Waterman & Associates GOVERNMENT RELATIONS

MEMORANDUM

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CC: Jim Wiltshire, Deputy Director, CSAC

DATE: January 2, 2013

SUBJECT: Summary of Fiscal Cliff Legislation - HR 8

In one of its final official acts, the 112th Congress approved early in the new year legislation that will keep the nation's economy from falling off the "fiscal cliff." The centerpiece of the bill, entitled the *American Taxpayer Relief Act* (HR 8), is a permanent extension of most of the Bush-era tax rates. The measure also will delay by two months the *Budget Control Act's* (BCA) across-the-board spending cuts, known as sequestration, which were originally scheduled to commence on January 2.

The eleventh-hour deal was reached after House Speaker John Boehner (R-OH) withdrew from the negotiations, leaving it to Senate leaders and Vice President Joe Biden to construct a final compromise. The resulting bill was approved in the Senate on an 89-8 vote in the early morning hours of January 1.

For its part, the House convened a rare New Year's day session in which GOP leaders discussed the possibility of amending the Senate package due to dissatisfaction within the Republican conference over the scope of the measure's tax and spending cuts. However, after failing to garner sufficient support for an alternative that would have called for targeted domestic spending cuts to offset the impending sequestration, the House approved HR 8 on a 257-167 margin, with 172 Democrats joining 85 Republicans in voting for the package.

In addition to major tax-related provisions, the fiscal cliff bill also provided for a number of other key changes to federal law, including an extension of the 2008 farm bill through the end of the current fiscal year (September 30, 2013). To the disappointment of House and Senate Agriculture Committee leaders, the bill does not fund energy provisions or other expired programs that were a part of the 2008 law. Accordingly, committee leaders consider the measure a "partial extension" of the previous farm bill.

Additionally, the bill includes an extension of emergency unemployment insurance (UI) benefits for two million individuals. Under HR 8, UI benefits will be extended in January for one additional year.

The legislation also includes a so-called Medicare "doc-fix," which avoids a 27 percent cut to reimbursements for doctors seeing Medicare patients for 2013. Under the bill, the cost of avoiding the reductions is offset by adjustments to a number of other payments made to Medicare providers, many of which have been used to pay for previous patches.

With regard to budget sequestration, the BCA's across-the-board cuts will be delayed for two months, until March 1, 2013. In order to pay for the two-month deferral - the cost of which is roughly $24 billion - the White House and congressional leaders agreed to a combination of new revenue and alternative spending cuts.

Under HR 8, half of the $24 billion in needed offsets will be realized by reducing the fiscal year 2013 and 2014 discretionary spending caps in the BCA. The $12 billion in spending cuts will be divided evenly between defense and non-defense programs.

The remaining $12 billion in offsets will come from new revenue generated from a change in law that will make it easier for owners of certain tax-deferred retirement plans to switch to Roth IRAs. Under the legislation, 401(k)s, 403(b)s, 457(b) plans offered by state or local governments, and federal thrift savings plans could be converted to a Roth IRA at anytime (not just during certain events such as changing jobs or retirement), which will generate additional revenue when taxes are paid on contributions to a Roth account.

With regard to tax relief, the fiscal cliff deal will protect millions of middle-class taxpayers from rate increases that were set to take effect later this month. Specifically, the legislation permanently extends tax provisions enacted in the 2001 and 2003 tax laws (PL 107-16 and PL 108-27) for taxable income levels of up to $400,000 for individuals, $425,000 for heads of households, and $450,000 for families. The legislation allows income tax rates, as well as capital gains and dividend tax rates, to rise on taxable income over those levels.

It should be noted that the legislation permanently extends the current 10, 25, 28, and 33 percent tax brackets, as well as the current 35 percent bracket - but only for taxable income that does not exceed the new threshold. Taxable income in excess of those levels will be taxed at the top 39.6 percent rate for income levels up from 35 percent.

The legislation also includes a number of provisions that will provide beneficial tax treatment to energy companies, with the renewable and fossil fuel industries viewed as big winners under the fiscal cliff deal. For example, the wind production tax credit was extended through 2013, with biofuels and other alternative fuels receiving retroactive extensions of credits that expired in 2011.

Notably, the bill does not extend the two-percentage-point reduction in worker's Social Security payroll tax that has been in effect for the past two years. Accordingly, employees will have more withheld from their paychecks beginning in January of 2013.

The legislation also does not include provisions to raise the debt ceiling, despite the fact that the country hit its debt limit on December 31. Although the Treasury Department is taking emergency measures to ensure that the nation does not default on its financial obligations, Congress will need to raise the debt ceiling by late February or early March.

To follow are other key tax-related provisions of HR 8:

Permanent and Temporary Tax Provisions

- Permanently repeals the Personal Exemption Phaseout (PEP) on income at or below $250,000 (individual filers), $275,000 (heads of households) and $300,000 (married filing jointly). Personal exemptions allow a certain amount per person to be exempt from tax.

- Permanently repeals the itemized deduction limitation on income at or below $250,000 (individual filers), $275,000 (heads of households) and $300,000 (married filing jointly).

