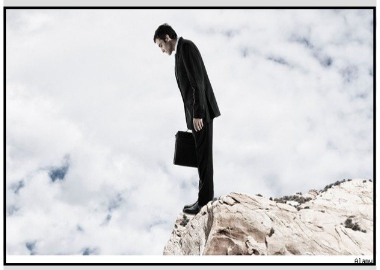
Fiscal Cliff & Affordable Healthcare Laws

The Economic Impact Is Coming Into Focus

January 10, 2012 by William L. Pittenger, MAI, SRA

The combination of the newly enacted fiscal cliff legislation, formally known as *"The Tax Payer Relief Act of 2012"* and *"The Patient Protection and Affordable Care Act"* known commonly and perhaps pejoratively as Obamacare has triggered a tsunami of new taxes. The total impact appears to be around $264 billion this year alone making 2013 significant for delivering one of the largest one-year tax increases in American history. And we're only 10 days into the new year.

We wrote about the fiscal cliff legislation almost immediately after it was signed into law. As is usually the case the devil is in the details and now those details are beginning to emerge. The math is simple. Key provisions of the so-called Bush tax cuts are eliminated by the new law thus generating about $39.5 billion each year for the next decade. The expiration of the so-called payroll tax holiday will create another $160 billion in taxes on average each year for the decade and the Affordable Care Act will add another $41.8 billion in taxes for each of the next 10 years.



While the number crunching continues, the tax impact of the 157-page *American Taxpayer Relief Act of 2012* is coming into sharper focus. In 2013, new tax revenues will include:

- **$160 Billion Hike in Payroll Taxes.** This is the result of the expiration of the payroll tax "holiday." It increases the payroll tax (FICA) that helps fund Social Security. The tax is increased from 4.2% to 6.2%. Some news outlets have incorrectly reported that as only a 2% increase. Actually, it is a two percentage point increase which translates into a 47.6% increase. Moreover, the non-partisan Tax Policy Center estimates that this increase will hit lower and middle income taxpayers hardest on a percentage basis.

- **$39.5 Billion in Income Tax Rate Hikes.** The so-called Bush tax cuts expire on high income earners. Such earners who make more than $400,000 ($450,000 for married couples) will see their marginal income-tax rates rise from 35 percent to 39.6 percent. That shift is projected to result in $395 billion in taxes over the next 10 years. While the tax affects less than one percent of American households it affects many high-spending professionals and small business owners who pay taxes on the personal returns (Sub Chapter "S" Corporations, etc.).

- **$15 Billion from Limiting Deductions.** The new law calls for a "personal exemption phase out," or PEP, affecting the exemptions and deductions that wealthier families can claim. It affects individual filers at $250,000, and $300,000 for joint filers. The tax bill for a couple earning $400,000 averaging about $50,000 in deductions each year will rise by about $1,000 according to a recent Wall Street Journal calculation.

- **$5.5 Billion in Capital Gain and Dividend Taxes.** The new tax rate for capital gains and dividends will rise from 15 percent to 20 percent (this figure doesn't include an additional 3.8 percent surcharge on investment income for high-income earners, which will kick in during 2013 to help defray the cost of The Affordable Care Act.

- **$2 Billion in Estate Taxes.** The law increases the top rate for gift and estate taxes from 35 to 40 percent. The Tax Policy Center reports that this change will affect over 77% of American households.

The hastily enacted 157 page law does not reduce spending but rather adds to it and increases the federal deficit another $3.9 trillion over the next decade. It also raises taxes about $600 billion over the decade. Also disturbing is that for every dollar of spending cut, there were $41 in tax increases.

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The Economic Impact of Affordable Health Care

In addition to the fiscal cliff law, taxes required by The Affordable Care Act are being implemented simultaneously. They will create yet another laundry list of taxes estimated to total some $41.8 billion in 2013. Here is a look at those taxes.

