The "Fiscal Cliff" and the American Taxpayer Relief Act of 2012

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Summary

The federal budget deficit has exceeded $1 trillion in each of the last four fiscal years (FY2009-FY2012). Concern over these large deficits, as well as the long-term trajectory of the federal budget, resulted in significant debate during the 112th Congress over how to achieve meaningful deficit reduction and how to implement a plan to stabilize the federal debt. Numerous expiring provisions, across-the-board spending cuts, and other short-term considerations having a major budgetary impact, were scheduled to take effect at the very end of 2012 or in early 2013. This combination of policies, estimated by CBO to reduce the deficit by $502 billion between FY2012 and FY2013, was referred to by some as the "fiscal cliff." Had these policies taken effect, CBO projected that the economy would have returned to recession in FY2013.

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (ATRA; H.R. 8 as enacted), which addressed many of these tax and spending policies. As Congress changed the trajectory of these policies by increasing spending and decreasing revenue, these policies have increased the deficit relative to the current law baseline. The provisions of ATRA were estimated by CBO to increase the budget deficit by $330 billion in FY2013 and nearly $4 trillion over the FY2013-FY2022 period.

ATRA addressed several revenue provisions that had been set to expire at the end of 2012. These included the "Bush-era tax cuts," provisions related to the estate tax, certain tax provisions enacted or expanded as part of the American Recovery and Reinvestment Act of 2009, the Alternative Minimum Tax (AMT), and a number of temporary tax provisions (also known as "tax extenders"). ATRA permanently extended a modified version of the "Bush-era tax cuts" and the estate tax, as well as a permanent AMT patch. The law also temporarily extended the ARRA tax provisions and a variety of "tax extenders." ATRA did not extend the two-percentage-point reduction in the Social Security payroll tax, which expired at the end of 2012, or delay the Affordable Care Act (ACA) taxes on higher-income tax filers, which are scheduled to take effect in 2013. Combined, these provisions were estimated by CBO and JCT to increase the deficit by $280 billion in FY2013 and $3.93 trillion over the FY2013-FY2022 period.

In addition to these revenue provisions, ATRA also addressed several spending policies that were scheduled to reduce spending beginning in FY2013. It extended the federal share of extended benefit payments for unemployment and postponed the expiration of the authorization for temporary emergency unemployment benefits through 2013. It delayed a reduction in payments to Medicare physicians under the Sustainable Growth Rate (SGR) system through 2013. It eliminated the first two months of the automatic spending cuts enacted as part of the Budget Control Act of 2011 (BCA; P.L. 112-25), postponing their onset from January 2 to March 1. It extended the 2008 farm bill through 2013. These provisions, some of which were offset, were estimated by CBO to increase the deficit by $48 billion in FY2013 and $34 billion over the FY2013-FY2022 period.

Despite the enactment of ATRA, many policy issues affecting the federal budget remain unresolved. Specifically, in early 2013, Congress will likely consider a debt limit increase, additional actions related to the postponed BCA automatic spending reductions, and appropriations for the final six months of FY2013. Finally, long-term fiscal sustainability issues remain unresolved.

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In the context of large budget deficits, Congress was faced with a variety of policies that were set to reduce spending and increase revenues at the end of 2012, referred to by some as the "fiscal cliff." Had these policies taken effect, CBO projected that the ensuing fiscal contraction would have resulted in a recession in 2013.

On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 (ATRA; H.R. 8 as enacted), which prevented many—but not all—of the fiscal cliff policies from going into effect. Budget issues are likely to continue into the 113th Congress surrounding two issues that the ATRA did not resolve. First, financing of the federal budget for the last six months of the fiscal year is unresolved because of uncertainties associated with the debt limit and appropriations. More specifically, the continuing resolution to fund the federal government, enacted in September, runs out at the end of March and current fiscal policy would require an increase to the debt limit in early 2013 to meet existing obligations. Second, the federal debt remains on an unsustainable path in the long-term because of the imbalance between spending and revenues.[1]

This report provides a brief overview of the major tax and spending policies that comprised the "fiscal cliff." It discusses how the provisions of ATRA did and did not address these policies and provides information on additional budget-related considerations for the 113th Congress.

Overview of Budget Deficit Issues Surrounding the "Fiscal Cliff"

A variety of revenue and spending provisions had been set to expire around the end of calendar year 2012. These included the "Bush-era tax cuts" and other related tax provisions,[2] extended emergency unemployment benefits, the Social Security payroll tax reduction, the "doc fix," other tax extenders[3], and the farm bill. Had Congress and the President allowed all of these measures to expire as scheduled and let the spending cuts under the Budget Control Act of 2011 (BCA) take effect (see discussion below), the budget deficits beginning in FY2013 would gradually have fallen as a percentage of gross domestic product (GDP) reaching sustainable levels between FY2014 and FY2022.[4] However, as a result the extension of certain revenue policies and the postponement of certain spending reductions under ATRA, budget deficits may rise to levels over

[1] For more information, see CRS Report R40770, *The Sustainability of the Federal Budget Deficit: Market Confidence and Economic Effects*, by Marc Labonte.

[2] Collectively, the Bush-era tax cuts reduced income taxes by reducing tax rates, reduced the marriage penalty, repealed limitations on personal exemptions and itemized deductions (PEP and Pease, respectively), expanded refundable credits, and modified education tax incentives. The Bush-era tax cuts also reduced tax rates on investment income and reduced estate tax liabilities by increasing the amount of an estate exempt from taxation and by lowering the tax rate.

[3] Prior to ATRA, a number of temporary tax provisions, often referred to as "tax extenders," expired at the end of 2011.

