

# **TIME BOMB ANALYSIS: AN EXAMINATION OF THE TAX POLICIES SET TO EXPIRE AND ROLL OVER THE ‘FISCAL CLIFF’**

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## **ABSTRACT**

*As the 2012 election decision concluded, the end of 2012 requires that the President and U.S. Congress to reach consensus on several tax provisions that are set to expire after December 31, 2012 as well as agreed to spending cuts, otherwise inaction will move the country over the “fiscal cliff.” If the latter occurs, the nation will be subjected to unprecedented tax increases beginning January 1, 2013. According to the Urban Tax Policy Center (Williams, Toder, Marron, and Nguyen, 2012), taxes would rise by more than \$500 billion in 2013, an average of \$3,500 per tax filer—as almost every tax cut enacted since 2001 would expire. Middle-income tax filers would see an average increase of almost \$2,000. For most tax filers, the largest increases would be the expiration of the temporary cut in Social Security taxes and the expiration of the 2001 and 2003 tax cuts. Upper income tax filers would see the top two individual rates adjust from 33 to 35 percent and 35 to 39.6 percent, as well as rates adjusting for qualified dividends and long-term capital gains. Lower-income tax filers would be particularly impacted by the the expiration of tax credits expanded or created by the 2009 stimulus bill. It is estimated that if the tax cuts expire, the already fragile economic recovery may sharply stall or lead the nation into recession. The purpose of this paper is to examine the tax expenditures affected by the fiscal cliff and to posit two arguments: one in favor of allowing the fiscal cliff to occur, one in favor of allowing some or part of the existing (pre-fiscal cliff) tax policies to continue.*

## **INTRODUCTION**

At December 31, 2012, the United States very well may be sitting ready to fall over the “fiscal cliff,” allowing billions in tax cuts to expire and revert to 2001 (and in some cases 2003 levels). This will translate into tax increases for every taxpayer in the U.S. There will also be massive spending cuts triggered, known as sequestration, causing billions in immediate cuts to both discretionary spending and defense programs. In addition, several tax provisions targeted to specific taxpayers will also expire, causing many taxpayers to lose out on tax benefit levels that they have become accustomed to. Some of these targeted provisions include: several education tax credits, deductions, and exemptions, the Child Care Credit (reverts to 2001 levels), marriage penalty relief, the adoption tax credit (reverts to 2001 levels), the capital gains and dividend tax rates, along with many other provisions. The purpose of this paper is to examine the tax expenditures affected by the fiscal cliff and to posit two arguments: one in favor of allowing the fiscal cliff to occur, one in favor of allowing some or part of the existing (pre-fiscal cliff) tax

policies to continue. The spending impact will not be examined, only impacts to tax expenditures.

### **IMPASSE IN PLACE**

As of this writing, the Obama Administration and the House and Senate have not coalesced around a single compromise measure. House Speaker John Boehner (R-OH) was set to bring up a bill (known as “Plan B”) to avert the fiscal cliff with his Republican caucus, but had to pull the bill on December 20, 2012, after learning that the majority of his caucus refused to support the measure since it would increase taxes on those with taxable income above \$1,000,000. The White House agreed to a \$400,000 threshold, but the Speaker argued that it would have to be \$1,000,000 in order to move it through his Republican caucus. With Congressional members adjourning for the Christmas holiday, the nation’s tax policy hangs in limbo. Members are expected to return the Washington, DC on December 27, 2012 to resume negotiations. However, the action by the Speaker on December 20<sup>th</sup> reveals a structural concern that makes it likely that the tax provisions will expire at the end of 2012: 229 members of the House and 39 members of the U.S. Senate signed the “Norquist Pledge” not to ever raise taxes. The December 20<sup>th</sup> stalemate by the Republican caucus by its refusal to allow the Speaker to bring “Plan B” up for a vote makes it nearly impossible to secure the 218 votes needed to move legislation through the House of Representatives. Senator Harry Reid (D-NV), the Democratic Leader in the U.S. Senate, has made statements that he would not bring up the House bill for a vote unless it’s negotiated in advance, reflecting more to the Democrat’s liking. The White House’s predispositions are much closer aligned to the Senate’s demands than the House’s.