- **$21Billion in Medicare Taxes.** The healthcare law calls for a nine-tenths of 1 percent increase in the hospital insurance (Medicare) payroll tax paid by couples earning more than $250,000 a year, or $200,000 per year for single filers.
- **$11 Billion from Surcharge on Capital Gains and Dividends.** Married couples earning more than $250,000 per year, or single filers earning $200,000 will incur a 3.8 percent surcharge in the tax rate for capital gains and dividends. That is in addition to the "fiscal cliff" compromise that hiked taxes on capital gains and dividends from 15 to 20 percent.
- **$4.5 Billion by Limiting Deductions**. The Affordable Health Care Act eliminates corporate deductions for retirees' prescriptions thereby raising tax costs to employers.
- **$2 Billion in Excise Fees.** A 2.3 percent excise tax on manufacturers and importers of medical devices such as stents, pace makers and certain medical supplies and equipment. This tax is widely expected to be passed through to patients (consumers).
- **$2 Billion by Limiting Healthcare Itemized Deductions.** This is a reduction in the amount tax payers can deduct from their income taxes if they incur high medical expenses.
- **$1.3 Billion from Limiting Flexible Savings Accounts**. A $2,500 limit will go into effect on tax-free flexible spending accounts, which employees use to help defray medical expenses. There was previously no government imposed limit. Limitations were plan related.

The tax burden associated with the Affordable Healthcare Act will climb even higher in 2014 when the tax penalty for not complying with the mandate to purchase healthcare insurance begins to kick in. Some experts predict that millions of Americans may opt to pay the tax penalty rather than comply with the mandate. The logic is that a 25 year old who typically has around $700 in expenses would not likely purchase a policy with an expected $4,000 premium. The CBO estimates the U.S. Treasury will collect $167 billion in such fines over the next 10 years.

Finally, some observers opine that the rising private insurance premiums which are almost certain to occur due to the health care act are form of "hidden tax " that will directly hit insured individuals and companies. For example, in California, Aetna has proposed a premium increase of 22%. Anthem Blue Cross of California will reportedly raise premiums as much as 26% and Blue Shield has proposed a 20% increase. In Ohio and Florida, the story is similar. Insurers have reportedly already been able to raise premiums by about 20%. These premium increases are significant and can amount to several hundred dollars each month for consumers depending upon their plan. There is a bit of irony here too. In 2010, Anthem Blue Cross proposed a 39% rate increase which was both widely criticized but touted as a reason for the Affordable Health Care Act which was expected to reduce such large rate increases.

The tax hikes resulting from the fiscal cliff legislation and the Affordable Healthcare Act are two separate and distinct taxes. Either will affect most Americans and the broader economy. Simultaneous implementation, however, is almost certain to have a profoundly negative effect on an economy struggling to recover from the worst recession since The Great Depression. Renewed recession in 2013 is not out of the question as some $160 billion in annual discretionary spending is being removed from the economy.

Pending Fiscal Crises. The fiscal cliff law did not deal with other issue plaguing the shaky economy. Spending cuts required by so-called sequestration were deferred another two months. Sequestration is an arcane government term loosely defined as *triggered spending cuts*. In this case The Budget Control Act (BCA) which was enacted after the bi-partisan super committee failed requires that nearly $1.0 trillion ($984 billion) be cut from defense and non-defense federal government spending in substantially equal parts of $492 billion each. This, of course, is unless Congress and the Administration decide to change the law which seems highly likely at this writing.

Congress and the Administration must also deal with the nation's "debt ceiling" of about $16.4 trillion which was already exceeded last December 31st. Current public debt at this writing now totals $16.432 trillion and is rising by the minute. As an aside, the per capita share of the national debt is now over $52,000.

The "United States Public Debt," as it is more formally called, is comprised of two major pieces. They are debt held by the public which totaled about $11.579 trillion or about 73% of the nation's Gross Domestic Product. The other component is Intra-Government Holdings which is largely U.S. debt held by foreign investors. Currently, China and Japan are the largest holders of U.S. debt at about $1.1 trillion each.

As public spending, debt and deficits are so important to the United States economy, we will follow the deliberations and peek behind the headlines to provide readers with unbiased analysis.

Data Sources & Disclaimer

The estimated dollar amounts cited herein have been taken from a wide variety of published sources including the Congressional Budget Office, Federal Reserve, Center for Tax Policy, U.S. Treasury, Heritage Foundation, Moody's Analytics, Ernst & Young, George Mason University, Aerospace Industries Association, Wall Street Journal, Washington Post, Washington Times, New York Times, Federal Times, DefenseNews, USA Today, Associated Press and Newsmax. To the extent possible, we have confirmed findings with multiple sources. We believe the aggregate tax estimates cited herein are as accurate as current information allows but we acknowledge the full impact of the laws may not yet be totally apparent. We also acknowledge that most of the implementing regulations have not yet even been crafted. As a result, these aggregate tax estimates are subject to modification over time.