[4] Budget deficits are considered sustainable if the budget deficit as a percentage of GDP does not exceed the growth in the economy. Generally, this implies a budget deficit of less than 3% of GDP. The budget deficit for FY2012 was 7.0% of GDP. Deficit figures from Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022*, August 2012, Table 1-1.

the next several years that will no longer be considered sustainable. (However, these levels are estimated to be lower than the levels seen over the FY2009-FY2012 period.)

Prior to the enactment of ATRA, the budget deficit was estimated to fall by $502 billion between FY2012 and FY2013.[5] As Congress changed the trajectory of these policies by increasing spending and decreasing revenue, these policies have increased the deficit relative to the baseline. Budget changes are measured by the Congressional Budget Office (CBO) relative to "current law" baseline, or the law in place at the time the legislation is being considered. Therefore, as shown in **Table 1**, the spending increases and revenue decreases in ATRA are estimated to increase the budget deficit by $330 billion in FY2013 and nearly $4 trillion over the FY2013-FY2022 period relative to current law.[6]

Table 1. Impact on the Budget Deficit of ATRA and Other "Fiscal Cliff" Policies Relative to Current Law

Increases or Decreases (-) in the Budget Deficit in FY2013 and in the FY2013-FY2022 period

	Billions of Dollars of Outlays	
Fiscal Policy Provision	**FY2013**	**FY2013-FY2022**
Revenue Policies		
Changes to Bush-era Tax Cuts, Estate and Gift Tax, and AMT Provisions[a]	207	3,852
Expiration of Payroll Tax Rate Reduction[b]	0	0
Extension of Other Expiring Tax Provisions[a]	74	76
Affordable Care Act (ACA) Taxes on High Income Filers[b]	0	0
Spending Policies		
Reduction and Postponement of Budget Control Act (BCA) Automatic Spending Cuts	14	24
Extension of Unemployment Insurance Benefits	22	30
Sustainable Growth Rate (SGR) Provisions	11	25
Extension of the Farm Bill[b]	0	0
Net Offsets		
Title VI Other Health Provisions[c]	2	-23
Title IX Roth IRA Provisions[d]	*	-12
Adjustment to Caps on Discretionary Appropriations[d]	-1	-10
Total	329	3,961

Source: Congressional Budget Office, *Estimate of the Budgetary Effects of H.R. 8, the American Taxpayer Relief Act of 2012, as passed by the Senate on January 1, 2013.*

Notes: Totals may not sum due to rounding. * indicates less than $500 million.

[5] Congressional Budget Office, *Economic Effects of Reducing the Fiscal Restraint That is Scheduled to Occur in 2013*, Table 1. These figures do not take into account any economic feedback which may further alter the impact on the deficit.

[6] These figures do not include associated debt service costs.

a. Includes outlay effects related to the refundable portion of tax credits.

b. Item was included in CBO baseline as part of prior law.

c. These provisions contain both additional health related spending as well as offsets. These offsets were intended to "pay for" the costs of the SGR provisions as well as for other purposes.

d. These provisions were intended to offset reduction and postponement of BCA cuts.

Compared to a "current policy" baseline, however, ATRA modestly reduced the deficit because it raised taxes relative to those policies that were in place at the end of 2012.[7] A current policy baseline measures changes relative to policies in place at the time legislation is being considered. For official scorekeeping purposes, policy changes are measured relative to current law.

Major Fiscal Policy Issues Addressed in ATRA

ATRA addressed several revenue provisions that had been set to expire at the end of 2012. These included the "Bush-era tax cuts," provisions related to the estate tax, certain tax provisions enacted or expanded as part of the American Recovery and Reinvestment Act of 2009, the Alternative Minimum Tax (AMT), and a number of temporary tax provisions (also known as "tax extenders"). In addition to these revenue provisions, ATRA also addressed several spending policies that were scheduled to reduce spending beginning in FY2013. These included temporary emergency unemployment benefits, payments to Medicare physicians under the Sustainable Growth Rate (SGR) system, the automatic spending cuts enacted as part of the Budget Control Act of 2011, and the 2008 farm bill.

Revenue Provisions

ATRA included a number of tax provisions that directly addressed two components of the "fiscal cliff"—the Bush-era tax cuts and other expiring tax provisions. On a permanent basis, ATRA addressed the Bush-era tax cuts, estate and gift tax, and AMT resulting in a $207 billion reduction in tax revenue in FY2013. ATRA also extended a number of expiring tax provisions resulting in a $74 billion reduction in tax revenue in FY2013.

Bush-era Tax Cuts, Estate and Gift Tax, and AMT Provisions

The Bush-era tax cuts included provisions—initially enacted as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27)[8]—which reduced income tax liabilities from 2002 to 2010. These tax cuts were extended for 2011 and 2012 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).The Bush-era tax cuts lowered income taxes in a variety of ways, including by reducing marginal tax

[7] See, for example, Office of Management and Budget, OMBlog, *American Taxpayer Relief Act Reduces Deficits by $737 Billion*, January 1, 2013, available at http://www.whitehouse.gov/blog/2013/01/01/american-taxpayer-relief-act-reduces-deficits-737-billion.

[8] Under the Bush-era tax cuts, tax rates in the top four brackets were reduced to 35%, 33%, 28%, and 25%. Under current law, these rates are scheduled to increase to 39.6%, 36%, 31%, and 28% after 2012. The Bush-era tax cuts also introduced a 10% tax bracket at the low-end of the income distribution. After 2012, the 10% bracket is scheduled to expire, with the lowest tax bracket scheduled to be 15%.

rates on ordinary income; reducing tax rates on long-term capital gains and dividends; reduced and ultimately repealed limitations for personal exemptions (PEP) and itemized deductions (Pease);[9] and expanded certain tax credits, including the Earned Income Tax Credit (EITC),[10] child tax credit,[11] adoption tax credit,[12] and dependent care tax credit.[13] The Bush-era tax cuts also contained provisions to reduce the marriage tax penalty,[14] as well as modifying and expanding various education-related tax incentives.

