The "Fiscal Cliff" Legislation

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The Senate passed a compromise bill, the American Taxpayer Relief Act of 2012, to avert the fiscal cliff at about 2 a.m. January 1, 2013, by an overwhelming 89-8 vote. The deal was brokered by Vice President Biden and Minority Leader Mitch McConnell. After speculation throughout New Year's Day on whether Speaker Boehner would bring the bill to a vote or if House Republicans would pass the bill with amendments that would likely be unpalatable to the Senate, the House eventually supported the bill with a 257-167 vote at 10:45 p.m. President Obama signed the bill on January 2, 2013.

Key Features of the Act

The bill addresses many of the outstanding fiscal cliff concerns, including the Bush era tax rates, estate and gift tax rates, Medicare reimbursement, and the sequester, among numerous other issues.

Tax rate changes. The bill will permanently extend current tax rates for individuals earning less than $400,000 and couples earning less than $450,000. Tax rates will revert to the Clinton-era rate of 39.6% (up from 35%) for those making more than $400,000. The higher rate will only be applied on the income above $400,000 for individuals and $450,000 for families. Wealthy taxpayers will experience an increase in the tax rate from 15% to 20% on capital gains and dividends. Married couples earning more than $300,000 and individuals earning at least $250,000 will face a phase-out of the personal exemption.

Estate tax. The estate tax exemption will remain the same as in 2012 but will be adjusted for inflation. The estate tax exemption for 2013 will be $5.25 million per person. Effective January 1, 2013, the top estate tax rate will increase from 35% to 40%. These rates and exemption levels are permanently extended. Portability is also extended and the gift tax exemption was adjusted for inflation and will be $5.25 million.

Payroll tax. The payroll tax holiday will not be extended for another year. Since 2011, the payroll tax rate, which funds Social Security, was 4.2%. The payroll tax rate will now revert to the pre-2011 level of 6.2%.

"Doc fix." There is a one-year "doc fix" included in the bill. This "doc fix" prevents the scheduled 27% reimbursement cuts to Medicare physicians. The "doc fix" will not be paid through cuts to the Affordable Care Act or by beneficiaries.

Older American funding. The fiscal cliff deal also provided older Americans added security by increasing funding for important Older Americans Act and other aging programs. For FY 2013, Area Agencies on Aging received $7.5 million in additional funds and Aging and Disability Resource Centers received an additional $5 million. The National Center for Benefits and Outreach Enrollment will also see a $5 million increase in funding for FY 2013. Medicare State Health Insurance Programs will receive $7.5 million in additional funding for FY 2013.

Sequestration. The bill addressed sequestration and delayed the automatic spending cuts by two months until March 1, 2013. The cost of continuing current spending levels will be paid equally through tax revenue increases and later spending cuts. The bill reduces the total amount of the sequester by $24 billion from $1.2 trillion to $1.176 trillion. If the sequester takes effect in FY 2013, total cuts will equal $85.33 billon next year instead of $109 billion due to the $24 billion reduction. Half of the $85.33 billion ($42.67 billion) in cuts would come from defense spending and the other half would come from nondefense spending.

CLASS Act repeal. Also included in the bill are the repeal of the CLASS Act and the establishment of a Commission on Long-Term Care. It is reported that President Obama agreed to repeal the CLASS program in exchange for Republicans agreeing to raise the tax rates on the wealthiest Americans. Many believe that CLASS would not have been implemented until a large Democratic majority in both chambers of the Congress could modify its structure and funding formula.

Commission on Long-Term Care. The Commission on Long-Term Care will "develop a plan for the establishment, implementation, and financing of a comprehensive, coordinated, and high-quality system that ensures the availability of long-term services and supports." The commission will investigate the interaction between Medicare, Medicaid, and private long-term care insurance. The commission should account for demographic changes and trends in order to improve the delivery system for long-term services and supports. The commission will consist of 15 members with the President, Senate Majority Leader, Senate Minority Leader, Speaker of the House, and House Minority Leader each appointing 3 members. Members will represent the interests of consumers, older adults, family caregivers, health care workers, private long-term care insurers, State insurance departments, and state Medicaid agencies.

Additional items. Additionally included in the bill are various tax extensions, including the deduction of state and local general sales taxes, the above-the-line deduction for qualified tuition, the research credit, and the credit for energy-efficient appliances. The federal unemployment benefits would be extended for a year without a budget offset elsewhere. The extended benefit provisions and the funding for reemployment services and reemployment and eligibility assessment activities are extended as well. The bill also extends Medicare programs of importance to older Americans, including the payment for outpatient therapy services and specialized Medicare Advantage plans for special needs individuals. The bill also extends the qualifying individual (QI) program. The bill included a one year extension of agricultural programs and a provision that would prevent members of Congress from receiving a cost of living adjustment.

Future Challenges

Although this bill addresses important issues such as the Bush-era tax cut expiration, it fails to provide a permanent solution to the sequester and does not resolve the debt limit debate. The United States reached the debt ceiling, or the legal borrowing limit, on Monday, December 31. The debt issuance suspension period will last through February 28, 2013. Congress will quickly be faced with the challenge of raising the debt ceiling. Almost immediately after the debt ceiling debate, Congress will have to address a more permanent answer to sequestration and will also be faced with funding the federal government after the Continuing Resolution expires on March 27, 2013.

Deficit reduction will remain a constant issue well into the 113th Congress. Congress will likely engage in tax system reform conversations, including non-retirement accounts, exemptions, tax code "loopholes" and charitable tax deductions. Entitlement reform will also be a major challenge for the 113th Congress with the Medicaid and Medicare programs facing increased scrutiny due to the mounting pressure to decrease the federal deficit and curb spending. Many of the same proposals that were a part of the National Commission on Fiscal Responsibility and Reform (Simpson/Bowles), Representative Paul Ryan's budget proposal, and other deficit reduction proposals will be a part of the discussion again this year.

January 3, 2013