Sorting Out the Fiscal Cliff Deal

January 3, 2013 - By now, you probably know that Congress and the White House have struck a deal to avoid going over the fiscal cliff. But what was in the bill that passed and how will it affect you personally? That's something that you may not know. Since the bill's passage will affect home loans, unemployment and taxes, we thought it might be a good idea to run through what has been agreed to so farâ€¦ and we really mean "so far". A number of issues were not decided in the agreement and they are going to come up again soon.

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Taxes

Regardless of what you have heard about the deal keeping a lid on taxes, everyone who is currently employed will see their taxes go up. That's because Congress didn't extend the payroll tax cut that had been in effect. Through last year, payroll taxes had been capped at 4.2%. In 2013, they will return to 6.2% for anyone who is a regular employee. If you are self-employed, your payroll taxes are also going up 2%.

These taxes impact everyone. So the person who makes 20,000 per year will see their payroll taxes increase by $400 in 2013. If you make $50,000, they will increase by $1,000.

Taxes are also increasing for individuals who make over $400,000 per year and for couples that make over $450,000 per year. The increase doesn't impact 99.4% of taxpayers but it is the first time since 1992 that any tax bracket has seen their taxes increase. And increasing taxes in an economic downturn is almost unheard of. It remains to be seen what the long term impact of this will be. The federal government has said that it expects to collect an additional $60 billion per

year as a result of the increase. But if history is any indicator, exactly the opposite will happen. It is worth noting that there was a lot of financial activity in the last two months of last year to indicate that wealthy people were shifting assets to avoid any new tax burdens. Income tax rates for everyone else will remain the same in 2013.

Inheritance tax laws also change under the new law. Estates valued at $5 million or less ($10 million or less for married couples that plan properly) will be exempt from inheritance taxes. Any amounts in excess of these limits will be taxed at 40%. In 2012, the maximum tax rate on estates was 35%.

Capital gains taxes will remain at 15% for anyone making under $400,000 as an individual or $450,000 for couples. For those earning more than this, capital gains taxes will increase to 20%

Congress also extended the tax exemption for people facing foreclosure or a short sale.

Perhaps the best thing to come out of the agreement was a permanent fix to the Alternative Minimum Tax (AMT). When Congress first enacted the AMT, it was meant to force 21 wealthy families who were avoiding taxes to start paying into the system. But Congress never indexed the law for inflation. As a result, there are now more than 3 million families that have to pay AMT. As bad as that sounds, without an agreement nearly 24 million additional people would have been forced to pay AMT, with incomes as low as $45,000. For the first time ever, the new law permanently indexes the AMT for inflation.

Unemployment

The new law extends unemployment benefits for an additional year for nearly 2 million people. What it doesn't do is address the issue of Sequestration - the term used for mandated government spending cuts that were supposed to kick in on January 1st. As we've previously reported, using the numbers that Congress itself was working with, Sequestration is likely to cause 2.1 million layoffs. Roughly half of these would be government employees, contractors and subcontractors. The other half would simply be average civilian jobs caused by a shrinking economy.

Instead of addressing the issue, Congress simply delayed the cuts for two months. That means that the new Congress - which is being sworn in today - will have to address the issue very quickly. We'll keep you posted on this.

Credit and Housing

One of the largest issues facing the economy as a result of the fiscal cliff had to do with home mortgage markets. Since these markets were largely responsible for the recession, allowing the country to go over the cliff could have been a financial disaster.

The main issue that was of concern was elimination of the home mortgage deduction. This is an idea that is still be bantered around Washington. For the time being, Congress has extended the deduction without any changes. That's very good news for anyone thinking about purchasing property or refinancing. Had the deduction been eliminated or reduced, housing prices would have fallen, lenders would have reduced the amount they are willing to give to borrowers, and middle class taxpayers would have seen a significant tax increase.

Unfortunately, the idea of changing the deduction is likely to come up again in 2 months during the Sequestration debate. We'll keep you posted.

Fiscal Pork

The entire fiscal cliff debate was supposed to be over reducing government spending and decreasing the deficit. That's why it is sickeningly ironic that the bill that passed was full of pork spending. Here is just a brief sampling.

- Electric scooters and cars - Purchasers can get up to 10% of the purchase price in a tax credit.

- Motorsport race track owners - Allows for tax breaks as long as they hold at least one event every 3 years.

- Tax credits for Algae and Asparagus growers involved with biofuel development.

According to the Washington Examiner, the bill contained $76 Billion in total pork spending.

byJim Malmberg
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