ATRA made a variety of changes to these tax provisions. The law *permanently* extended and in certain cases modified tax provisions originally included in EGTRRA and JGTRRA. Specifically, ATRA permanently extended the reduced tax rates on both ordinary income and capital gains and dividends for taxpayers with taxable income[15] below $400,000 ($450,000 for married taxpayers filing jointly).[16] For taxpayers with taxable income above these thresholds, the marginal tax rate on ordinary income rose from 35% to 39.6% on the portion of their income above these thresholds, and the top tax rate on long term capital gains and dividends rose from 15% to 20%. ATRA also reinstated PEP and Pease for taxpayers with adjusted gross income (AGI) above $250,000 ($300,000 for married couples filing jointly), allowing these limitations on personal exemptions and overall itemized deductions to expire for those with AGI below these thresholds. ATRA also permanently extended the tax changes to a variety of tax credits, the marriage penalty and education-related tax incentives.

The Joint Committee on Taxation estimates that the permanent extension of the modified 2001 and 2003 income tax cuts will reduce revenues by $65 billion in FY2013 and $1.53 trillion over the FY2013 to FY2022 period.[17]

For additional background information on these tax provisions, see CRS Report R42020, *The 2001 and 2003 Bush Tax Cuts and Deficit Reduction*, by Thomas L. Hungerford and CRS Report R42485, *An Overview of Tax Provisions Expiring in 2012*, by Margot L. Crandall-Hollick.

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[9] See CRS Report R41796, *Deficit Reduction: The Economic and Tax Revenue Effects of Personal Exemption Phaseout (PEP) and Limitation on Itemized Deductions (Pease)*, by Thomas L. Hungerford.

[10] See CRS Report RL31768, *The Earned Income Tax Credit (EITC): An Overview*, by Christine Scott and CRS Report RS21477, *The Earned Income Tax Credit (EITC): Legislative Issues*, by Christine Scott.

[11] See CRS Report R41935, *The Child Tax Credit: Economic Analysis and Policy Options*, by Margot L. Crandall-Hollick and CRS Report R41873, *The Child Tax Credit: Current Law and Legislative History* , by Margot L. Crandall-Hollick

[12] See CRS Report RL33633, *Tax Benefits for Families: Adoption*, by Christine Scott.

[13] See CRS Report RS21466, *Dependent Care: Current Tax Benefits and Legislative Issues*, by Christine Scott and Janemarie Mulvey.

[14] For background information on marriage tax penalties and bonuses, see CRS Report RL33755, *Federal Income Tax Treatment of the Family*, by Jane G. Gravelle.

[15] Taxable income is equal to adjusted gross income (AGI) minus personal exemptions and either the standard deduction or the sum of itemized deductions, whichever is larger.

[16] After tax year 2013, these thresholds are adjusted for inflation.

[17] These revenue loss estimates include the outlay effects of certain tax provisions. For more information, see Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. The "American Taxpayer Relief Act of 2012," as Passed by the Senate on January 1, 2013*, January 1, 2013, JCX-1-13.

Estate and Gift Tax

EGTRRA enacted provisions to phase out the estate tax[18] over a 10-year period. In 2010, there was no federal estate tax. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 temporarily reinstated, through 2012, the estate tax. As reinstated, the top rate for the estate tax was lower than it had been in 2009 (35%, as opposed to 45%). The exemption amount, as reinstated, was also higher than it had been in 2009 ($5.0 million, as opposed to $3.5 million). Absent legislative action, after 2012 the estate tax would have returned to pre-EGGTRA rules, with a top rate of 55% and a $1 million exemption level per decedent. ATRA permanently extended the estate tax rules established by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010,[19] *except for the top tax rate* which was increased from 35% to 40%. Hence, under ATRA, $5 million of a decedent's estate would be exempt from the estate tax (this threshold is indexed for inflation occurring after 2011 and was $5.12 million per decedent in 2012), and the top rate on estates over this threshold would be 40%.

The Joint Committee on Taxation estimates that the permanent extension of the estate tax as included in ATRA will reduce revenues by $334 million in FY2013 and $369 billion over the FY2013 to FY2022 period.[20]

For additional information on the estate tax, see CRS Report R41203, *Estate Tax Options*, by Jane G. Gravelle; CRS Report 95-416, *Federal Estate, Gift, and Generation-Skipping Taxes: A Description of Current Law*, by John R. Luckey; and CRS Report 95-444, *A History of Federal Estate, Gift, and Generation-Skipping Taxes*, by John R. Luckey.

Alternative Minimum Tax (AMT) Patch

The Alternative Minimum Tax (AMT) was designed to ensure that higher-income taxpayers who owed little or no taxes under the regular income tax because they could claim tax preferences would still pay some tax.[21] When calculating the AMT, taxpayers first add back various "tax preference items" (like certain deductions) to their taxable income, to determine the amount of income subject to the AMT (the "AMT tax base"). Second, taxpayers subtract a basic exemption amount from their AMT tax base. Third, a two-tiered rate structure of 26% and 28% is assessed against the AMT tax base to determine tax liability. Finally, if a taxpayer's AMT is greater than their regular tax liability, the taxpayer pays the difference in addition to their regular tax liability.

