Independent Electrical Contractors

IEC Legislative Brief: The Fiscal Cliff

American Taxpayer Relief Act of 2012

On New Year's Day, Congress approved legislation, (H.R. 8) *American Taxpayer Relief Act of 2012*, to address the year-end tax hikes and spending cuts known as the "fiscal cliff." The measure passed the U.S. House of Representatives late on January 1, after the U.S. Senate had approved it with bi-partisan support earlier that same day. President Obama signed it into law on January 2.

It is clear that passage of this measure certainly averted a financial calamity. The Congressional Budget Office (CBO) projected that if all of the expiring tax cuts were allowed to go away, the nation would slide into another recession and the unemployment rate would rise to 9.1%.

However, the new law imposes the first increase in income tax rates in almost two decades. In addition, over 77% of all Americans will see their tax obligations increase as the 2% reduction in payroll tax relief was not renewed.

Undoubtedly, this measure failed to solve the real problems facing the nation's financial health. It most certainly sets up another major showdown in the coming months over across-the-board spending cuts, the debt ceiling, tax and entitlement reform, and a long-term solution to the nation's debt and deficits.

What is the Fiscal Cliff?

The term "fiscal cliff" is used to describe the mix of $607 billion in U.S. tax increases and spending cuts that were set to expire on December 31, 2012, and threatened to severely damage the national economy.

The combination of tax provisions and spending cuts include the Bush era tax cuts, the 2010 Obama payroll tax holiday, the partial expensing of investments and the onset of tax provisions to support the implementation of the 2010 *Affordable Care Act* (ACA), the expiration of emergency unemployment insurance (UI) benefits, and the start of what is referred to as "automatic sequestration" or across-the-board cuts in discretionary and defense spending under the 2011 *Budget Control Act*.

Impact on Deficit Reduction and Spending

What is the bill's impact on the deficit? Among budget experts, the answer lies with your baseline. Do you start with a baseline of "current policy" — which assumed the Bush tax cuts would have been extended for everyone, as they were in 2010 — or "current law," which called for the expiration of all the Bush tax cuts on January 1, 2013.

Assuming "current policy," President Obama's Office of Management and Budget (OMB) claims the deal reduces the deficit by $737 billion, mostly by increasing the tax rates for the wealthiest Americans.

But assuming "current law," as the non-partisan Congressional Budget Office (CBO) does, the deal actually increases the deficit by nearly $4.6 trillion over 10 years, because it permanently extends the Bush tax cuts for most taxpayers.

According to the CBO's stance, provisions related to revenue in the law account for $3.639 trillion of the deficit increase between 2013 and 2022. Additional spending in the bill, some of it related to tax policy, adds $332 billion in debt. Preserving the bottom 10 percent tax bracket alone leads to a revenue loss of $442.6 billion and capping the dividends tax rate at 20 percent costs another $231 billion. The most expensive single provision in the agreement, at a cost of $1.8 trillion, is preserving the income threshold for the alternative minimum tax to $50,600 for single filers and $78,760 for couples.

What about spending? Very little in the bill dealt with curtailing the spending crisis this nation faces, and of course this issue will be among the forefront in the coming months.

Energy Sector Focus

Overall, the energy sector, particularly the renewables, fared well in the deal. Among the highlights:

- Section 179D was extended, which enables a deduction of up to $1.80 per square foot for energy-efficient components such as lighting, HVAC, and the building envelope.
- Section 179D, which also covers the 50% bonus depreciation, is extended for another year. In addition to helping businesses accelerate depreciation of investments in machinery and equipment, many developers/owners struggle to find tax equity investors willing to monetize bonus depreciation, but there are a handful of tax equity investors who will monetize it for particularly strong projects.
- The new market tax credit, which several renewable energy projects have used, is extended through 2013. The credit requires an allocation from the U.S. Treasury and the project must be in areas with low income populations.
- Various tax incentives for individuals to purchase energy efficient appliances, energy efficient new homes, and electric vehicles and plug-in stations for are also extended.

There were two proposals that, unfortunately, were not incorporated in the act. First, the solar industry was not able to obtain a comparable "begin construction" change for the 30 percent investment tax credit that expires at the end of 2016. Given the long runway that credit has, it was difficult to find support for such a proposal in the legislative atmosphere of the fiscal cliff. Second, income from renewable energy projects was not added to the definition of "qualified income" for master limited partnerships, which are publicly traded companies that are not subject to corporate income tax.

What the Deal Failed to Include

The law successfully averted many of the year-end tax hikes and spending cuts that were set to kick in. But it was a major failure in addressing some of the major issues that have divided Congress in recent months.

Grand bargain. Congressional lawmakers did not address the country's long-term fiscal issues in this bill—namely, simplifying our tax code and curtailing entitlement spending. At the onset of negotiations, the goal was to have a fully comprehensive deal instead of a last minute, stop-gap effort. However, an agreement, or grand bargain, was not reached.