- Permanently extends the capital gains and dividend rates on income at or below $400,000 (individual filers), $425,000 (heads of households) and $450,000 (married filing jointly). For income in excess of $400,000 (individual filers), $425,000 (heads of households) and $450,000 (married filing jointly), the rate for both capital gains and dividends will be 20 percent.

- Permanently extends marriage penalty relief for the standard deduction, the 15 percent bracket, and the Earned Income Tax Credit (EITC).

- Permanently extends the expanded dependent care credit, which provides a taxpayer credit for an applicable percentage of child care expenses for children under 13 and disabled dependents.

- Permanently extends the increased adoption tax credit and the adoption assistance programs exclusion.

- Permanently extends the credit for employer expenses for child care assistance, whereby employers are provided with a credit of up to $150,000 for acquiring, rehabilitating, or expanding property which is used for a child care facility.

- Permanently extends the 2001 modifications to the child tax credit, which generally allows taxpayers with incomes below a certain threshold to claim the child tax credit to reduce federal income tax for each qualifying child under the age of 17.

- Extends through 2017 modifications to the child tax credit so that earnings above $3,000 count towards refundability.

- Temporarily extends the third-child EITC. Under current law, working families with two or more children qualify for an EITC equal to 40 percent of the family's first $12,570 of earned income. HR 8 extends through 2017 provisions that increase the EITC to 45 percent for families with three or more children.

- Permanent Alternative Minimum Tax (AMT) patch. HR 8 prevents tens of millions of taxpayers from being subject to the AMT, which was created by the Tax Reform Act of 1986 to prevent higher-income taxpayers from using credits and deductions to completely offset their federal income tax liability. HR 8 increases the exemption amounts for 2012 to $50,600 (previously $33,750 for individuals) and $78,750 (previously $45,000 for married filing jointly) and adjusts those amounts yearly for inflation.

- Permanent increase in estate tax. The legislation increases tax rates to 40 percent from 35 percent on the value of estates over $5 million.

Tax Extenders and Key Business Tax Provisions

- Deduction for state and local general sales taxes. The bill extends for two years the option to take an itemized deduction for State and local sales taxes in lieu of the itemized deduction permitted for State and local income taxes.

- Temporary extension of tax-free benefits for transit and parking. HR 8 extends through 2013 a provision of the economic stimulus law that increases the monthly exclusion for employer-provided transit and vanpool benefits from $125 to $240 (the provision ensures that the benefits would be the same as the exclusion for employer-provided parking benefits).

- Mortgage Debt Relief. Under HR 8, up to $2 million of forgiven mortgage debt is eligible to be excluded from income ($1 million if married filing separately) through tax year 2013. This provision was created in the Mortgage Debt Relief Act of 2007 to prevent the taxation of so-called “shadow income” from foreclosures.

- Contributions of capital gain real property made for conservation purposes. The bill extends for two years the increased contribution limits and carryforward period for contributions of appreciated real property (including partial interests in real property) for conservation purposes.

- Temporary extension of above-the-line deduction for qualified tuition related expenses. HR 8 extends through 2013 the "above-the-line" tax deduction for qualified higher education expenses. The maximum deduction is $4,000 for taxpayers with adjusted gross income (AGI) of $65,000 or less ($130,000 for joint returns) or $2,000 for taxpayers with AGI of $80,000 or less ($160,000 for joint returns).

- Tax-free distributions from individual retirement plan for charitable purposes. The bill extends for two years a rule that allows those age 70-and-a-half or older to make up to $100,000 in tax-free distributions to charities from their individual retirement accounts.

- Empowerment zone tax incentives. HR 8 extends for two years the designation of certain economically depressed census tracts as Empowerment Zones, which allows individuals and business within the zones to be eligible for special tax incentives.

- Temporary Credit Rate Freeze for Low-Income Housing Tax Credit Program. The temporary minimum low-income housing tax credit rate of nine percent for non-federally subsidized new buildings is extended for one year.

- Temporary extension of the New Markets Tax Credit (NMTC). HR 8 extends for two years the NMTC, which is provided to businesses that make certain investments in community development entities. Under the bill, a maximum annual amount of qualified equity investments of $3.5 billion is allowed.

- The work opportunity tax credit (WOTC) is extended for two years. The provision allows businesses to claim a WOTC equal to 40 percent of the first $6,000 of wages paid to new hires of certain targeted groups, including but not limited to members of families receiving TANF benefits, food stamps, and SSI payments.

- Qualified zone academy bond (QZAB) tax credit program. QZABs, which can be used to finance renovations, equipment purchases, and training teachers and personnel at a qualified zone academy, are extended through 2013, providing $400 million in bond volume per year.

- Treatment of military basic housing allowances under low-income housing credit. HR 8 continues for two years the practice of allowing a member of the military's basic housing allowance not to be considered income for purposes of calculating whether the individual qualifies as a low-income tenant for the low income housing tax credit program.

- Returning Heroes and Wounded Warriors WOTC. HR 8 allows businesses to claim for an additional year a work WOTC for hiring qualified veterans in certain targeted groups, such as veterans who receive SNAP benefits, disabled veterans, and both short and long-term unemployed veterans.

- Indian employment tax credit. The bill extends through 2013 the business tax credit for employers of qualified employees who work and live on or near an Indian reservation.

We hope this information is useful to you. Please do not hesitate to contact us if you have any questions or if you need any additional information.