NATIONAL CENTER FOR POLICY ANALYSIS

Congressional Brief: Taxes, Spending and the Debt Limit

In March 2013, the Budget Control Act of 2011 went into effect, automatically cutting spending in certain federal outlay categories. These cuts were initially set to begin in January 2013, but were delayed by the American Taxpayer Relief Act of 2012.

Key Facts about Taxes and Spending

The Budget Control Act of 2011. This Act attempted to resolve the U.S. debt ceiling crisis in 2011. Its goal was to reduce the deficit by $2.3 trillion over 10 years by creating a joint committee in Congress (known as the "Supercommittee") charged with finding $1.5 trillion in deficit reduction. It also imposed automatic cuts in discretionary spending ("the sequester") if the committee's recommendations did not become law.

Because the committee could not agree on alternative cuts:

- Planned defense spending will be cut $55 billion across-the-board every year from 2013 to 2021, for a total of $440 billion over the entire period.
- Nondefense spending will be cut $55 billion across-the-board in every year from 2013 to 2021, for a total of $440 billion over the entire period.
- The nondefense spending cuts include a 2 percent annual cap on increases in Medicare spending, reducing projected spending on the program from 2013 to 2021 by $123 billion.

The American Taxpayer Relief Act of 2012. This Act temporarily extended the Obama tax cuts in the American Recovery and Reinvestment Act of 2009. It permanently extended the 2001 and 2013 Bush tax cuts for most Americans. It also delayed across-the-board spending cuts — or budget sequestration — required by the Budget Control Act of 2011. These changes in tax policy helped to avert a predicted recession — negative economic growth — but the automatic cut in spending was only postponed two months.

Among its tax provisions, the law:

- Retained the 10, 25, 28 and 33 percent income tax brackets, and kept the 35 percent bracket for taxable income under $400,000 for individuals, $450,000 for joint filers.
- Kept the child tax credit at $1,000 (averting a 50 percent drop to $500).
- Extended the refundable Earned Income Tax Credit (EITC) for low-income workers.

Furthermore, the Act:

- Allowed taxpayers to apply the EITC credit against the Alternative Minimum Tax and repealed the AMT offset of refundable credits.
- Set the standard deduction and 15 percent bracket for married filing jointly at twice the amount for a single filer, and modified and simplified the EITC.
- Raised the highest estate and gift tax rate from 35 percent to 40 percent, but exempted estates worth up to $5.25 million per person. This is still lower than the 55 percent tax on estates over $675,000 in effect in 2001.
- Extended for one year the so-called "doc fix," avoiding a 27 percent cut to reimbursements for doctors seeing Medicare patients for 2013.

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- Authorized a new commission on long-term care to replace the Community Living Assistance Services and Supports Act (CLASS), a long-term care program in the 2010 Patient Protection and Affordable Care Act that proved to be unworkable.

A number of new taxes took effect:

- New taxes in the Affordable Care Act included an increase in taxes on salaries and investment income for high-income taxpayers, raising an estimated $18 billion in additional revenue in 2013.
- A 3.8 percent health care tax was imposed on the investment income of taxpayers with adjusted gross incomes of more than $200,000 for a single filer and $250,000 for joint filers.
- Because the Bush tax cuts were not extended for high income taxpayers, tax rates on incomes over $400,000 for single filers and $450,000 for joint filers increased from 35 percent to 39.6 percent.

The Bipartisan Budget Act. Passed in December 2013, this Act raised some of the spending caps, and provided about $63 billion in sequester relief over a two-year period, split evenly between defense and non- defense spending.

- In fiscal year 2012, the budget deficit was over $1 trillion.
- But in 2013 and 2014, when sequestration was in effect, budget deficits were $680 billion and $483 billion, respectively.

The annual deficit has been declining, but the Congressional Budget Office expects it to increase again, to $1 trillion annually, by 2016.

The Tax Increase Prevention Act of 2014. This Act extended many expiring provisions from previous years into tax year 2014.

- Private mortgage insurance: Homeowners paying for private mortgage insurance (PMI) on their home can deduct those payments from their taxable income.
- Sales taxes: Taxpayers who itemize may deduct state and local sales taxes rather than state and local income taxes (the option was available to all taxpayers, not just those in no income tax states).
- Mortgage debt: If a lender canceled, forgave or restructured a debt in 2014, the income a taxpayer saved from the discharge of that debt, up to $2 million, is not taxable this year.
- Tuition and fees deduction for higher education: This allows taxpayers to claim up to $4,000 in education expenses so long as they meet certain income criteria. This is an above the line deduction, meaning itemizing is not necessary.

The Medicare "Doc Fix." Congress recently passed a Medicare "doc fix" to ostensibly solve the problem of decreasing fees to Medicare providers. It is expected to increase the budget deficit by $141 billion through 2025.

Debt Limit/Ceiling. In February 2014, the debt ceiling on the national debt was "suspended" until March 2015, meaning that a dollar amount limit was not determined. If the debt ceiling is not raised, the United States will not be able to borrow money to pay for all of the scheduled spending, since 36 percent of annual federal spending is now financed by increased borrowing. But under a suspension, the limit was technically not increased, instead allowing money to be borrowed into the next year, effectively handing Congress a blank check.

The current national debt is at $18.2 trillion. Because Congress has not passed a new debt ceiling the Treasury has taken "extraordinary measures" to continue paying the federal government's bills. This usually starts with suspending payments to government pension funds and suspending issuance of certain state and local government securities.

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