Fiscal Cliff

How Steep Are We Talking?

By Bill Waltz

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The Bush tax cuts – set to expire on January 1, 2013 – represent only the tip of the fiscal iceberg before Congress. Unfortunately, considerable political attention is being focused on just that top category – the highest individual tax rate bracket. What's actually at stake is of much, much more fiscal significance and can be divided into two parts: "Taxmageddon," a nearly $500 billion per year increase in taxes starting day one of the New Year; and federal spending cuts totaling more than $100 billion.

The table below outlines the variety of tax and fiscal matters that will require congressional action before the end of 2012.

To illustrate the scope of the potential dilemma: The so-called Buffet Rule to tax millionaires at a minimum effective rate of 30% would generate a relatively minuscule $5 billion annually. That number pales in comparison to the dollars involved with any one of the issues outlined. Examples: The payroll tax holiday costs $117 billion, the sequestration is $110 billion and another Alternative Minimum Tax (AMT) patch is $92 billion, while the extenders account for $78 billion. Or compare that potential $5 billion in new revenue to the amount of tax that simply goes uncollected each year – estimated by the U.S. Treasury to be $450 billion.

Many economists fear Taxmageddon alone would plunge the nation into another recession. Yet politicians continue to fight over philosophy, thus ignoring the big (dollar) picture that could have so much impact. The issues are many, the dollars are huge and the time is short. Little is likely to get done before the election. This leaves only a limited number of weeks in November and December for a lame duck Congress to resolve a collection of massive fiscal issues that have been stymied by the Washington gridlock for over two years. On the positive side, these are not new problems. They have been debated many times and a lot has been hashed out previously.

On the negative side, persistent disagreements remain. These are all politically sensitive matters, with middle grounds elusive and few details considered minor. It will entail much debate, necessarily involve negotiation and maybe even require

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Fiscal Issues Congress Needs to Address

The Bush Tax Cuts	Expire, revert back to higher rates at year's end	Current rates of 10, 15, 25, 28, 33 and 35% go back up to 15, 28, 31, 36 and 39.6%
Alternative Minimum Tax (AMT)	No patch in place for this tax year (2012)	Some 30 million taxpayers will pay more unless exemption amount is adjusted for inflation
Capital Gains	Revert back to higher rate at year's end	Current rate of 15% goes back up to 20%
Qualified Dividends	Special rate expires	Current rate of 15% goes away, will be taxed at ordinary income rates
Estate, Gift Taxes	Revert back to higher rates and lower exclusion	Current maximum rate of 35% with $5M exclusion goes back up to 55% with only $1M exclusion
Extenders/Numerous Other Tax Provisions	Some 80 changes to deductions, credits and exclusions expire	Business examples: research and experimentation credit, § 179 enhancement of the deduction for equipment. Individual examples: marriage penalty relief, child care, earned income credit
The "Doc Fix"	No extension in place	Medicare reimbursements to physicians will drop 27%
Federal Budget	No 2013 budget or appropriations bills have passed*	Poses the threat of government shutdowns
Sequestration	The Budget Control Act of 2011 goes into effect	Will cause indiscriminant 10% cuts to defense and 8% for other non-discretionary spending
Payroll Tax Cut/Holiday	Terminates at year's end	Rates will go back up by 2%
Unemployment Insurance	Extended benefits end 1/1/13	Long-term benefits scaled back when temporary benefits end
Debt Ceiling Limit	Will have to be raised by year's end (or very early next year)	Jeopardizes credit rating and unnerves stock market
Affordable Health Care Act Taxes	Go into effect next year	Imposes 0.9% Medicare tax on high income individuals and a 3.8% Medicare contribution tax on unearned income; also a substantial new tax on medical device manufacturers

*July 31 announcement that current funding woudl be extended six months past September 30 funding expiration

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some (dare I use the word) compromise. Can some kind of "grand bargain" be struck, or will they drive us off the fiscal cliff?

Although there are differences in viewpoint, philosophy and principle, there is a bipartisan recognition that these items must be addressed. And there is even some level of consensus on many of them. Sadly, the most probable result is that Washington policy leaders will take the approach that has been applied too many times already and choose to kick the can down the road by passing more temporary measures. But in this case that would still be far better than their other favorite practice – doing nothing. Perhaps by buying some time this go-around, policy makers can set the stage for making broad, comprehensive reforms next year. Eventually, they must take that step if they hope to avoid an even more treacherous and bigger fiscal cliff that looms somewhere on the horizon.

INFORMATION LINK

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