Raising the debt ceiling. The nation has already hit its $16 trillion borrowing limit, and the Treasury Department has said it will use "extraordinary measures" to avert default as long as it can—likely into February. Then Congress will have to once again take up the contentious issue of raising the country's debt ceiling. Last time, the negotiations resulted in a downgrade of the U.S. credit rating by S&P, a major rating agency, and instability in the markets. This time, the risks will be just as high. Treasury Secretary Timothy Geithner wrote to Congress: "These extraordinary measures… can create approximately $200 billion in headroom under the debt limit. Under normal circumstances, that amount of headroom would last approximately two months. However, given the significant uncertainty that now exists with regard to unresolved tax and spending policies for 2013, it is not possible to predict the effective duration of these measures. At this time, the extent to which the upcoming tax filing season will be delayed as a result of these unresolved policy questions is also uncertain. If left unresolved, the expiring tax provisions and automatic spending cuts, as well as the attendant delays in filing of tax returns, would have the effect of adding some additional time to the duration of the extraordinary measures. Treasury will provide more guidance regarding the expected duration of these measures when the policy outlook becomes clearer."

Extension of the payroll-tax cut. A temporary, two-percentage-point cut to the payroll tax expired at midnight on December 31, 2012, and was not renewed. This affects 77% of Americans.

What the Deal Included

The deal successfully focused on the revenue side of the equation.

Higher taxes on individuals earning $400,000 and on families making $450,000 or more. Under that threshold, the Bush-era tax cuts will be permanent for all but the wealthiest households. The $450,000 threshold for families is a significant increase from Democrats' initial proposal to raise taxes on Americans making $250,000 or more, but it is lower than Republicans' earlier proposal to raise taxes on households making $1 million or more.

Higher tax rates on capital gains and dividends for wealthier households. Taxes on capital gains and dividends will be held at their current levels of 15% for individuals making less than $400,000 and households with income of less than $450,000. They will rise to 20% for individual taxpayers and for households above those thresholds.

Business tax breaks. The Senate Finance Committee passed a package in August that tackled a variety of routinely expiring tax provisions known as extenders. These popular tax provisions include breaks for research and development and energy. Included in the deal was:

- Renewable energy production tax credit (PTC) for wind, geothermal, and some biomass projects, which gives credit for each kilowatt-hour of energy they produce;
- Section 45L tax credit which rewards multifamily developers with tax credits of $2,000 per energy efficient apartment unit; and
- Section 179D. (Details on page 2).

Personal exemptions phased out for individuals making over $250,000. Personal exemptions will be phased out and itemized deductions will be limited for taxpayers making over $250,000 and families earning more than $300,000.

Estate tax provisions. The current estate tax exemption amount, $5 million and indexed for inflation for years after 2011, is permanently extended by the measure. Additionally, the maximum rate will rise to 40% from its current 35% level. Democrats had earlier sought a higher increase to 45% and a lower exemption of $3.5 million.

Permanent fix to the Alternative Minimum Tax. In 1969, Congress noticed that 155 people with high incomes were legally using so many deductions and other tax breaks that they were paying absolutely nothing in federal income taxes. In response, Congress instituted the AMT with the aim of making the tax system fairer. But, because the AMT was never indexed to inflation—as the regular income tax is—each year, more and more middle-income taxpayers are snared by a this tax . In recent years, Congress has passed legislation providing a temporary fix to keep the AMT from spreading to taxpayers who aren't considered wealthy. The most recent fix was a permanent fix and was passed on January 2, 2013.

Work Opportunity Tax Credit Extended. The measure extends the Work Opportunity Tax Credit for qualified wages paid to members of targeted groups, as well as an employer wage credit for activated military reservists.

Automatic spending cuts delayed for two months. The "sequester," which would impose steep, across-the-board cuts to domestic and defense programs, will be delayed for two months. As part of the compromise to delay sequestration, the legislation reduces to $85 billion the required sequester of discretionary and mandatory spending for FY2013.

One-year Extension of Unemployment Insurance (UI) Benefits. The measure extends for one year, long-term federal UI benefits for laid- off workers. The restructured benefit tiers enacted under last February's benefit extension are maintained, including a reduction in the maximum number of weeks an individual is entitled to receive benefits, as well as job search requirements. The measure extends the availability of railroad extended unemployment benefits. The measure also extends the current authorization for federal aid to help states carry out re-employment services through FY2014.

Farm Bill Extension. The fiscal cliff deal extends through the end of FY2013 most provisions of farm policy as they were in effect on September 30, 2012, under the 2008 Farm Bill (P.L. 110-246), but fails to extend mandatory funding for renewable energy and rural development.

Deduction of state and local sales taxes extended. At the end of 2011, the ability to deduct state and local sales taxes in lieu of state income taxes expired. The deduction for state and local sales taxes is one of the so-called "tax extenders" that Congress must revisit every so often and is a provision that is mostly pertinent to residents in states that levy no individual income tax. The cliff deal revives the provision, extending it for two years until the end of 2013.

Make an impact on the Congress' decisions! Join your fellow merit shop electrical contractors at the 2013 IEC National Legislative Conference, May 6-8, 2013, in Washington, D.C. This is your chance to speak directly to your elected officials about the issues that are pertinent to you and your business.

Visit www.ieci.org for more information!