### **THEORIES OF POLITICAL GRIDLOCK**

In order to understand legislative phenomenon, we will briefly discuss the work of Keith Krehbiel (1998). In understanding legislative behavior, the focus of analysis often begins with the existence of either divided government, where one or both chambers of Congress are controlled by members of the opposite party, versus unified government where the executive branch and both chambers of Congress are from the same party. David Mahew (1991) argues that members of Congress are motivated mainly by actions that will get them re-elected, such as voting in favor of bills that will move monies and resources to their districts or states, and other pieces of legislation that will enhance their images to their voters. This “self-centered” behavior by members of Congress, according to Mahew, has assisted in producing gridlock at times within the legislative process. Members become more individualized and concerned about re-election and may defy their party leadership at times to protect their seats. Keith Krehbiel (1998) argues that divided government does not explain why and when gridlock will occur and that political parties do not matter. Krehbiel’s pivot politics theory is based on collective choice settings where issues are well-defined and decision-makers’ preferences are well-ordered, a specific decision-maker is shown analytically to be pivotal to the final policy choice. This is where the Tea Party Caucus comes into our discussion in this paper.

Krehbiel argues that divided government does not explain why and when gridlock will occur but that his model of pivotal voters does; his theory drills deeper into Mahew’s theory. Since all policy making in Congress is incremental, Krehbiel’s median voter theory can assist in understanding how tax cut and sequestration action is impacted.

Krehbiel’s model assumes the following: all players are arranged along a single dimensional policy space. Parties are not a considered, just “liberal” or “conservative,” and the status quo is assumed to be exogenously given. The model is based on the concept of a pivot, meaning “a person or thing around which something turns or depends” (Krehbiel, 1998, p. 23). The pivotal players in the model are as follows:

$m$  = median voter

$f$  = the Senate filibuster pivot (60 votes or 2/3)

$v$  = the veto override pivot (3/5 vote in each chamber)

$p$  = the President

$q$  = status quo

### **MEDIAN VOTER THEORY**

Krehbiel argues that policy positions are reflected through the median voter, which in a democracy is reflected through its legislative members by open elections. In other words, voters tend to vote for individuals who share their policy preferences. Elections are viewed as exogenous determinants of legislators' preferences, which are sometimes called "induced preferences" (p. 13). Krehbiel argues that changes are reflected by the median voter through the median legislator after each election:

After each election, [legislator] preferences may and usually do change. Any time the position of the median legislator changes—as in the case of national partisan tides, for example—the old status quo (the previous-period median legislator's ideal point) is out of equilibrium. A new play of lawmaking game then occurs, and the new median voter's ideal point is selected via majority rule as the new policy (1998, p. 13)

In the case of the 112<sup>th</sup> Congress, which was sworn in in January 2011, the median voter shifted more rightward: Control of the House of Representative was regained by the Republicans, but more importantly, the composition of members within the Republican Party has a sizeable "faction" of members predisposed to smaller government by cutting federal spending and maintaining low income taxes (the Tea Party Caucus). In the Senate, there was a loss of seats by the Democrats, but not sizeable enough to change chamber control; further, there were only one or two Tea Party members elected, not enough to form a durable caucus, as is the case in the House. Where Krehbiel's median voter model is relevant is in the House, where a significant portion of the composition of members of the caucus controlling the chamber (in this case Republicans) is the Tea Party Caucus. As discussed, these newly elected members greatly influenced the outcome of the August 2011 debt ceiling debate and are a key block of votes that are holding firm in preventing the Speaker from bringing up legislation that would increase *any* taxes.

### **THE FILIBUSTER PIVOT**

The filibuster pivot ( $f$ ) is only relevant if the president is ideologically opposite of 40 members of the U.S. Senate; at least 40 votes required to sustain a filibuster. For example, the 112<sup>th</sup> Congress has a Senate comprised of 49 members of the opposition party to the President and can filibuster legislation that is predisposed towards the President. If a filibuster is sustained, then the bill does not come up for a vote and dies. If, however, the filibuster is blocked (at least 60 members vote to proceed with the bill), then an up-or-down vote can proceed, then requiring a simple majority of votes (51) for passage.