[18] The federal estate tax is a tax on the estate of a decedent, levied against and paid by the estate, as opposed to an inheritance tax which is imposed on and paid by the heirs of the decedent based upon what they receive. The federal estate tax is computed through a series of adjustments and modifications of a tax base known as the "gross estate." Certain allowable deductions reduce the gross estate to the "taxable estate," to which is then added the total of all lifetime taxable gifts made by the decedent. The tax rates are then applied. The result is the decedent's estate tax which, after reduction for certain allowable credits, is the amount of tax paid by the estate. For more information, see CRS Report 95-416, *Federal Estate, Gift, and Generation-Skipping Taxes: A Description of Current Law*, by John R. Luckey.

[19] Thus, ATRA also extends the gift tax levels of a $5.12 million ($5 million indexed for inflation after 2011) exemption and a 40% top rate. In addition, it extends portability rules related to the passing of an exemption amount onto a surviving spouse.

[20] For more information, see Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. The "American Taxpayer Relief Act of 2012," as Passed by the Senate on January 1, 2013*, January 1, 2013, JCX-1-13.

[21] For more information on the Alternative Minimum Tax, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire.

Crucially, prior to the enactment of H.R. 8, key parts of the AMT—including the exemption amount—were not indexed for inflation. This meant that additional taxpayers—an estimated 27 million in 2012—would be subject to the AMT due to the rise of their nominal income levels over time.[22] Over the past decade, Congress had regularly enacted temporary increases of the AMT exemption amount to adjust for inflation and allowed nonrefundable personal tax credits to reduce AMT tax liability (these policies are often known as the AMT "patch"). ATRA permanently adjusts the AMT exemption amount for inflation,[23] ending the need for temporary "patches," and permanently allows nonrefundable personal tax credits to offset AMT liability.

The Joint Committee on Taxation estimates that the permanent indexing of the AMT for inflation and the permanent allowance of certain personal nonrefundable tax credits against the AMT will reduce revenues by $139 billion in FY2013 and $1.816 trillion over the FY2013 to FY2022.[24]

For more information, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire.

Expiring Tax Provisions

The expiring provisions temporarily extended by ATRA can be differentiated based upon the length of their extension—with provisions originally enacted as part of the American Recovery and Reinvestment Act of 2009 being extended through the end of 2017 and other provisions (commonly referred to as tax extenders) that were extended through the end of 2013.

The American Recovery and Reinvestment Act of 2009 ("2009 Tax Cut") Tax Provisions

The American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) made modifications to two provisions of the Bush-era tax cuts and enacted two new tax provisions. Specifically, ARRA's modifications expanded the refundability of the child tax credit and further reduced the marriage penalty of the EITC. In addition, ARRA increased the EITC for families with three or more children and enacted a new higher education tax credit—the American Opportunity Tax Credit (AOTC).[25] Like the Bush-era tax cuts, the four tax law changes enacted by ARRA were

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[22] Joint Committee on Taxation, *Overview of the Federal Tax System as in Effect for 2012*, JCX-18-12, Washington, DC, February 24, 2012, p. 30. The number of additional taxpayers that would be subject to the AMT in the years beyond 2013, absent legislative action, depends on whether the provisions of EGTRAA and JGTRRA are extended. For example, in 2013, if both EGTRRA and JGTRRA are extended and the AMT indexed for inflation, a projected 4 million taxpayers will be subject to the AMT. Under current law, a projected 19.2 million taxpayers would be subject to the AMT in 2013. If, however, the provisions of EGTRRA and JGTRRA were extended, and the AMT exemption amount is not indexed for inflation, an estimated 32.7 million taxpayers would be subject to the AMT in 2013.

[23] ATRA also permanently adjusted both the exemption phaseout level for inflation and the income levels at which the 26% tax bracket ends and the 28% bracket commences for inflation occurring after 2012

[24] For more information, see Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. The "American Taxpayer Relief Act of 2012," as Passed by the Senate on January 1, 2013*, January 1, 2013, JCX-1-13.

[25] See CRS Report R42561, *The American Opportunity Tax Credit: Overview, Analysis, and Policy Options*, by Margot L. Crandall-Hollick and CRS Report R41967, *Higher Education Tax Benefits: Brief Overview and Budgetary Effects*, by Margot L. Crandall-Hollick.

also extended through the end of 2012 by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312).[26]

ATRA *temporarily* extended these four ARRA tax provisions for five years, through the end of 2017.[27] The Joint Committee on Taxation estimates that the temporary extension of these four ARRA tax provisions will reduce revenues by $3 billion in FY2013 and $134 billion over the FY2013 to FY2022 period

Tax Extenders

A number of temporary tax provisions expired at the end of 2011, and more expired at the end of 2012.[28] In August 2012, the Senate Finance Committee voted to approve a package that would have extended more than 50 expired and expiring tax provisions through 2013.[29] Among the provisions that would be extended under the Family and Business Tax Cut Certainty Act of 2012 (S. 3521; 112th Congress) were those that targeted research and development (R&D),[30] increased expensing allowances designed to encourage investment,[31] were related to the tax treatment of foreign-source income such as the active financing exception under subpart F,[32] and benefited a number of energy sources,[33] among others. Most of these temporary provisions had previously been extended as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312). Ultimately, many of these temporary expiring provisions included in S. 3521 were extended for 2012 and 2013 by ATRA.

The Joint Committee on Taxation (JCT) estimates that the temporary extension of tax extenders included in ATRA will reduce revenues by $74 billion in FY2013 and $76 billion over the FY2013 to FY2022 period.[34] Of this total 10-year cost, $12 billion of these revenue losses are attributable to the temporary extension of individual income tax extenders, $46 billion of these

[26] P.L. 111-312 also included a temporary provision to disregard tax refunds when determining eligibility for federal programs and federally assisted programs.

[27] ATRA also included a permanent extension of the provision to disregard tax refunds when determining eligibility for federal programs and federally assisted programs.

