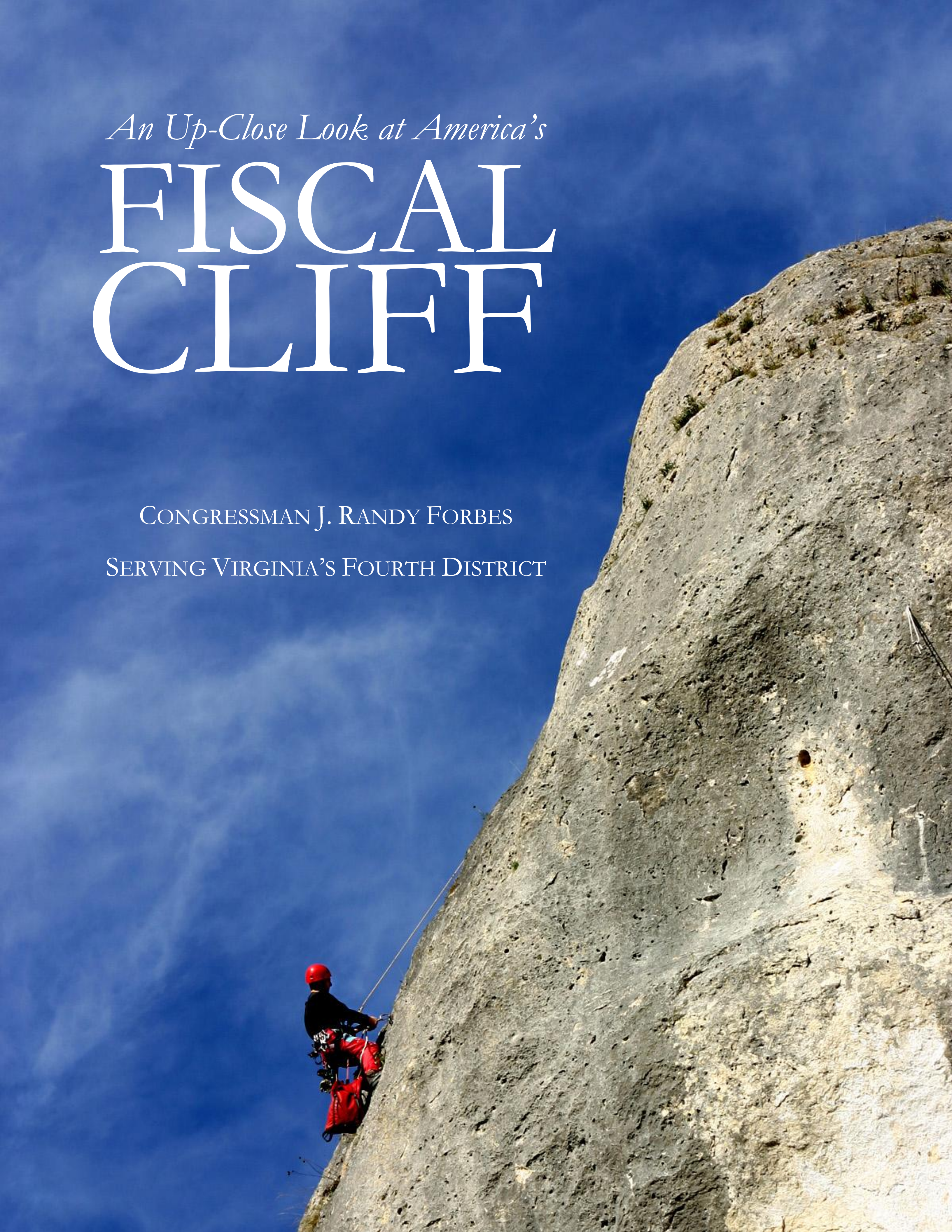

An Up-Close Look at America's

FISCAL CLIFF

Congressman J. Randy Forbes

Serving Virginia's Fourth District

An Introduction by

CONGRESSMAN J. RANDY FORBES

The term "fiscal cliff" was coined by Ben Bernanke, Chairman of the Federal Reserve, in early 2012, when he testified before Congress saying, "Under current law, on January 1st, 2013, there is going to be a massive fiscal cliff of large spending cuts and tax increases." The phrase quickly gained popularity as a useful catch-all to describe a combination of year-end policy events including significant impending tax increases, sharp sequestration budget cuts, and the expiration of several stop-gap provisions ranging from doctor reimbursements to unemployment benefits.

Today, the term "fiscal cliff" dominates the local headlines, national news, and blogosphere. But what exactly is the fiscal cliff and how does it impact you? I have put together this primer to break down the fiscal cliff, to share facts on how these policies might impact you and your job, and to give you insight into my views on and actions to avert our nation's most pressing and significant problem.