In the example of the debt ceiling vote, majorities in both parties voted for the measure in both chambers. However, prior to that vote, the Tea Party Caucus forced a measure through the House that was considered too controversial for the opposition party and the president. When that measure reached the Senate, the filibuster pivot (*f*) prevented the measure from moving to an up-or-down vote, killing the bill. Had the filibuster pivot not been sustained, and the bill reached the floor of the Senate for an up-or-down vote and secured at least 51 votes, President Obama would have most likely vetoed the bill. Neither the House nor the Senate would have had the votes to override the president's veto (the veto pivot or *v*).

### **THE VETO PIVOT**

The veto pivot is relevant usually when there is complete divided government, where the executive branch (the president) is in an opposite party than both chambers of Congress. This existed during the latter six years of the Clinton presidency (104<sup>th</sup> through the 106<sup>th</sup> Congresses) and during the last two years of the Bush (43) presidency (110<sup>th</sup> Congress). If a president vetoes legislation under these circumstances, both chambers of Congress would have to secure 3/5 of the chamber to override a veto (261 votes in the House; 67 in the Senate). The House, while controlled by Republicans, lacks the 261 votes; the Senate is controlled by Democrats.

Given the composition of players in the 112<sup>th</sup> Congress, the veto pivot (*v*) is not relevant in most scenarios because there are not enough votes in either chamber to easily override a veto, particularly in the Senate.

Krehbiel's theory is tested in the 112<sup>th</sup> Congress in the sense that to attain equilibrium a bill can either be signed by the president or a veto can be overridden. While the debt ceiling bill was enacted by President Obama, had the bill failed to be signed, the government would have defaulted on its debt.

### **TAX POLICY GRIDLOCK AND THE BENEFITS OF MOVING OVER THE 'FISCAL CLIFF'**

As of this writing, even though President Barack Obama won re-election with a slim majority, and Democrats picked up a net gain of 8 seats in the House and a net gain of 1 seat in the U.S. Senate, the 113<sup>th</sup> Congress will not be sworn in until January 4, 2013. Even then, there was no change in control of either chamber, only a slight strengthening of the Democrat's hand. The 112<sup>th</sup> Congress is negotiating these expiring tax provisions and prevention of spending sequestration. As it stands on December 21, 2012, lawmakers rejected Speaker Boehner's "Plan B" and are refusing to consider bringing to the floor any bill that would increase any taxes on any American. This stance, should it hold, will prevent the U.S. House of Representatives for taking any legislative action. The situation is not as simple as it seems. The Speaker's hands are essentially tied with by his Tea Party Caucus (signatories of the "Norquist tax pledge"); Democratic Senate Leader, Harry Reid and his caucus in the U.S. Senate have specifics they require in order to bring a bill up in that chamber. President Obama continues to adjust the White House bill slightly, but as this proceeding is concluded, the cement is drying on options for a resolution. The nation's tax and spending policy are heading over the fiscal cliff on December 31, 2012.

The negative implications of expiring tax provisions after December 31, 2012 are significant: tax rates will rise on all income brackets, causing withholdings to increase and extracting monies out of the economy; the Internal Revenue Service, lacking Congressional action, will have to adjust withholding tables and reconfigure significant portions of its computers to reflect the pre-Bush (43) provisions (and remove provisions that have expired), and adjust for the millions of Americans who will be subject to the alternative minimum tax; Wall Street, which has factored

the possibility of going over the cliff into the Market, will see dividends taxed at ordinary rates and capital gains rates increase; the tax preparer community will have to significantly adjust to the changes to provisions, many which have been around more than a decade.