[28] For a complete list of expiring tax provisions, see U.S. Congress, Joint Committee on Taxation, *List of Expiring Federal Tax Provisions 2011 –2022*, committee print, 112th Cong., January 6, 2012, JCX-2-12, https://www.jct.gov/publications.html?func=startdown&id=4383.

[29] See the Chairman's Mark of the Family and Business and Tax Cut Certainty Act of 2012. Provisions were also included to increase the AMT exemption amount and allow personal tax credits against the AMT (see the section "Alternative Minimum Tax (AMT) Patch" above). For more information on tax extender legislation as considered in the Senate Finance Committee, see http://www.finance.senate.gov/hearings/hearing/?id=c36e29ca-5056-a032-5260-7997a539f948.

[30] See CRS Report RL31181, *Research Tax Credit: Current Law, Legislation in the 112th Congress, and Policy Issues*, by Gary Guenther.

[31] See CRS Report RL31852, *Section 179 and Bonus Depreciation Expensing Allowances: Current Law, Legislative Proposals in the 112th Congress, and Economic Effects*, by Gary Guenther.

[32] See CRS Report R41852, *U.S. International Corporate Taxation: Basic Concepts and Policy Issues*, by Mark P. Keightley.

[33] See CRS Report R41769, *Energy Tax Policy: Issues in the 112th Congress*, by Molly F. Sherlock and Margot L. Crandall-Hollick.

[34] For more information, see Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. The "American Taxpayer Relief Act of 2012," as Passed by the Senate on January 1, 2013*, January 1, 2013, JCX-1-13.

revenue losses are attributable to the temporary extension of business tax extenders and $18 billion of these revenues losses are attributable to energy tax extenders.[35]

For additional background on expired or expiring provisions, see CRS Report R42105, *Tax Provisions Expiring in 2011 and "Tax Extenders"*, by Molly F. Sherlock and CRS Report R42485, *An Overview of Tax Provisions Expiring in 2012*, by Margot L. Crandall-Hollick.

Budget Control Act of 2011 and Changes to Roth IRA Accounts

Spending cuts had been scheduled to take effect beginning on January 2, 2013 as a result of the Budget Control Act of 2011 (BCA; P.L. 112-25).[36] The BCA contained a variety of measures intended to reduce the deficit by at least $2.1 trillion over the FY2012-FY2021 period, along with a mechanism to increase the debt limit. The deficit reduction provisions included $917 billion in savings from statutory caps on discretionary spending and the establishment of a Joint Select Committee on Deficit Reduction (Joint Committee) to identify further budgetary savings of at least $1.2 trillion over 10 years. On November 21, 2011, the co-chairs of the Joint Committee announced that they were unable to reach an agreement before the committee's deadline. As a result, a $1.2 trillion automatic spending reduction process had been triggered to begin on January 2, 2013.

For FY2013, automatic across-the-board spending reductions (referred to as a sequester) amounting to $109 billion had been scheduled to take effect on January 2, 2013, with $54.7 billion being cut from defense spending and $54.7 billion cut from non-defense spending. Spending reductions of a similar amount are also scheduled to occur in each year between FY2014 and FY2021. With the passage of ATRA, the FY2013 spending reductions were reduced by $24 billion, to roughly $85 billion equally divided between defense and non-defense, and postponed for two months.[37] The modified spending reductions are now scheduled to take effect on March 1, 2013, unless changes are made as a result of the enactment of subsequent legislation. Several other minor modifications were also made to the process by which these spending cuts would be calculated.

In order to offset the cost of the changes related to the postponement and reduction of the BCA's automatic spending cuts, ATRA contains spending reductions and revenue increases. On the spending side, the BCA's FY2013 and FY2014 discretionary spending caps were reduced, which offset roughly half of the cost.[38] In addition, ATRA also contained a provision which raises revenue by permitting certain retirement accounts to be transferred to designated Roth accounts

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[35] For more information, see Joint Committee on Taxation, *Estimated Revenue Effects of the Revenue Provisions Contained in an Amendment in the Nature of a Substitute to H.R. The "American Taxpayer Relief Act of 2012," as Passed by the Senate on January 1, 2013*, January 1, 2013, JCX-1-13.

[36] See CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan.

[37] Several measures were also proposed in the 112th Congress to cancel or modify the BCA's spending reduction process. President Obama has also offered his own proposal as part of his FY2013 budget. For more information, see CRS Report R42675, *The Budget Control Act of 2011: Budgetary Effects of Proposals to Replace the FY2013 Sequester*, by Mindy R. Levit.

[38] Scorekeeping convention typically does not account for savings if they are dependent on future Congressional action. In this case, the CBO score does not count changes in discretionary spending as it relates to discretionary cap reductions as deficit reduction under ATRA. This is because adherence to the new discretionary cap levels depends on future Congressional appropriations action.

without distribution. Roth contributions are subject to taxation when they are made, rather than when the distributions are received, as with other types of tax-preferred retirement accounts. As a result, this change increases revenue to the government within the 10-year budget window, and decreases revenue outside the 10-year window.

For more information on how the Budget Control Act's automatic spending reductions affect the budget deficit, see CRS Report R42506, *The Budget Control Act of 2011: The Effects on Spending and the Budget Deficit When the Automatic Spending Cuts Are Implemented*, by Mindy R. Levit and Marc Labonte.[39] For more information on individual retirement accounts, see CRS Report RL30255, *Individual Retirement Accounts (IRAs): Issues and Proposed Expansion*, by Thomas L. Hungerford and Jane G. Gravelle and CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by John J. Topoleski.

