, the difficulty the current gridlocked Congress has had in effecting compromise, and the likely acrimonious post-election environment, a political agreement during the lame-duck session may be elusive. President Obama has said he will veto any further extension of the Bush-era tax cuts for upper income families. The President and the Republicans will need to produce a compromise that raises taxes on some Americans or watch the Bush-era tax cuts expire for all Americans. Under either scenario, "affluent" taxpayers will likely face higher taxes in 2013. Not to mention the adverse impact the tax increase will have on the economy.

The tax increase story continues...To help finance the ACA which the Supreme Court held constitutional in late June, Congress approved a new tax on investment income which takes effect in 2013. Beginning next year, taxpayers whose overall income is above $250,000 will pay an additional tax of 3.8% on taxable investment income (e.g., interest, dividends, capital gains, rents, and royalties). This additional tax will <u>not</u> apply to tax-exempt municipal bond interest, nor to amounts withdrawn from qualified pension plans and IRAs. In addition, in order to help fund the ACA, there will be an additional Medicare tax equal to 0.9% on wages in excess of $250,000 on joint returns and $200,000 for single taxpayers. This will apply to employees and self-employed persons as well.

When the new tax measures to finance the ACA are added to the expiration of the Bush-era tax cuts, here is the line up of increased tax rates for 2013:

- The top tax rate on ordinary income will rise from the current 35% to 43.4%* - an increase of 24% over the current 35% tax rate.
- The top tax rate on capital gains will rise from the current 15% to 23.8% - an increase of almost 60%.
- The top tax rate on dividends will rise from 15% to 43.4%* - an increase of almost 200%.
- The estate tax exemption will decrease to $1 million from this year's $5.12 million and the top estate tax rate will rise from the current 35% to 55%.
- The Social Security Tax -- Employment compensation in excess of $250,000 on joint tax returns and $200,000 in the case of individual taxpayers will be subject to Medicare tax at the rate of 2.35% rather than the current 1.45%.

Here is the irony: neither Congress nor the President need pass any tax legislation for these new tax rates to take effect in 2013. They will happen by default. Hence, if our wonderful politicians in Washington cannot act to produce compromise, the above rates will become effective.

Depending on the expected outcome of legislation (hopefully we will know more in November), in some cases, it may behoove taxpayers to consider accelerating income into 2012 before future tax increases.

Stay tuned for further developments.

---

* These tax rates include the new 3.8% ACA funding tax on unearned income.