COMMITTEE ON WAYS AND MEANS
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DEMOCRATS' TICKING TAX BOMB, PART I

Overview: Congress Must Prevent Massive Tax Increases from Hitting Families and Job Creators on January 1, 2013

It's been called the "ticking tax bomb" and even "Taxmageddon" – and it's a central issue that must be addressed in order to avoid the so-called "fiscal cliff" when the clock strikes midnight on December 31, 2012. But by whatever name it's known, one thing is clear: the looming, year-end expiration of the low-tax policies originally enacted in 2001 and 2003 – and extended, at Republicans' urging, by a Democrat Congress and President Obama in 2010 – threatens our already weak economy with the largest tax increase in American history. House Republicans have announced plans to hold a vote prior to the August recess on legislation to extend all of these low-tax policies again – while also establishing a pathway to comprehensive tax reform next year – sending a clear signal to families, employers, and the financial markets that taxes will not go up on January 1, 2013, as a result of their expiration.

The economic impact of these potential tax increases would have a devastating effect on the economy. According to the Joint Committee on Taxation (JCT), a one-year extension of these low-tax policies – including a one-year AMT patch – would prevent a $300 billion tax increase. Extending these policies on a permanent basis – or, as Republicans have called for, enacting comprehensive tax reform consistent with historical revenue levels – would prevent a $4.3 trillion tax increase over the next decade. In light of the continuing string of dismal economic data and jobs reports, prominent Democrats – such as former President Bill Clinton, former Obama economic advisor Larry Summers, and Senate Budget Committee Chairman Kent Conrad (D-ND) – are joining the growing bipartisan chorus calling for an extension of these policies for <u>all</u> taxpayers. The question is: Will President Obama and the Democrats who run Washington work with House Republicans to prevent this massive, job-killing tax increase on small businesses and on every American who pays income taxes, or will they insist on higher taxes to pay for continued bailouts and wasteful Washington spending?

If the low-tax policies originally enacted in 2001 and 2003 – and extended on a bipartisan basis in 2010 – are allowed to expire at the end of this year, what will it mean for individuals, families, and small businesses on January 1, 2013? This document provides an overview of the potential consequences of Democrats' ticking tax bomb, including:

Higher Marginal Income Tax Rates on Every American Who Pays Income Taxes, Including Small Business Owners		
Individuals and Small Businesses* with Taxable Income in the Following Ranges…	**… Pay This Rate on that Range of Income in 2012…**	**…But will Pay This Rate on that Range of Income in 2013**
Up to $8,700 for single filers and Up to $17,400 for married couples	10 percent	15 percent
Between $8,700 and $35,350 for single filers and Between $17,400 and $70,700 ($60,350 for 2013)** for married couples	15 percent	15 percent
Between $35,350 and $85,650 for single filers and Between $70,700 ($60,350 for 2013)** and $142,700 for married couples	25 percent	28 percent
Between $85,650 and $178,650 for single filers and Between $142,700 and $217,450 for married couples	28 percent	31 percent
Between $178,650 and $388,350 for single filers and Between $217,450 and $388,350 for married couples	33 percent	36 percent ***
Over $388,350 for both single filers and married couples	35 percent	39.6 percent (40.8 percent when also accounting for the additional hidden rate of approximately 1.2 percent from the reinstatement of the Pease limitation, discussed below) ***

Dollar amounts listed in the table above will be indexed for inflation in 2013. Amounts listed for married couples are for married couples filing joint returns.

**According to the Joint Committee on Taxation (JCT), 95 percent of all U.S. non-farm businesses in 2009 were S corporations, partnerships, or sole proprietorships – "pass-through" business entities commonly used by small businesses that file their taxes on their owners' individual Form 1040s and pay taxes at the individual tax rates. Also according to JCT, roughly half (46 percent) of total business income earned by all U.S. non-farm businesses in 2009 was earned by such pass-through businesses.*

*** Because of one of the marriage penalties that will be reinstated (see below), this $70,700 amount will drop to $60,350 in 2013, meaning that a married couple with as little as $60,350 in taxable income will be subject to the higher 28 percent rate on their next dollar earned, rather than the 15 percent rate.*

**** As explained below, while the top two statutory rates will be 36 percent and 39.6 percent in 2013, because of the imposition of additional hidden tax rates due to the reinstatement of the personal exemption phase-out (PEP) and the Pease limitation on itemized deductions, the top two effective marginal rates could actually be considerably higher for many taxpayers.*

Higher Taxes if You Are Married (Marriage Penalties Reinstated)		
For Married Couples Filing Jointly, the Marriage Penalty Is Reinstated With Respect To...	**2012**	**2013**
The Standard Deduction (which shields the first several thousand dollars of income earned by non-itemizers from tax)	Singles: $5,950 Married: $11,900 No marriage penalty because the standard deduction for married couples is exactly twice the standard deduction for singles	Singles: $6,050 Married: $10,150 Marriage penalty is reinstated because the standard deduction for married couples is less than twice the standard deduction for singles
The last dollar of income taxed at the 15 percent rate (instead of at 25 percent in 2012 or at 28 percent in 2013, the next highest tax rate in effect)	Singles: $35,350 Married: $70,700 No marriage penalty because the last dollar of income taxed at 15 percent (instead of at 25 percent, the next highest rate) for married couples is exactly twice the corresponding amount for singles	Singles: $36,100 Married: $60,350 Marriage penalty is reinstated because the last dollar of income taxed at 15 percent (instead of at 28 percent, the next highest rate) for married couples is less than twice the corresponding amount for singles

Dollar amounts listed in the table above for 2013 are JCT estimates reflecting expected inflation adjustments.