Unemployment Compensation

The Unemployment Compensation (UC) program is a joint federal-state effort with basic income support for unemployed workers provided through the state-funded UC benefit. Once UC benefits are exhausted, the temporarily authorized Emergency Unemployment Compensation (EUC08) and the permanently authorized Extended Benefit (EB) programs may provide additional unemployment benefits, depending on worker eligibility, state law, and state economic conditions.

States provide funds for the regular UC benefit (approximately the first 26 weeks of benefits) and the state share of the EB payments. The federal government provides funds for UC program administration, the federal share of EB payments, and the EUC08 program. Under permanent law (P.L. 91-373), the EB program is funded 50% by the federal government and 50% by the states. P.L. 111-5, as amended most recently by H.R. 8, temporarily provides for 100% federal funding of the EB program until the end of 2013 when the federal share reverts back to 50%.

The 100% federally funded EUC08 program was first authorized by P.L. 110-252. The EUC08 program's structure and authorization have been amended numerous times, most recently by H.R. 8. Until the signing of H.R. 8 on January 2, 2013, the authorization for EUC08 technically had lapsed on December 28, 2012. The entire EUC08 benefit structure is scheduled to expire at the end of 2013. As currently authorized, the EUC08 program provides up to four tiers of additional weeks of unemployment benefits to certain workers who have exhausted their rights to UC benefits in states with high unemployment.[40]

CBO has estimated that these provisions will increase the deficit by $30 billion in calendar year 2013 ($22 billion in FY2013 and the remaining $8 billion in FY2014) for the temporary provisions in EUC08 and EB.

[39] For more information on the Budget Control Act, see CRS Report R41965, *The Budget Control Act of 2011*, by Bill Heniff Jr., Elizabeth Rybicki, and Shannon M. Mahan and CRS Report R42050, *Budget "Sequestration" and Selected Program Exemptions and Special Rules*, coordinated by Karen Spar.

[40] For the more details on the level of EUC08 benefits and state unemployment requirements for each tier please see CRS Report R42444, *Emergency Unemployment Compensation (EUC08): Current Status of Benefits*, by Julie M. Whittaker and Katelin P. Isaacs.

For more information on unemployment insurance benefits, including benefits from the EUC08 and EB programs, see CRS Report RL33362, *Unemployment Insurance: Programs and Benefits*, by Julie M. Whittaker and Katelin P. Isaacs.

Sustainable Growth Rate System ("Doc Fix")

Reductions in payment rates to physicians under the Medicare program, as required under the Sustainable Growth Rate (SGR) system, were averted through December 31, 2012 as part of the Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96). The SGR system, the statutory method for determining the annual updates to the Medicare physician fee schedule, was established as part of the Balanced Budget Act of 1997 (P.L. 105-33) in an attempt to maintain Medicare physician spending levels close to a "sustainable" target level that reflected growth in GDP per capita, efficiency in delivering health care, and other measures. In the first few years of the SGR system, the actual expenditures did not exceed the targets and the updates to the physician fee schedule were close to the Medicare economic index (MEI, a price index of inputs required to produce physician services). For the next two years, in 2000 and 2001, the actual physician fee schedule update was more than twice the MEI for those years. Beginning in 2002, the actual expenditure exceeded allowed targets, and the discrepancy has grown with each year. With the exception of 2002, when a 4.8% decrease was applied, Congress has enacted a series of laws to override the reductions. However, legislative overrides since 2002 have only provided temporary reprieve from projected reductions in payments under the SGR calculation, requiring even steeper reductions in payment rates in the future.

Section 601 of ATRA keeps Medicare physician payments at the current level through December 31, 2013, overriding the statutory SGR changes that would have reduced physician fees by 27% in calendar year 2013. CBO estimates that this provision will increase the budget deficit by $11 billion in FY2013 and by $25 billion over the FY2013 to FY2022 period.

For additional background information and history on the SGR system, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn and Janemarie Mulvey.

Other Health Provisions

ATRA also includes many additional health care provisions that extend expiring provisions or modify existing payments to providers under the Medicare program, among other purposes. Some of the provisions add to direct spending, including all of the extensions for increased Medicare provider payment (such as the floor on the physician work geographic adjustment and the ambulance add-on payments) as well as the provisions extending beneficiary assistance programs (such as the qualifying individual (QI) program and the Transitional Medical Assistance (TMA) program). Other provisions would result in savings to the federal budget, including the elimination of funds from the Medicare Improvement Fund and the rescission of unobligated amounts in the consumer operated and oriented plan program contingency fund, or reductions to provider payments through modifications in the treatment of multiple service payment policies and documentation and coding adjustments for Medicare inpatient services. On net, CBO estimates that all other health provisions in Title VI (excluding the doc fix) would result in an increase in the budget deficit of $2 billion in FY2013 and a decrease in the deficit of $23 billion over the FY2013 to FY2022 period.

Farm Bill Extension

ATRA extends the 2008 farm bill (the Food, Conservation, and Energy Act of 2008, P.L. 110-246) for one additional year until September 30, 2013, or, in the case of the farm commodity programs that are on a different calendar, through crop year 2013.[41] Parts of the 2008 farm bill had expired on September 30, 2012. However, to extend the Milk Income Loss Contract (MILC) program at desired rates, an additional $110 million was needed. The offset for this authority was a reduction of $110 million from a nutrition education program.[42]

A different subset of 2008 farm bill programs did not have a continuing baseline, and thus would have required new funding to be continued. These programs did not receive any additional funding under ATRA, although many would have been funded in the five-year farm bills and extension proposals that were developed in 2012. This group includes certain conservation programs, agricultural disaster assistance programs, specialty crop research, organic research and certification, beginning and socially disadvantaged farmer programs, rural development, bioenergy, and farmers market promotion programs.[43]

There is no net cost to the extension provided in ATRA because funding to continue most of the major farm bill programs, such as for the farm commodity, conservation, trade, and nutrition programs, was already in the baseline.[44] The 113th Congress is expected to write a new farm bill in 2013, and the one-year extension preserves the budget baseline to write a new bill.