The benefits of the expiring tax provisions after December 31, 2012 are equally significant: in addition to every tax rate increasing, the top two tax rates, which are at the heart of the political stalemate, currently at 33% and 35%, will increase to 35% and 39.6%, respectively. With the Tea Party Caucus refusing to budge in 2012 on allowing legislative action that will cause them to vote in favor of a tax increase, by allowing the top two rates to automatically readjust on January 1, 2013, these members will not violate the “Norquist” pledge. President Obama and the congressional leadership can then craft a bill that allows for the tax rates for middle-income filers to return to the pre-January 1, 2013 levels. Moreover, the President has made tax reform a major priority in order to clean up and seek out savings by reducing or eliminating provisions in the tax code. **Tables 1 through 4** below highlight the specific provisions that encompass the “Bush” tax cuts, the amount in revenue loss in millions if the expiring provisions are allowed to continue.

**Table 1: Cost of Tax Expenditures**

Provisions	Effective	Cost in Millions	
		2013-17	2013-22
<b>A. Permanent Extension of 2001 Tax Relief</b>			
<b>1. Individual income tax rate relief:</b>			
a. Retain 10% income tax bracket	tyba 12/31/2012	-211,322	-442,641
b. Retain the 25% and the 28% income tax brackets	tyba 12/31/2012	-93,598	-212,234
c. Retain the 33% and the 35% income tax brackets	tyba 12/31/2012	-99,379	-257,757
e. Repeal overall limitation on itemized deduction and the personal exemption phase-out	tyba 12/31/2012	-60,217	-162,712
<b>2. Retain the child tax credit at \$1,000:</b>			
refundable up to greater of 15% of earned income in excess of \$10,000 (indexed from 2001) or the taxpayer's social security tax liability to the extent that it exceeds the taxpayer's earned income credit; allow credit against the AMT; repeal AMT offset of refundable credits	tyba 12/31/2012	-153,151	-354,493
<b>3. Marriage penalty relief:</b>			
a. Standard deduction and 15% rate bracket set at two (2) times single for married filing jointly	tyba 12/31/2012	-28,575	-55,604
b. EIC modification and simplification - increase in joint returns beginning and ending income level for phase-out by \$3,000 indexed after 2008; simplify definition of earned income; use AGI instead of modified AGI; simplify definition of qualifying child and tie-breaker rules; and allow math error procedure with Federal Case registry data beginning in 2004	tyba 12/31/2012	-12,458	-29,026

Source: Joint Committee on Taxation (JCX-78-12) December 19, 2012

**Legend for Effective Column:**

tyba = taxable years beginning after

**Table 2: Cost of Tax Expenditures (Continued)**

Provisions	Effective	Cost in Millions	
		2013-17	2013-22
<b>A. Permanent Extension of 2001 Tax Relief</b>			
<b>4. Education Tax Relief:</b>			
a. Coverdell Education Savings Accounts ("ESAs") - increase the annual contribution limit to \$2,000; allow ESA contributions for special needs beneficiaries above the age of 18; allow corporations and other entities to contribute to ESAs; allow contributions until April 15 of the following year; allow a taxpayer to exclude ESA distributions from gross income and claim the HOPE or Lifetime Learning credits as long as they are not used for the same expenses; repeal excise tax on contributions made to ESA when contribution made by anyone on behalf of same beneficiary to QTP; modify phase-out range for married taxpayers; allow tax-free expenditures for elementary and secondary school expenses; expand the definition of qualified expenses to include certain computers and related items	tyba 12/31/2012	-81	-271
b. Employer provided educational assistance - extend the exclusion for undergraduate courses and graduate level courses	cba 12/31/2012	-4,982	-11,477
c. Student loan interest deduction - eliminate the 60-month rule and the disallowance for voluntary payments; increase phase-out ranges to \$50,000-\$65,000 single/ \$100,000-\$130,000 joint, indexed for inflation	ipa 12/31/2012	-4,082	-9,675
d. Eliminate the tax on awards under the National Health Service Corps Scholarship program and F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program	tyba 12/31/2012	-683	-1,501
e. Increase arbitrage rebate exception for governmental bonds used to finance qualified school construction from \$10 million to \$15 million	bia 12/31/2012	-13	-72
f. Issuance of tax-exempt private activity bonds for qualified education facilities with annual State volume caps	bia 12/31/2012	-27	-152

