WNTS Insight

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Fiscal cliff differences remain unresolved as 2012 year-end approaches

In brief

Congress is set to recess for Christmas without a "fiscal cliff" agreement to avoid scheduled tax increases and spending reductions that will take effect in 2013. Prospects are uncertain for reaching by year-end a compromise addressing the expiration of 2001 and 2003 tax rates and several other year-end issues that would resolve differences in current proposals offered by President Barack Obama and House Speaker John Boehner (R-OH). If no action is taken in coming days by President Obama and the current Congress, the 113th Congress will be sworn into office on January 3, 2013, and debate over resolving fiscal cliff tax and spending differences likely will be the first order of business for the new Congress.

Speaker Boehner last night announced that there were insufficient votes among his members for a "Plan B" proposal House Republican leaders had expected to pass on a party-line basis. Scheduled action was cancelled on a bill (H.J. Res. 66, as amended) that would make permanent 2001 and 2003 tax rates for incomes below $1 million. Under that bill, the current 35-percent top income tax rate would increase in 2013 to 39.6 percent for incomes of $1 million and above, and the top rate for capital gain and qualified dividend income would increase to 20 percent for individuals with incomes of $1 million and above.

The "Plan B" bill also would make permanent the estate tax with a 35-percent rate and $5.12 million exemption amount (indexed for inflation). In addition, the bill would provide permanent individual AMT tax relief, by indexing for inflation 2012 AMT exemption amounts that would be set at $50,600 for single filers ($78,750 for joint returns). Finally, the withdrawn bill would provide a permanent indexed increase in section 179 expensing to $250,000, with a $800,000 threshold limit. The Joint Committee on Taxation staff has estimated that the House measure would reduce federal revenues by $4.1 trillion over 10 years.

The "Plan B" bill did not address business and individual "tax extenders," including the research credit and the individual deduction for State sales taxes, that expired at the end of 2011, and others that are set to expire at the end of 2012.

The White House had announced that President Obama would veto the bill before it was withdrawn by Speaker Boehner. Senate Majority Leader Harry Reid (D-NV) yesterday stated that the Senate would not consider the proposal if it passed the House, and House Minority Leader Nancy Pelosi (D-CA) announced that no House Democrats were expected to support the House Republican leadership's bill.

The Senate is scheduled to meet on December 27 after a short Christmas recess, and House leaders have indicated that members in that chamber could return with 48-hour notice as warranted. House Majority Leader Eric Cantor (R-VA) has stated that the House will not adjourn this year until an agreement has been reached on fiscal cliff issues.

Actions to think about

In light of the increased likelihood that individual tax rates will increase in 2013 at some income level, many individuals and pass-through businesses are putting themselves into position to be able to accelerate income into this year. As discussed below, the most recent reports suggest that any potential limitations on individual itemized deductions, including deductions for charitable donations, could be delayed until Congress considers tax reform legislation next year.

There is a significant risk that Congress will fail to enact an extension of expired and expiring business tax provisions that could be signed into law by President Obama by December 31. Publicly traded corporations may want to consider the financial statement effect of the lack of action on the research credit, CFC look-through, active financing, and other business tax provisions before the end of the current calendar year.

Update on recent fiscal cliff proposals

President Obama and Speaker Boehner over the past few weeks have been exchanging offers and counter-offers to resolve differences over how to increase revenues and decrease spending as part of a general federal deficit reduction agreement that could be passed by Congress and signed by the President.

President Obama's most recent deficit reduction proposal calls for revenue increases totalling $1.2 trillion over 10 years, down from the $1.6 trillion level originally proposed, and $1.2 trillion in spending reductions (including roughly $290 billion in interest savings on the federal debt). It has been reported that the Administration continues to request $50 billion in stimulus spending and an extension of expanded federal unemployment benefits, but has dropped a proposal to extend a temporary reduction in the employee share of the federal payroll tax that is set to expire on December 31, 2012.

Speaker Boehner reportedly has proposed revenue increases totalling $1 trillion over 10 years, up from the $800 billion revenue increase to be achieved through tax reform that was offered on December 10. Speaker Boehner also has proposed $1.4 trillion in spending reductions (excluding interest savings).

The most recent proposal by President Obama and counter-proposal by Speaker Boehner reportedly would increase the top tax rates for ordinary income and investment income from capital gains and qualified dividend income, but differences remain over what level of income would be subject to higher rates.

President Obama generally is proposing that higher rates would apply at incomes above $400,000, while Speaker Boehner reportedly offered to increase rates for incomes above $1 million, as reflected in the House-approved bill.

If no action is taken before the end of 2012, current law would provide for a top rate of 39.6 percent on ordinary income, the top capital gains tax rate would revert 20 percent, and dividends again would be taxed as ordinary income. For 2013, the top tax bracket of 39.6 percent under current law would begin at $398,350 for single and joint filers. Higher rates also would apply in 2013 at lower income levels, but all parties involved in the talks have proposed to extend current tax rates at least for incomes below $250,000.

It has been reported that roughly $500 billion of the increased revenue offered by Speaker Boehner would be achieved through tax reform in 2013. President Obama reportedly has proposed that if Congress failed to enact tax reform legislation next year, then this increased revenue could be triggered automatically by limiting at the 28-percent bracket the value of itemized deductions and certain income exclusions, effective in 2014.

There were reports that President Obama's most recent offer proposed a permanent indexing of AMT relief (similar to the provision in the House bill), along with a permanent extension of the research credit and of some but not all temporary business and individual tax provisions.

Finally, President Obama and Speaker Boehner continue to disagree on how Congress should address the federal debt limit. President Obama has proposed that he receive debt limit increase authority subject to Congressional disapproval for two years (through the end of 2014), and Speaker Boehner reportedly had offered a one year debt limit increase. The Treasury Department has indicated that the current $16.394 trillion debt limit will be reached by the end of 2012, but Treasury officials have indicated they can use "extraordinary measures" to meet the government's debt obligations through at least February 2013.

Both the House and Senate during the summer approved differing individual tax rate bills generally along party-lines. The Democratic-led Senate on July 25 voted 51 to 48 to approve the "Middle Class Tax Cut Act of 2012" (S. 3412), which generally would extend for one year current individual tax rates for individuals with adjusted gross income (AGI) below $200,000 ($250,000 for joint filers). The Republican-controlled House on August 1 voted 256 to 171 to approve the "Job Protection and Recession Prevention Act of 2012" (H.R. 8), which would extend for one year 2001 and 2003 tax provisions for individuals at all income levels.

Let's talk

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