NACo National Association of Counties
The Voice of America's Counties

LEGISLATIVE BRIEF

The County Perspective: The Fiscal-Cliff Deal

On New Year's Day, Congress approved legislation (H.R. 8) to address the year-end tax hikes and spending cuts known as the "fiscal cliff." The measure passed the U.S. House of Representatives late on January 1 after the U.S. Senate had overwhelmingly approved it earlier that same day.

The measure, the "American Taxpayer Relief Act of 2012," is expected to be signed into law by President Barack Obama, guaranteeing the first increase in income tax rates in almost two decades and setting up another showdown in the coming months over automatic, across-the-board spending cuts known as "sequestration," the debt ceiling, tax and entitlement reform, and a long-term solution to the nation's debt and deficits.

While the passage of this measure will temporarily avert and delay various elements of the fiscal cliff, counties will continue to be confronted with significant negative risks associated with the many aspects of the fiscal cliff that would adversely impact their budgets and the millions of people and local communities they serve.

Elements of the Fiscal Cliff

- Sequestration or automatic, across-the-board cuts
- Budget caps for annual appropriations process
- Addressing federal debt ceiling
- Tax cut extensions for 2001, 2003, and 2010 provisions
- Tax reform of corporate and individual tax provisions
- 2 percent payroll tax holiday
- Extended unemployment benefits
- Medicare physician (i.e. "doc" fix)
- AMT patch (massive tax increase for 30 million Americans)
- Entitlement and Tax Reform
- Affordable Care Act taxes

What is the Fiscal Cliff?

The term "fiscal cliff" is used to describe the mix of $607 billion in U.S. taxes and spending that expired on December 31, 2012. The mix of tax provisions and spending cuts include the Bush era tax cuts, the 2010 Obama payroll tax holiday, the partial expensing of investments and the onset of tax provisions to support the implementation of the 2010 Affordable Care Act (ACA), the expiration of emergency unemployment insurance (UI) benefits, a scheduled reduction in Medicare payment rates for physicians, and the start of sequestration—the across-the-board cuts in discretionary and defense spending under the 2011 Budget Control Act.

House Dynamics

The House backed the measure 257-167, after Republicans leaders spent much of the day counting votes and determining that there was not enough support to call up an alternative measure favored by conservatives that would have amended the Senate bill to force larger spending cuts. In the end, the measure that permanently extends the Bush-era tax cuts and delays about $110 billion in across-the-board spending cuts, had bipartisan support with 85 Republicans backing the bill (with 151 opposed) and 172 Democrats supporting it (with only 16 opposed). Signifying the split among Republicans, House Speaker John Boehner (R-OH) and House Budget Chairman Paul Ryan (R-WI) both backed the measure, while other GOP leaders, including Majority Leader Eric Cantor (R-VA) and Majority Whip Kevin McCarthy (R-CA), voted against it.

Although the legislation will avert many of the year-end tax hikes and spending cuts that were set to kick in,

it failed to address some of the major issues that have divided Congress in recent months.

Impact on Spending and Deficit Reduction

According to the Congressional Budget Office which had scored the measure, the fiscal cliff compromise would add approximately $3.971 trillion to the deficit over the next 10 years, primarily by continuing tax cuts that otherwise would have expired at the end of 2012. Provisions related to revenue in the measure would account for $3.639 trillion of the deficit increase between 2013 and 2022.

Additional spending in the bill, some of it related to tax policy, would add approximately $332 billion in debt. Preserving the bottom 10 percent tax bracket alone would lead to a revenue loss of $442.6 billion and capping the dividends tax rate at 20 percent would cost another $231 billion. The most expensive single provision in the agreement, at a cost of $1.8 trillion, would raise the income threshold for the alternative minimum tax to $50,600 for single filers and $78,760 for couples.

However, the White House's Office of Management and Budget (OMB) countered that the estimates provided by the CBO do not provide a realistic perspective of the impact of H.R. 8. According to OMB, the CBO score measured the effects of this legislation relative to "current law," vs. "current policy." Current law assumes the expiration of all of the 2001/2003 tax cuts, cuts to Medicare physicians of almost 27 percent, and allowing the across-the-board cuts from sequestration to take effect. Taking "current policy" into consideration, OMB argues that H.R. 8 would reduce the deficit by $737 billion. Within that total, it would reduce spending by $107 billion.

What the Deal Failed to Include

Although the legislation will avert many of the year-end tax hikes and spending cuts that were set to kick in, it failed to address some of the major issues that have divided Congress in recent months. Here's what it left out:

- **This deal was no grand bargain.** Congressional lawmakers did not address the country's long-term fiscal issues in this bill—namely, a complicated tax code and rising entitlement spending.

- **An agreement to raise the debt ceiling.** The nation reached its $16.394 trillion borrowing limit on Monday, and the Treasury Department has said it will use "extraordinary measures" to avert default as long as it can—likely into February. Then Congress will have to once again take up the contentious issue of raising the country's debt ceiling. Last time, the negotiations resulted in a downgrade of the U.S. credit rating by one major rating agency and instability in the markets. This time, the risks will be just as high.