Source: Joint Committee on Taxation (JCX-78-12) December 19, 2012

**Legend for Effective Column:**

- bia = bonds issued after
- ipa = interest paid after
- tyba = taxable years beginning after

Provisions	Effective	Cost in Millions	
		2013-17	2013-22
<b>Table 3: Cost of Tax Expenditures (Continued)</b>			
<b>A. Permanent Extension of 2001 Tax Relief</b>			
<b>5. Dependent Care Credit:</b>			
Increase the credit rate to 35%, increase the eligible expenses to \$3,000 for one child and \$6,000 for two or more children (not indexed), and increase the start of the phase-out to \$15,000 of AGI	tyba 12/31/2012	-970	-1,791
<b>6. Adoption Credit:</b>			
Increase the expense limit and the exclusion of \$10,000 for both non-special needs and special needs adoptions, make the credit independent of expenses for special needs adoptions, extend the credit and the exclusion, increase the phase-out start point to \$150,000, index for inflation the expenses limit and the phase-out start point for both the credit and the exclusion, and allow the credit to apply to the AMT	tyba 12/31/2012	-2,344	-5,580
<b>7. Employer-provided Child Care Credit:</b>			
Credit of 25% for child care expenditures and 10% for child care resource	tyba 12/31/2012	-93	-209
<b>8. Allow election Alaska Native Settlement Trusts to the Trust not to beneficiaries</b>			
	tyba 12/31/2012	-21	-46
<b>B. Permanent Extension of 2003 Tax Relief</b>			
<b>1. Tax capital gains with a 0%/15%/20% rate structure</b>	tyba 12/31/2012	-30,050	-71,689
<b>2. Tax dividends with a 0%/15%/20% rate structure</b>	tyba 12/31/2012	-81,337	-210,799

Source: Joint Committee on Taxation (JCX-78-12) December 19, 2012

**Legend for Effective Column:**

tyba = taxable years beginning after



Provisions	Effective	Cost in Millions	
		2013-17	2013-22
<b>Total Cost to Make Permanent Certain Tax Cuts Enacted in 2001 and 2003</b>	12/31/2012	-783,383	1,827,729
<b>Cost to Permanently Extend Estate and Gift Tax Provisions of the Tax Relief Act of 2010:</b> \$5 million Unified and Indexed Exemption Amount; 35% maximum rate; portability of Exemption Amount	dda gma 12/31/2012	-141,528	-388,160
<b>Cost to Make Permanent §179 Expensing:</b>			
Amounts and Threshold limits (\$250,000/\$800,000); Amounts indexed for inflation	ppisa 12/31/2012	-28,962	-45,669
<b>Permanent Individual Alternative Minimum Tax Relief:</b>			
Increase the AMT Exemption Amount to \$50,600 (\$78,750 Joint) in 2012 and Index the AMT Exemption Amount, Exemption Phase-out Threshold, and Income Bracket Beginning in 2013	tyba 12/31/2012	-678,114	-1,879,697
<b>Net Total Cost of ALL Tax Expenditures</b>		<b>-1,631,987</b>	<b>-4,141,255</b>

Source: Joint Committee on Taxation (JCX-78-12) December 19, 2012

**Legend for Effective Column:**

- dda = decedents dying after
- gma = gifts made after
- ppisa = property placed in service after
- tyba = taxable years beginning after

The Tables 1 through 4 above reflect how much of the U.S. Tax Code has become an instrument used to effect social change; instead of attempting to pass a spending bill to finance a program, it is easier to insert or create a provision in the Code that allows taxpayers to exclude, deduct, or reduce their tax liability (in the form of a tax credit) for personal outlays for student loan repayments, child adoption cost, child care, etc. Structured as tax expenditures, the federal government calculates these standing tax provisions in the form of revenue losses in the four (4) tables above.