As we look to avert the fiscal cliff, I believe options to increase revenue streams without raising taxes and options to enact serious spending cuts should be put on the table and analyzed by both parties. Here is where I stand:

- **On taxes and revenue:** The best way to preserve jobs and protect the middle class is to increase revenues through tax reform rather than through tax rate increases. At the end of this document, I've included a section with voices from our business community on how increasing tax rates would affect jobs and our economy. Take a moment to read these viewpoints. I think you'll find that raising tax rates overall will hurt small businesses and destroy jobs – a result neither Democrats nor Republicans want. I believe there is common ground, however, when it comes to tax reform and I am eager to work with my Democrat colleagues to find it.

- **On spending:** America has spent too much, not taxed too little. Any tax reform must be accompanied by serious, thoughtful spending cuts that preserve national security and needed federal programs. Again, there is common ground here.

- **Overall:** My door is open to any colleague – Democrat, Republican, or Independent - to work together, to brainstorm, to share ideas with and to begin substantive negotiations to implement a framework to put America back on a path to financial stability. We might not agree on everything, but we can agree to get this done.

These are my thoughts, but I want to hear yours as well. Please share this primer with others that might find it informative. Then, weigh in on my blog, take my instapoll, join the discussion on Facebook or e-mail me. Your voice is important. I look forward to hearing from you.

Yours in service,

J Randy Forbes

Randy Forbes

What *is* the Fiscal Cliff?

America is facing a difficult and imminent combination of scheduled tax increases, sharp sequestration budget cuts, and the expiration of several stop-gap provisions ranging from doctor reimbursement to unemployment benefits. This combination of events, set to occur at the end of the year, includes $536 billion in tax increases caused by a return of rates to 2001 levels (before the Bush tax cuts), an end to Obama's 2% payroll tax holiday and various business and investment tax breaks, and $110 billion in spending cuts almost immediately affecting everything from the military to Medicare. The Congressional Budget Office (CBO) estimated in May that this would drain about $600 billion from the U.S. economy in the first nine months of 2013, or about $800 billion for the whole year.

In an August 2012 report, the Congressional Budget Office stated that "such fiscal tightening will lead to economic conditions in 2013 that will probably be considered a recession, with real GDP declining by 0.5% between the fourth quarter of 2012 and the fourth quarter of 2013 and the unemployment rate rising to about 9% in the second half of calendar year 2013."

The CBO predicts that the following policy changes, due to occur in January, will have the largest impact on the budget and the economy:

- Expiration of Bush tax cuts
- Sharp reductions in Medicare's payment rates for physicians' services
- Sequestration cuts
- Extensions of emergency unemployment benefits
- A reduction of 2% in the payroll tax for Social Security which is scheduled to expire.

HOW WOULD A FAILURE TO AVERT THE FISCAL CLIFF IMPACT ME?

According to the non-partisan Joint Committee on Taxation, the impact of not extending our current tax policy would be:

- A family of four earning $50,000 per year could pay almost $2,200 in higher taxes (a five-fold increase in their tax liability.)
- A single mom earning $36,000 per year could pay more than $1,100 in higher taxes (nearly doubling her tax liability.)
- Married senior citizens earning $40,000 per year could pay nearly $1,700 in higher taxes (more than doubling their tax liability.)
- 940,000 small businesses would see an increase in taxes, which would affect 53% of all small business income

A look at tax policies *on the* fiscal cliff

REINSTATING THE MARRIAGE PENALTY. The marriage penalty would be reinstated, decreasing the current deduction of $11,900 to $10,150 for married couples filing jointly.

REDUCTION IN THE CHILD TAX CREDIT. The child tax credit would be reduced from $1,000 per child under 17, to $500 per child under 17.

INCREASED TAXES ON INVESTMENTS. Capital gains rates would increase from 15% to 20% and dividends would be treated as ordinary income rather than at the capital gains rate.

DEDUCTIONS REDUCED ON TAX RETURNS. The total amount of itemized deductions, such as mortgage interest and charitable contributions, would be reduced by 3% of the amount by which adjusted gross income above $177,550, up to a maximum reduction of 80% of itemized deductions.

SHARP INCREASE IN THE ESTATE TAX. The exemption amount for the estate tax would fall from $5 million to $1 million and the top rate would rise from 35% to 55%.

HIGHER INDIVIDUAL TAX RATES. The individual tax rates set in 2001 and 2003 were originally scheduled to expire at the end of 2010, but were extended until the end of 2012. Beginning in January of 2013, rates would revert back to 2000 levels if Congress does not act.

