Pocketbook Issues - The Fiscal Cliff Q & A

November 14, 2012 - With the presidential election over, there are several issues being driven at the federal level that will hit Americans in the pocketbook. These issues will affect unemployment levels, the amount we pay in taxes and your ability to get credit. So, we're going to take a look at these issues and give you some simple, straight answers as to how you are going to be affected without all of the partisan rhetoric. The first one we're going to cover is the "fiscal cliff".

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If you listen to the news, over the next few weeks you are going to be hearing a lot about the so called fiscal cliff. But there is a lot of evidence that the average consumer isn't paying attention and doesn't really understand what it is. That's unfortunate because the issue impacts the earnings of absolutely everyone living in the United States in some way, shape or form. For many, it will impact their ability to get a job or keep their current job. And for anyone who is already facing financial difficulty, going over the cliff will only make matters worse.

While we have given the issue previous coverage, it has become apparent that there are very few non-partisan resources that explain the fiscal cliff. To remedy that, here is ACCESS Q & A on the subject.

Q - What is the "fiscal cliff"?

A - The fiscal cliff is the result of an agreement between Congress and the Obama Administration. These two branches of government couldn't agree on a plan to rein in the federal deficit; now more than $16 Trillion. So last year they came to an agreement for automatic tax increases and spending cuts that would take effect on January 1, 2013 if they couldn't come up with another plan.

The way that the fiscal cliff was structured was supposed to be so unattractive to everyone involved that coming up with an alternative was the only option. Now, with about seven weeks to go until we go over the fiscal cliff, we are no closer to a compromise plan than we were when Congress and the White House struck the original bargain.

Q - Are there any other terms used in association with the fiscal cliff?

A - Yes. It is also referred to in the media and by politicians as "sequestration".

Q - Does the fiscal cliff impact the amount I will pay in income taxes?

A - Yes. Unless an agreement is reached, all personal income tax rates will go up on January 1st. additionally, inheritance taxes, capital gains taxes, taxes on dividends, etcâ€¦ will all go up. This includes that taxes that you will pay if you are retired and taking 401K or IRA distributions.

Q - If we go over the fiscal cliff, will the amount of income tax I pay for 2012 be impacted?

A - Possibly. One of the items that Congress needs to address is the Alternative Minimum Tax (AMT). When the AMT was put into law, it was only designed to get 21 wealth families to pay higher taxes. But Congress didn't index the AMT to account for inflation, so now more than 4 million families are impacted by the law.

Congress has already made several changes to the AMT to avoid increasing taxes on millions of additional families, but if they don't address it this year, 28 million additional families will be hit with the AMT in the 2012 tax year. Virtually all of these families are middle class and many are small business owners. The amount of money that these people will have to pay in taxes is likely to go up substantially if they are faced with the AMT. When you consider that 70% of all new jobs are created by small businesses, this portion of the fiscal cliff could have a substantial impact on layoffs, new job creation and even the viability of many businesses.

Q - Are there any other taxes or government fees that will increase?

A - Yes. Payroll taxes will also go up by 2% for all taxpayers on January 1st regardless of your tax bracket. The child tax credit will be reduced. Tax forgiveness on foreclosures and short sales will end. Tax deductions and credits for student loans will be reduced or eliminated. And a large number of tax credits and deductions for business will be reduced or eliminated.

Q - How much can I expect my taxes to go up if no agreement is reached?

A - The nonprofit Tax Policy Center estimates that the average American household will see their taxes increase by $3,700 in 2013 if there is no agreement.

Q - How would going over the fiscal cliff impact the ability of consumers to get access to credit?

A - Going over the fiscal cliff will impact virtually everyone's personal finances by increasing their taxes. Since this is a factor in lending, it is likely to mean that some consumers will no longer be able to borrow money at all because their debt to income ratio exceeds the lenders' limits. In many more cases, it will mean that the amount of money consumers are eligible to borrow is reducedâ€¦ sometimes significantlyâ€¦ due to higher tax expenses. Those higher expenses could also lead to higher interst rates by lenders due to the increased risk that the consumer will have trouble repaying the loan.

Q - If an agreement isn't reached by the end of the year, how will that impact jobs & unemployment?

A - Other than the AMT (see above), going over the fiscal cliff will impact unemployment in several ways.

First, anyone who works for defense contractors should be concerned. Sequestration would cut $50 Billion per year from the defense budget for the next ten years. That means that there will be tens of thousands of layoffs in companies working with the Dept. of Defense. Additionally, companies that function as subcontractors will also be impacted; as will other companies that service them.

Second, virtually all economists agree that raising taxes in a recession hurts employment. At the very least, job creation is likely to stagnate; and that is a best case scenario. The Congressional Budget Office has predicted that if Congress and the White House can't come to an agreement, the recession will get worse and that unemployment will move back above 9%. The CBO is also predicting that the economy would shrink by 2.9% and that the US would enter a "significant recession".

Third, at the same time that unemployment numbers are going up the federal government will be cutting spending across the board. This includes likely reductions in unemployment benefits.

Q - Other than defense spending, what other government programs will be cut?

There are several programs that will see immediate spending cuts.

Medicare payments will be reduced by $11 Billion. In addition to this, all discretionary spending programs will be reduced. This includes things like highway construction, education spending, public health programs, etcâ€¦

Q - Could going over the fiscal cliff shut down the government?

A - No, but there is a possibility that will also happen. The government's ability to operate is dictated by its ability to borrow. That ability is limited by a congressionally imposed "debt ceiling". The Treasury Department expects spending to reach the debt ceiling sometime in December. If that happens, and no agreement is reached, the government could shut down. We'll have more on this in another Q and A.

Q - If Congress and the White House come to an agreement after January 1st, what will happen?

A - That really depends on how long after January 1st. If it only takes a few more weeks, the impact of going over the cliff will be much less than if it takes months to reach an agreement. Regardless of when an agreement is reached, Congress does have the power to make it retroactive to the beginning of the year.

But even approaching the fiscal cliff is already causing damage. Financial markets are dropping in value. For anyone who has an IRA, 401K or a pension that is invested in the market, they are already being impacted.

Hiring is also being impacted already. When companies are uncertain about how they will be impacted by taxes, investment income or consumer spending, they tend to hold off on making new purchases or hiring. This is not likely to change until an agreement is reached.

byJim Malmberg
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