**A MODEL FOR TAX POLICY CHANGE**

In December 2010, the National Commission on Fiscal Responsibility and Reform (“Fiscal Commission”) issued its report, titled “The Moment of Truth” (National, 2010). The Fiscal Commission was charged with examining the short-term and long-term economic effects of the federal budget deficit and level of national debt in the United States. The Fiscal Commission, authorized in 2009 by President Barack Obama, was co-chaired by former Clinton White House Chief of Staff, Erskine Bowles, and former U.S. Senator, Alan Simpson (R-WY). The Fiscal Commission’s summative diagnosis of the looming fiscal states:

Since the last time our budget was balanced in 2001, the federal debt has increased dramatically, rising from 33 percent of GDP to 62 percent of GDP in 2010. The escalation was driven in large part by two wars and a slew of fiscally irresponsible policies, along with a deep economic downturn. We have arrived at the moment of truth, and neither political party is without blame . . . Economic recovery will improve the deficit situation in the short run because revenues will rise as people go back to work, and money spent on the social safety net will decline as fewer people are forced to rely on it. But even after the economy recovers, federal spending is projected to increase faster than revenues, so the government will have to continue borrowing money to spend. The Congressional Budget Office (CBO) projects if we continue on our current course, deficits will remain high throughout the rest of this decade and beyond, and debt will spiral ever higher, reaching 90 percent of GDP in 2020 . . . Over the long run, as the baby boomers retire and health care costs continue to grow, the situation will become far worse. By 2025 revenue will be able to finance only interest payments, Medicare, Medicaid, and Social Security. Every other federal government activity – from national defense and homeland security to transportation and energy – will have to be paid for with borrowed money. Debt held by the public will outstrip the entire American economy, growing to as much as 185 percent of GDP by 2035. Interest on the debt could rise to nearly \$1 trillion by 2020. These mandatory payments – which buy absolutely no goods or services – will squeeze out funding for all other priorities . . . Federal debt this high is unsustainable. It will drive up interest rates for all borrowers – businesses and individuals – and curtail economic growth by crowding out private investment. By making it more expensive for entrepreneurs and businesses to raise capital, innovate, and create jobs, rising debt could reduce per-capita GDP, each American’s share of the nation’s economy, by as much as 15 percent by 2035 (National, 2010, pp. 10-11).

In order to solve these challenges, the Fiscal Commission discussed recommendations subdivided into six (6) major components for congressional action, including:

1. Enacting tough discretionary spending cuts,
2. Comprehensive tax reform,
3. Health care cost containment,
4. Enacting mandatory savings,
5. Social Security reforms to ensure long-term solvency and reduce poverty, and
6. Ensure debt reduction is on a sustainable path (National, 2010, pp. 15-16).

The second recommendation, comprehensive tax reform, involves both individual and corporate income tax reform. The Fiscal Commission’s tax reform recommendations, discussed later in this paper, provide one of the first major attempts at reforming the U.S. Tax Code since the last reform bill nearly 26 years earlier, known as the *Tax Reform Act of 1986* (P.L. 99-514). The Fiscal Commission’s tax reform recommendations are largely structural, stripping the various tax expenditures from the tax code to develop a “zero plan” whereby the tax base is derived using a flat base for assessing income tax rates. The recommendations then “add” limited and targeted tax expenditures back to this flat base in the areas of mortgage interest, support for low-income workers and families, employer-provided health insurance exclusion, charitable donations, and savings for retirement (National, 2010, p. 30).

#### **THE FISCAL COMMISSION’S INDIVIDUAL TAX REFORM RECOMMENDATIONS**

Figure 1.1 below summarizes the effect of the impact on both individual and corporate rates. Individual tax reform will be examined first.