Higher Taxes if You Are A Parent (Child Credit Cut in Half)		
Pro-family Tax Benefit	**2012**	**2013**
Child Tax Credit	$1,000 per child under 17	$500 per child under 17

Higher Taxes on Investments that Grow the Economy and Create Good Jobs		
Investment Incentive	**2012**	**2013**
Top rate on long-term capital gains	15 percent	20 percent (25 percent when also accounting for the 3.8 percent ObamaCare surtax on net investment income, and the additional hidden rate of approximately 1.2 percent from the reinstatement of the Pease limitation, discussed below)
Top rate on qualified dividends	15 percent	39.6 percent (44.6 percent when also accounting for the 3.8 percent ObamaCare surtax on net investment income, and the additional hidden rate of approximately 1.2 percent from the reinstatement of the Pease limitation, discussed below)

Higher Taxes through Additional Hidden Tax Rate Increases (PEP and Pease Limitation Reinstated)

Hidden Tax Rate Increase Reinstated	Individuals and Small Businesses* with Adjusted Gross Income Above These Amounts…	… Pay this additional hidden tax rate increase in 2012…	… But pay this additional hidden tax rate increase in 2013
Personal exemption phase-out (PEP)**	$177,550 for single filers and $266,300 for married couples filing jointly	None	Variable, based on the number of personal exemptions
Pease limitation on itemized deductions (such as for mortgage interest, charitable contributions, and state and local taxes)***	$177,550 for both single filers and married couples filing jointly	None	Approximately 1.2 percent (until 80 percent of itemized deductions are eliminated)

For **ordinary income**, when factoring in the reinstatement of these additional hidden tax rates, the top effective marginal tax rate in 2013 will be **40.8 percent**:

39.6 percent (top statutory rate on ordinary income)
\+ 1.2 percent (Pease limitation)
40.8 percent

For **capital gains**, when factoring in the reinstatement of these additional, hidden tax rates, the top effective tax rate in 2013 will be **25.0 percent:**

20.0 percent (top statutory rate on long-term capital gains)
3.8 percent (ObamaCare surtax on net investment income)
\+ 1.2 percent (Pease limitation)
25.0 percent

For **dividends**, when factoring in the reinstatement of these additional, hidden tax rates, the top effective tax rate in 2013 will be **44.6 percent**:

39.6 percent (top statutory rate on dividends)
3.8 percent (ObamaCare surtax on net investment income)
\+ 1.2 percent (Pease limitation)
44.6 percent

Dollar amounts listed in the table above are JCT estimates for 2013 reflecting expected inflation adjustments.

**According to the Joint Committee on Taxation (JCT), 95 percent of all U.S. non-farm businesses in 2009 were S corporations, partnerships, or sole proprietorships – "pass-through" business entities commonly used by small businesses that file their taxes on their owners' individual Form 1040s and pay taxes at the individual tax rates.*

***The personal exemption phase-out (PEP) strips away a taxpayer's personal exemptions by 2 percent for each $2,500 that the taxpayer's income exceeds the listed threshold amount. PEP will generally affect taxpayers in the 36 percent bracket, but not the 39.6 percent bracket, because taxpayers in the top bracket generally have had their personal exemptions fully phased out. In addition, the design of PEP is such that the effective marginal rate it imposes varies by the number of personal exemptions claimed. For these reasons, PEP has been excluded from the calculations of top effective marginal rates in this table, even though it can have a significant impact.*

****The Pease limitation eliminates up to 80 percent of a taxpayer's itemized deductions otherwise permitted.*

Higher Death Taxes on Small Businesses and Family Farms		
Estate Tax Provision	**2012**	**2013**
Exemption amount	$5.12 million (indexed for inflation)	$1 million (not indexed for inflation)
Top rate	35 percent	55 percent

Higher Taxes for 31 Million Households Due to the Alternative Minimum Tax (AMT)		
AMT Feature	**Tax Returns Due in April 2012 (for Tax Year 2011)**	**Tax Returns Due in April 2013 (for Tax Year 2012)**
Exemption amount	$48,450 singles / $74,450 joint filers	$33,750 singles / $45,000 joint filers
Non-refundable personal credits allowed against the AMT?	Yes	No
Taxpayers affected	Approximately 4 million	Approximately 31 million

For examples of how Democrats' ticking tax bomb will affect typical taxpayers, stay tuned for Part II of this series, coming soon.