  Treasury Secretary Timothy Geithner wrote to Congress the following: "These extraordinary measures… can create approximately $200 billion in headroom under the debt limit. Under normal circumstances, that amount of headroom would last approximately two months. However, given the significant uncertainty that now exists with regard to unresolved tax and spending policies for 2013, it is not possible to predict the effective duration of these measures. At this time, the extent to which the upcoming tax filing season will be delayed as a result of these unresolved policy questions is also uncertain. If left unresolved, the expiring tax provisions and automatic spending cuts, as well as the attendant delays in filing of tax returns, would have the effect of adding some additional time to the duration of the extraordinary measures. Treasury will provide more guidance regarding the expected duration of these measures when the policy outlook becomes clearer."

Medicaid was not included…YET

As one of the big three federal entitlement programs, Medicaid will inevitably be a target for savings in any grand bargain negotiation.

Medicaid is the federal health insurance program for low-income children and their parents, pregnant women, elderly, blind and disabled, and is jointly financed and administered by the federal government, states, and often through counties. The ACA offers states the opportunity to expand Medicaid to cover all adults up to 133 percent of the federal poverty level.

Why do counties care about Medicaid in a grand bargain?

- Counties put up part of the non-federal match for Medicaid in 27 states
- Counties are required to provide health care for indigent residents in 32 states
- Counties own 964 hospitals and 647 nursing homes serving Medicaid beneficiaries
- Reducing federal financial contributions to Medicaid puts counties at risk for absorbing shifted costs

- **Extension of the payroll-tax cut.** A temporary, two-percentage-point cut to the payroll tax expired at midnight on December 31, 2012, and was not renewed.

- **Medicaid was not included…YET.** The deal did not include any major reforms to entitlements, including Medicaid. However, it is still on the table for future action or a grand bargain.

- **Congressional pay freeze.** President Obama recently authorized a congressional pay raise in a move that angered many congressional Republicans. Under the new measure, Members of Congress will not see their pay increase.

What the Deal Included

- **Higher taxes on individuals earning $400,000 and on families making $450,000 or more.** Under that threshold, the Bush-era tax cuts will be permanent for all but the wealthiest households. The $450,000 threshold for families is a significant increase from Democrats' initial proposal to raise taxes on Americans making $250,000 or more, but it is lower than Republicans' earlier proposal to raise taxes on households making $1 million or more.

- **Higher tax rates on capital gains and dividends for wealthier households.** Taxes on capital gains and dividends will be held at their current levels of 15 percent for individuals making less than $400,000 and households with income of less than $450,000. They will rise to 20 percent for individual taxpayers and for households above those thresholds.

- **Deduction of state and local sales taxes extended.** At the end of 2011, the ability to deduct state and local sales taxes in lieu of state income taxes expired. The deduction for state and local sales taxes is one of the so-called tax extenders that Congress must revisit every so often and is a provision that is mostly pertinent to residents in states that levy no individual income tax. The cliff deal revives the provision, extending it for two years until the end of 2013.

- **Personal exemptions phased out for individuals making over $250,000.** Personal exemptions will be phased out and itemized deductions will be limited for taxpayers making over $250,000 and families earning more than $300,000.

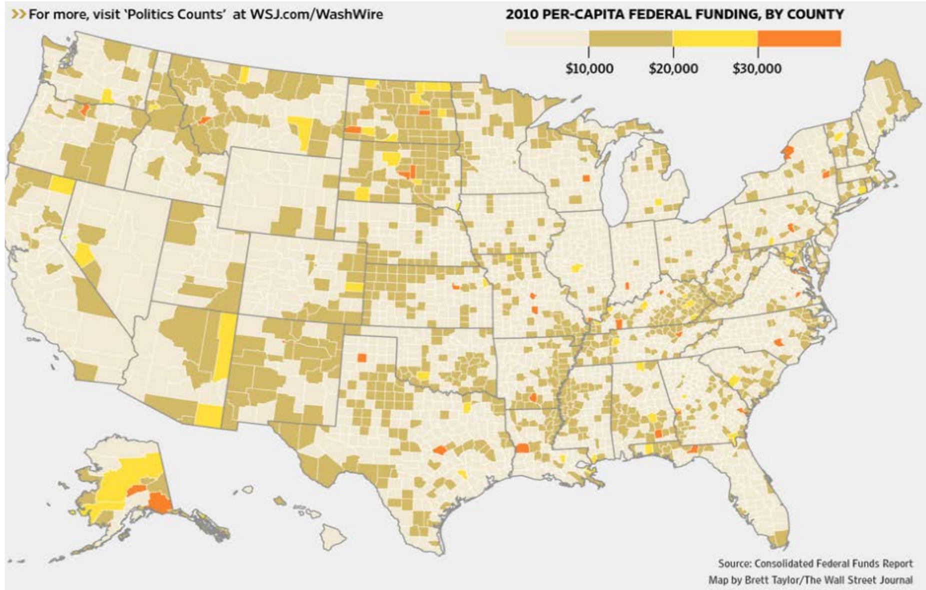
  Of interest to counties, the limitation on itemized deductions does not apply to tax-exempt municipal bond interest. Counties, however, should remain vigilant on this issue as proposals that could impact the tax-exempt status of municipal bonds could arise when the debate to reform the U.S. tax code begins in earnest.