For more information about the farm bill extension, see CRS Report R42442, *Expiration and Possible Extension of the 2008 Farm Bill*, by Jim Monke, Megan Stubbs, and Randy Alison Aussenberg.

Major Fiscal Policy Issues Not Addressed in ATRA

ATRA did not address two policies considered to be part of the "fiscal cliff"—the expiration at the end of 2012 of the two-percentage-point reduction in the Social Security payroll tax and the ACA taxes on higher-income tax filers, which are scheduled to take effect in 2013.

Payroll Tax Reduction

In an effort to stimulate the economy, Congress, in December 2010, temporarily reduced the employee and self-employed shares of the Social Security payroll tax by two percentage points (4.2% for employees and 10.4% for the self-employed). Social Security trust funds were "made whole" by a transfer of general revenue, so that Social Security did not lose revenues as a result of the payroll tax rate reduction. The temporary reduction was scheduled to expire at the end of

[41] A crop year refers to the year in which a commodity is harvested. Thus, the extension will apply to the farm commodity programs in the 2008 farm bill to covered commodities harvested in 2013. The dairy price support program is extended until Dec. 31, 2013.

[42] CBO score of H.R. 8, footnote "e," at http://cbo.gov/sites/default/files/cbofiles/attachments/American%20Taxpayer%20Relief%20Act.pdf.

[43] CRS Report R41433, *Expiring Farm Bill Programs Without a Budget Baseline*, by Jim Monke.

[44] CRS Report R42484, *Budget Issues Shaping a 2012 Farm Bill*, by Jim Monke.

2011, but the reduction was extended for two months as part of the Temporary Payroll Tax Cut Continuation Act of 2011 (P.L. 112-78). Congress later extended the payroll tax rate reduction through the remainder of 2012 as part of the Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96). ATRA did not extend the payroll tax reduction past its current expiration date of December 31, 2012 and it has therefore reverted back to the original rates (6.2% for employees and 12.4% for the self-employed). Thus, the employee share of Social security payroll taxes is again 6.2% on the first $113,700 of wages in 2013.[45]

For more information on the temporary payroll tax rate reduction, see CRS Report R42103, *Extending the Temporary Payroll Tax Reduction: A Brief Description and Economic Analysis*, by Donald J. Marples and Molly F. Sherlock and CRS Report R41648, *Social Security: Temporary Payroll Tax Reduction*, by Dawn Nuschler.

ACA Taxes on Higher-Income Tax Filers

The Patient Protection and Affordable Care Act (ACA; P.L. 111-148 as amended) is expected to, among other things, increase access to health insurance coverage (with most coverage provisions effective in 2014).[46] In addition to financial penalties imposed on most individuals who do not purchase health insurance coverage and certain employers who do not provide affordable and/or adequate coverage, the law includes a number of explicit revenue provisions to pay for expanded coverage. One-third of those revenues will be derived from taxes and fees on health insurers, plan administrators, and employers, with initial effective dates varying from 2011 up to 2018. However, nearly half of those revenues are to be derived from taxes on high-income taxpayers that will be effective in 2013. These include a Medicare payroll tax and a tax on unearned income.[47] According to CBO, these two taxes are projected to raise $18 billion in revenue in 2013.[48]

Under current law, employers and employees each pay a payroll tax of 1.45% to finance Medicare Hospital Insurance (Part A). ACA includes additional hospital insurance taxes on high-income taxpayers. Specifically, ACA imposes an additional payroll tax of 0.9% on high-income workers with wages over $200,000 for single filers and $250,000 for joint filers effective for taxable years after December 31, 2012. The additional payroll tax only applies to wages above these thresholds. Thus, the hospital insurance portion of the payroll tax will increase from 1.45% to 2.35% for wage income over the threshold amounts. These revenues will be credited to the Medicare Hospital Insurance Trust Fund (Part A).

ACA as amended also imposes an additional tax on net investment income. Households with modified adjusted gross income (MAGI) under specified thresholds will not be subject to the investment income tax. Specifically, effective for taxable years after December 31, 2012, the law will impose a tax equal to 3.8% of the *lesser* of

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[45] This level of earnings is sometimes referred to as the maximum taxable earnings and is adjusted annually for inflation. For more information, see http://www.socialsecurity.gov/planners/maxtax.htm.

[46] For more information on other ACA provisions, see CRS Report R41664, *ACA: A Brief Overview of the Law, Implementation, and Legal Challenges*, coordinated by C. Stephen Redhead.

[47] Also effective in 2013, ACA imposes an excise tax on certain medical devices.

[48] Congressional Budget Office, *Economic Effects of Reducing the Fiscal Restraint That is Scheduled to Occur in 2013*, Table 1.

(1) net investment income for such taxable year, or

(2) the excess of MAGI[49] over $250,000 for joint filers and $200,000 for single filers.

ATRA did not alter the ACA taxes imposed on higher-income tax filers.

For more information about these taxes, see Archived CRS Report R41128, *Health-Related Revenue Provisions in the Patient Protection and Affordable Care Act (ACA)*, by Janemarie Mulvey and CRS Report R41413, *The 3.8% Medicare Contribution Tax on Unearned Income, Including Real Estate Transactions*, by Mark P. Keightley.

Other Short-Term Considerations

As noted above, Congress may choose to reconsider several provisions temporarily extended in ATRA before they expire. In March, the automatic spending reductions from the Budget Control Act of 2011 are scheduled to take effect. At the end of 2013, unemployment provisions, the farm bill, the "doc fix," and several tax extenders are scheduled to expire. In addition, this section discusses two other issues that Congress is likely to consider in early 2013, appropriations and the debt limit.