Higher Individual Tax Rates		
Taxable Income in the Following Ranges	**2012**	**2013**
Up to $8,700 for single filers and Up to $17,400 for married couples	10%	15%
Between $8,700 and $35,350 for single filers and Between $17,400 and $70,700 ($60,350 for 2013) for married couples	15%	15%
Between $35,350 and $85,650 for single filers and Between $70,700 ($60,350 for 2013) and $142,700 for married couples	25%	28%
Between $85,650 and $178,650 for single filers and Between $142,700 and $217,450 for married couples	28%	31%
Between $178,650 and $388,350 for single filers and Between $217,450 and $388,350 for married couples	33%	36%
Over $388,350 for both single filers and married couples	35%	39.6%

NEW TAXES UNDER THE HEALTH CARE LAW. Under current law, employers and employees each pay a payroll tax of 1.45% to finance Medicare Hospital Insurance (Part A). The health care law includes an additional 0.9% hospital insurance tax on high-income workers, increasing the hospital insurance portion of the payroll tax from 1.45% to 2.35% for wage income over these threshold amounts. Additionally, the health care law imposes an additional tax of 3.8% on net investment income for high-income filers.

INCREASE IN EMPLOYEES' SHARE OF THE PAYROLL TAX. The temporary two-percentage-point reduction in the employee's share of the Social Security payroll tax expires at the end of 2012. Next year, rates will revert back to 6.2% for employees and to 12.4 % for the self-employed. During the payroll tax holiday, money from the payroll tax that would have gone to the Social Security Trust Fund was replaced with funds from the Treasury's general fund, adding to our nation's debt.

INCREASE IN TAXPAYERS SUBJECT TO THE AMT. 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. For tax year 2011, the AMT-exemption amounts were $74,450 for married individuals filing joint returns and $48,450 for unmarried individuals. These exemption amounts revert to $45,000 for married individuals and $33,750 for unmarried individuals in tax year 2012. According to the Congressional Research Service, without Congressional action, 26 million additional taxpayers could be subject to the AMT.

A look at spending cuts *on the* fiscal cliff

In 2011, the Budget Control Act of 2011 (BCA) was introduced in response to concerns over raising the debt limit. In addition to including a mechanism to raise the debt ceiling, the BCA included arbitrary and sharp spending reductions as a means of reducing the deficit. Congressman Forbes voted against this bill, but it was ultimately signed into law by President Obama on August 2, 2011.

The BCA contained two measures designed to reduce the deficit by roughly $2 trillion over the FY2012-FY2021 period: (1) $917 billion in savings from caps on spending; and (2) the establishment of the "supercommittee" that was expected to find further savings of at least $1.2 trillion over 10 years.

As a result of the supercommittee's failure to reach an agreement, $1.2 trillion in automatic and arbitrary spending cuts, known as sequestration, are scheduled to take place on January 2, 2013, unless Congress and the President act to eliminate or change the process.

DEFENSE SEQUESTRATION CUTS. Since 2009, the Obama Administration has cut $800 billion from the defense budget, cancelling numerous Navy, Marine Corps, Army, and Air Force modernization programs. Our nation's highest military commanders have stated on the record that any further defense cuts would be extraordinarily difficult and very high risk. Despite this, the sequestration process stands to cut an additional $492 billion from the defense budget.

If defense sequestration cuts are implemented there will be major consequences for our national security:

- 200,000 soldiers and Marines separated from service, resulting in the smallest ground force since 1940
- A Navy fleet of fewer than 230 ships
- The smallest tactical fighter force in the history of the Air Force
- Additional rounds of the Base Realignment and Closure (BRAC) process

NON-DEFENSE SEQUESTRATION CUTS. While a vastly disproportionate amount of sequestration cuts are scheduled to come by slashing national security, sequestration cuts are far ranging and will impact much more than just defense spending. $984 billion will be cut over nine

CONGRESSIONAL ACTION TO DATE TO AVOID THE FISCAL CLIFF

MAY 2012: The House passed, with Congressman Forbes' support, H.R.4966, the Sequester Replacement Reconciliation Act, to replace the automatic cuts by lowering overall spending caps and taking recommendations from six Committees, proposing cuts from programs within their jurisdictions.

JULY 2012: *The Senate passed a plan supported by the President preventing an extension of tax cuts for high-income earners and many small businesses. According to a study from the nonpartisan Joint Committee on Taxation, this proposal would affect 940,000 businesses. An independent study from Ernst & Young study, estimated that this plan could cost over 700,000 jobs. This proposal was rejected in the House.*

AUGUST 2012: *The House passed, with Congressman Forbes' support, H.R.8, the Job Protection and Recession Prevention Act. This legislation provides a one year extension of all current individual tax rates, as well as the 15% top rate on capital gains and dividends, the estate tax rates at their current levels, the $1,000 child tax credit, and relief from the marriage penalty relief.*

years, resulting in annual cuts of approximately $109 billion. Approximately $492 billion ($55 billion each year) will be cut from programs such as education, law enforcement, Medicare, housing, and medical research. While these cuts will affect almost all federal government programs, there are some areas of government exempt from sequestration cuts including Social Security, Medicaid, Pell Grants, school lunch programs, and Department of Veterans' Affairs programs.