**Figure 1.1: Tax Rates Under Various Scenarios**

	<i>Bottom Rate</i>		<i>Middle Rate</i>		<i>Top Rate</i>		<i>Corporate Rate</i>
Current Rates for 2011	10%	15%	25%	28%	33%	35%	35%
Scheduled Rates for 2013	15%		28%	31%	36%	39.6%	35%
Eliminate all Tax Expenditures ("Zero Plan")	8%		14%		23%		26%
Keep Child Tax Credit + EITC	9%		15%		24%		26%
Enact Illustrative Tax Plan (Figure 1.2)	12%		22%		28%		28%

The add-backs to the zero plan are summarized in Figure 1.2 below. Some of the more prominent highlights of the Fiscal Commission’s plan include stripping the Code of a majority of the existing tax expenditures, eliminating the need for itemized deductions.

*Figure 1.2: Illustrative Individual Tax Reform Plan*

	<i>Current Law</i>	<i>Illustrative Proposal (Fully Phased In)</i>
<b>Tax Rates for Individuals</b>	In <b>2011-12</b> , six brackets: 10%, 15%, 25%, 28%, 33%, 35%. In <b>2013</b> , five brackets: 15%, 28%, 31%, 36%, 39.6%.	Three (3) brackets: 12%, 22%, 28%
<b>Alternative Minimum Tax</b>	Scheduled to impact middle-income individuals, but "patched" annually.	Permanently repealed
<b>PEP and Pease</b>	Repealed in 2011-12, resumes in 2013	Permanently repealed
<b>EITC and Child Tax Credit</b>	Partially refundable child tax credit over \$1,000 per child. Refundable EITC of between \$457 and \$5,666.	Maintain current law or equivalent alternative.
<b>Standard Deduction and Exemptions</b>	Standard deduction of \$5,700 (\$11,400 for couples) for non-itemizers; personal and dependent exemptions of \$3,650.	Maintain current law; itemized deductions eliminated, so all individuals take standard deductions
<b>Capital Gains and Dividends</b>	In 2011-12, top rate of 15% for capital gains and dividends. In 2013, top rate of 20% for capital gains, and ordinary dividends.	All capital gains and dividends taxed at ordinary income rates
<b>Mortgage Interest</b>	Deductible for itemizers; mortgage capped at \$1 million for principal and second residences, plus up to \$100,000 for home equity loans.	12% non-refundable tax credit available to all taxpayers; Mortgage capped at \$500,000; No credit for interest from second residence and equity loans.
<b>Employer Provided Health Insurance</b>	Excluded from income. 40% excise tax on high cost plans (generally \$27,500 for families) begins in 2018; threshold indexed to inflation.	Exclusion capped at 75th percentile of premium levels in 2014, with cap frozen in nominal terms through 2018 and phased out by 2038; Excise tax reduced to 12%
<b>Charitable Giving</b>	Deductible for itemizers	12% non-refundable tax credit available to all taxpayers; available above 2% of Adjusted Gross Income (AGI) floor
<b>State and Municipal Bonds</b>	Interest exempt from income	Interest taxable as income for newly-issued bonds
<b>Retirement</b>	Multiple retirement account options with different contribution limits; saver's credit up to \$1,000	Consolidate retirement accounts; cap tax-preferred contributions to lower of \$20,000 or 20% of income, expand saver's credit
<b>Other Tax Expenditures</b>	Over 150 additional tax expenditures	Nearly all other income tax expenditures are eliminated

**CONCLUSION**

As tax policy is headed over a “fiscal cliff,” President Barack Obama and congressional leaders should look toward the 2010 Fiscal Commission’s recommendations on tax reform. President Ronald Reagan made tax reform a centerpiece of his second term. It will be difficult to see if the President can exact legislative action from a highly divisive congress. Going over the fiscal cliff could impart irreparable damage on the United States’ economy. However, if the Tea Party Caucus refuses to allow a vote on tax increases and Majority Leader Reid refuses to bring a bill up in the Senate that addresses his policy preferences, the only way to enjoin compromise is the expiration of the Bush tax cuts. Congress has demonstrated at crucial points to come together and find compromise on matters of domestic and wartime policy. Given the uncompromising actions during the 2011 debt ceiling negotiations, along with the stalemate that exists as of this writing, compromise is nowhere to be found by either political party. Moving over the fiscal cliff might readjust the tax rate barometer so that a more meaningful legislative deliberation can occur.

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