FY2013 Appropriations Bills

On September 28, 2012, President Obama signed a continuing resolution (CR) which provided appropriations for the first 6 months of FY2013 (P.L. 112-175). After March 27, 2013 the day that currently enacted funding expires, a funding gap will occur unless further appropriations are provided, either through the enactment of the 12 appropriations bills, another CR, or some combination of the two.[50] If there is a funding gap due to the absence of an agreement to provide additional appropriations, government activities will cease, except for emergency operations. In the past, government shutdowns have reportedly necessitated furloughs of several hundred thousand federal employees, required cessation or reduction of many government activities, and affected numerous sectors of the economy. [51]

Debt Limit

Government borrowing is constrained by a statutory debt limit that Congress periodically alters. Current fiscal policy would require an increase to the debt limit in early 2013 to meet existing obligations. Treasury Secretary Geithner indicated in a December 26, 2012 letter to Congress that the current debt limit would be reached on December 31, 2012. After that time, certain

[49] Modified adjusted gross income is defined as adjusted gross income increased by the excess of foreign earned income (defined in IRC Sec. 911(a)(1)) over the amount of any deductions or exclusions disallowed under IRC Sec. 911(d)(6) when determining foreign earned income.

[50] For the most up-to-date status of FY2013 appropriations bills, see CRS Report AppropriationsStatusTable, *FY2013 Status Table of Appropriations*, by Justin Murray, Merete F. Gerli, and Jared Conrad Nagel.

[51] For more information, see CRS Report RL34680, *Shutdown of the Federal Government: Causes, Processes, and Effects*, by Clinton T. Brass and CRS Report RS20348, *Federal Funding Gaps: A Brief Overview*, by Jessica Tollestrup.

extraordinary measures can be taken which would be able to extend headroom under the debt limit by for roughly two additional months.[52] Negotiations on this issue in 2011 led to the passage of the BCA, which included a debt limit increase and deficit reduction provisions shortly before the limit was reached. Some in Congress have expressed a desire to see a similar agreement accompanying the next debt limit increase. The debt subject to limit will generally continue to rise as long as the budget remains in deficit or trust funds remain in surplus. Further, seasonal fluctuations could still require Treasury to sell debt even if the annual level of federal debt subject to limit does not increase. The current debt limit stands at $16.394 trillion.

For more information on the debt limit and potential consequences of not increasing it, see CRS Report R41633, *Reaching the Debt Limit: Background and Potential Effects on Government Operations*, coordinated by Mindy R. Levit and CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

The Budget Deficit and the Economy

Many budget analysts are concerned about future levels of federal debt and acknowledge that the current spending and revenue policies resulting in large deficits cannot continue indefinitely. However, making significant changes to reduce the deficit at this time may be harmful to the ongoing economic recovery.[53] Some economists believe that the uncertainty surrounding the "fiscal cliff" was holding back the recovery as individuals, businesses, and state and local governments did not know what they would be facing in January 2013, leading some to reduce or delay purchases of goods and services.[54] Although ATRA eliminated uncertainty surrounding some major tax and spending policies, it did not restore fiscal sustainability.[55]

The effects on the economy of certain policies enacted to combat the economic downturn, such as the spending and revenue provisions of the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), are waning under current law. CBO recently projected that the economy will not return to full employment until FY2018.[56] Though ATRA is likely to increase economic growth in the short-run relative to what growth would have been if the policies of the "fiscal cliff" had taken effect, ongoing large budget deficits could dampen economic growth over the long-run.[57]

Many policy issues affecting the federal budget over the next decade and beyond remain unresolved. Increases in mandatory spending due to rising healthcare costs and the aging of the population are expected to begin taking effect towards the end of the decade. Keeping future

[52] Letter from Timothy F. Geithner, Secretary of the Treasury, to The Honorable Harry Reid, Majority Leader, United States Senate, December 26, 2012, http://www.treasury.gov/connect/blog/Pages/Secretary-Geithner-Sends-Debt-Limit-Letter-to-Congress-12-26.aspx.

[53] For discussion, see CRS Report R41849, *Can Contractionary Fiscal Policy Be Expansionary?*, by Jane G. Gravelle and Thomas L. Hungerford.

[54] Bank of America Merrill Lynch, US Economic Weekly, *The post-cliff economy*, October 25, 2012 and Chris Isidore, "Economists: Fiscal cliff a serious threat, but unlikely," *CNN Money*, October 1, 2012.

[55] Committee for a Responsible Federal Budget, *Washington's Gift for the New Year: Another Kicked Can*, January 4, 2013, available at http://crfb.org/sites/default/files/washingtons_gift_for_the_new_year.pdf.

[56] Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022*, August 2012, Table B-1.

[57] The economic effects of extending many of the policies addressed in ATRA are discussed in Congressional Budget Office, *Economic Effects of Reducing the Fiscal Restraint That is Scheduled to Occur in 2013*, pp. 1-2.

federal outlays at 20% of GDP, or approximately at its historical average, and leaving fiscal policies unchanged, according to CBO projections, would require drastic reductions in all spending other than that for Medicare, Social Security, and Medicaid, reining in the costs of these programs, or some combination of the two.[58] Putting the budget on a sustainable path would require less spending, increases in revenue collections, faster-than-average economic growth, or a combination of these things. Increasing levels of debt require interest payments that can strain budgets if debt levels and interest rates are high. High debt levels could limit the government's flexibility in meeting its obligations or in responding to emerging needs of its citizens.

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[58] CRS calculations based on Congressional Budget Office, *The Long-Term Budget Outlook*, June 2012.