Policy and Regulation Alert

President and Congress Reach Tentative Agreement on Tax Components Relating to the "Fiscal Cliff"

December 31, 2012

On December 31, 2012, President Obama and congressional leaders reached tentative agreement on a package of legislative changes to avert the tax aspects of the so-called "fiscal cliff" that would have occurred on January 1, 2013. At the time of the writing of this alert, negotiations are continuing on the possibility of postponing the budget sequester that is scheduled to take effect on January 2, 2013. It is expected that the House and Senate will act on this agreement (in one or two bills) later today or tomorrow. This alert briefly describes the key elements of the emerging tax agreement as well as important policy issues that are not addressed.

KEY COMPONENTS

1. **Top tax rate:** The Bush tax cuts enacted in 2001 and 2003 are made permanent for taxpayers with incomes below $400,000/450,000. The top tax rate of 39.6 percent is reinstated for taxpayers with incomes above those levels. The overall limitation on personal exemptions (PEP) and itemized deductions (Pease) is reinstated for taxpayers with incomes in excess of $250,000/300,000 (joint).

2. **Capital gains and dividends:** Tax rates on capital gains and dividends are permanently increased from 15 percent to 20 percent, for taxpayers with incomes above $400,000/450,000. The 15 percent rate will be permanently retained for taxpayers below the $400,000/450,000 thresholds. The new 3.8 percent investment income tax, enacted in the Affordable Health Care Act of 2010, will be additive.

3. **Alternative Minimum Tax (AMT) relief:** The AMT "patch" that prevents over 28 million taxpayers from having to pay the alternative minimum tax is made permanent.

4. **Federal estate tax:** The top federal estate tax rate will be 40 percent for estates above $5 million.

5. **Tax extenders:** The business tax extenders, including bonus depreciation, are extended through 2013.

6. **Medicare physician payment reimbursements:** The so-called "doc fix," which prevents a 27 percent reduction in reimbursement rates to Medicare physicians, is extended through 2013.

7. **Unemployment benefits:** Emergency unemployment benefits are extended through 2013.

POLICY ISSUES NOT ADDRESSED IN THE TAX AGREEMENT

1. **Budgetary sequester:** Enacted as part of the August 2011 debt ceiling legislation, a $1.2 trillion "sequester" of federal spending, equally divided between defense and non-defense discretionary spending, will take effect on

January 2, 2013. The budgetary effect of the scheduled sequester is expected to reduce federal spending by approximately $100 billion in the 2013 fiscal year. Negotiations on a possible postponement of the sequester are ongoing at the time of the writing of this alert.

2. **Debt ceiling:** Treasury Secretary Geithner has given Congress official notice that the current $16.4 trillion debt ceiling will be reached on December 31, 2012. Secretary Geithner has administrative authority to utilize "extraordinary measures" to avoid default. It is anticipated that such action by the Treasury Secretary will postpone default by several months into 2013. However, a statutory increase in the debt ceiling will be required in the first quarter of 2013 to avoid an unprecedented default by the federal government.

3. **Stimulus initiatives:** The payroll tax relief, enacted in 2010 and extended in 2012, will be allowed to expire. The agreement also does not include the President's proposals for additional fiscal stimulus such as increased infrastructure spending.

4. **Deficit reduction, entitlement reform and tax reform:** Negotiations on additional deficit reduction, entitlement reform and tax reform are anticipated in 2013.

CONTACT INFORMATION

If you have any questions concerning this alert, please contact—

Robert J. Leonard
rleonard@akingump.com
202.887.4040
Washington, D.C.

Jeffrey D. McMillen
jmcmillen@akingump.com
202.887.4270
Washington, D.C.

Jayne T. Fitzgerald
jfitzgerald@akingump.com
202.887.4581
Washington, D.C.