SHARP CUTS TO MEDICARE REIMBURSEMENTS TO PHYSICIANS. Each year since 2002, scheduled reductions in payments to physicians have been overridden due to concerns that these decreases could create a disincentive for doctors to treat Medicare patients. Again, these decreases loom – this time, however, in the form of a drastic reduction by over ¼ of the payments physicians currently receive. On November 1, 2012, the Center for Medicare and Medicaid projected that payment rates will be reduced by 26.6% in 2013 if Congress does not act. Such a drastic decrease in Medicare reimbursements for physicians could lead many physicians to choose not to accept Medicare, leaving patients without access to care.

LAPSE OF EXTENDED UNEMPLOYMENT BENEFITS. In February, unemployment benefits were extended through December 31, 2012, and there will not be a further extension. In contrast to previous reauthorizations of the federal unemployment benefits program, current law does not allow for federal benefits to be gradually phased out. Rather, federal benefits will end at the end for the year and unemployed individuals would have to rely on regular state benefits.

A cliff *and a* ceiling

As of November 13, 2012, our nation's debt is $16.245 trillion, which is more than the size of the U.S. economy. In addition to the looming tax increases and spending cuts, we are fast approaching the debt limit, which is currently set at $16.394 trillion. This breaks down into:

- Debt per person = $51,612
- Debt per household = $136,881

On March 29, 2012, the House passed a budget for Fiscal Year 2013; however, it has been nearly 1,300 days since the Senate has passed a budget for our federal government. In fact, when the Senate last passed a budget on April 29, 2009, our national debt was $11.15 trillion. Passing a sustainable budget that prevents additional debt is critical to our nation's fiscal health.

Make *your* voice heard

As Congress and the President begin negotiation to avert our nation's most pressing and most significant problem, I want to hear your thoughts on America's fiscal cliff. Please:

BLOG. Weigh in on my blog.

INSTAPOLL. Take my instapoll.

FACEBOOK. Join the discussion on Facebook.

EMAIL. Email me via my website at forbes.house.gov.

Appendix

Voices *on* Increasing Tax Rates: Bad for Small Businesses, Bad for American Workers

National Federation of Independent Business

"In the current economic environment, the last thing small businesses should face is a tax increase. …The expiration of current individual tax rates is particularly important to small businesses because 75 percent of them are organized as pass-through entities that pay taxes at the individual rate. …Raising taxes on small businesses, especially in the current economic environment, stifles their ability to grow and create jobs. Congress must act to avoid this economic hit to over half of the business community that creates two-thirds of net new jobs and employs over half the private sector workforce."

International Franchise Association

"Franchise business owners are local small businesses, and as pass-through entities, their business profits are taxed at the individual tax rate. Many of these franchisees own the rights to develop multiple locations and have the strong desire to expand their businesses, creating more jobs and the economic output our country urgently needs. Yet in the current economic environment, with so much uncertainty about what tax rates will be next year, many franchisees have begun pulling back on developing additional locations, which means jobs are not created and economic growth is not realized."

National Retail Federation

"It is particularly important during this debate that lawmakers listen to small businesses, including the independent Main Street retail stores that are some of our nation's most important job creators. Many small business owners report their business income on their personal income tax returns and will be critically impacted by the outcome of this debate. The U.S. economy cannot afford a man-made disaster of the magnitude of the fiscal cliff."

National Electrical Contractors Association

"Small businesses, the primary source of our nation's' job growth, continue to struggle and many are unable to keep their doors open. The threat of going over the cliff has further increased uncertainty. Businesses large and small cannot plan for the future and are delaying hiring of more workers which would grow and strengthen the U.S. economy."

Associated Builders & Contractors

"While large, public corporations are important drivers of the economy, small, pass-through businesses in commercial construction and other industries stand to suffer the most from the president's proposed tax increases. Despite the administration's continued rhetoric about millionaires and billionaires, these tax hikes begin at just $250,000, a threshold that would raise marginal tax rates on nearly one million small businesses…"

Financial Executives International

"A majority of FEI's 15,000 members represent pass-through entities, meaning that their companies are structured in a way that allows for business income to pass through to their owners' individual tax returns. If rates on this income are allowed to increase, private companies will be negatively impacted on a potentially devastating scale."