- **40 percent estate tax.** The current estate tax exemption amount, $5 million and indexed for inflation for years after 2011, is permanently extended by the measure. Additionally, the maximum rate will rise to 40 percent from its current 35 percent level. Democrats had earlier sought a higher increase to 45 percent and a lower exemption of $3.5 million.

- **Permanent fix to the Alternative Minimum Tax.** The alternative minimum tax was levied to ensure the wealthiest Americans paid a fair share of taxes. It was not indexed for inflation but is usually "patched" annually to prevent an increasingly large swath of middle-class Americans from being caught in its net. As part

Under Deal, Sequestration Postponed for Two Months

The looming 'fiscal cliff' carries with it over $100 billion in government cuts. Although the most recent deal delays the automatic, across the board cuts known as 'sequestration' for two months, it remains a critical outstanding issue that will have a significant impact on counties across the country. The map shown here, from the 2010 Consolidated Federal Funds Report, shows total federal spending per capita at the county level. Most counties receive at least $8,500 per capita, although some collect much more. But there are also high figures across the Great Plains and scattered throughout military communities. The net result: There would be plenty of pain to go around in both politically 'blue' and 'red' states.



of the fiscal deal, the AMT will be permanently indexed to inflation.

- **Tax breaks for working families.** The deal includes five-year extensions of the American Opportunity Tax Credit, which can be claimed for college-related expenses, the Child Tax Credit, and the Earned Income Tax Credit, which is a refundable income-tax credit for low- to moderate income working Americans.

- **Business tax breaks.** The Senate Finance Committee passed a package in August that tackled a variety of routinely expiring tax provisions known as extenders. These popular tax provisions include breaks for research and development. That package passed as part of the broader cliff deal and includes the extension of "new markets tax credit" program which is provided to businesses that make certain investments in community development entities, and a maximum annual amount of $3.5 billion in qualified investments for 2012 and 2013; The measure also extends for one year through end of 2014, the temporary minimum low-income housing tax credit rate of nine percent for non-federally subsidized new buildings.

- **Work Opportunity Tax Credit Extended.** The measure extends the Work Opportunity Tax Credit for qualified wages paid to members of targeted groups, as well as an employer wage credit for activated military reservists.

- **Automatic spending cuts delayed for two months.** The "sequester," which would impose steep, across-the-board cuts to domestic and defense programs, will be delayed for two months.

As part of the compromise to delay sequestration, the legislation reduces to $85 billion the required sequester of discretionary and mandatory spending for FY2013. This would be offset by decreasing the current statutory caps on discretionary spending set for FY2013 and FY2014 by a total of $12 billion ($4 billion from FY2013 and $8 billion from FY2014, split evenly each year between security and non-security spending), and by raising $12.2 billion in revenue over 10 years by making it easier for individuals with certain tax-deferred retirement accounts to transfer those funds to a Roth IRA.

This means that future cuts as part of the annual appropriations process can be expected.

- **Medicare Doctors' pay cut delayed one year, hospitals absorb the cost.** The measure will put off scheduled cuts in physician payments under Medicare. In the absence of an agreement, the payments were going to be reduced by 27 percent in January 2013. CBO estimates the cost of a one year "doc fix" at $25.2 billion over ten years, offset in part by $4.2 billion from Medicaid disproportionate share hospital (DSH) payments.

  County hospitals use DSH payments to help cover the cost of caring for uninsured and underinsured patients as well as those covered by Medicaid, with its notoriously low reimbursement rates. The ACA imposed cuts to DSH beginning in 2014, which would have expired at the end of 2019, sending payments back up to current levels. However, Congress "re-based" the formula to help pay for last year's "doc fix" and H.R. 8 does the same through 2022. NACo strongly opposes any cuts to DSH, especially to pay for non-Medicaid spending, but even strong Medicaid supporters on Capitol Hill have been willing to pocket the savings from re-basing for the "doc fix."

  Other offsets include a cut to Medicare reimbursement for acute inpatient care ($10.5 billion/ten years); a cut to Medicare reimbursement for end stage renal dialysis treatments ($4.9 billion/ten years) and a cut to private Medicare Advantage plans ($2.5 billion/ten years).

- **Low-Income and Rural Health Programs Extended for One Year.** Of interest to counties, the following programs were extended: Qualified Individual (QI) program, which enables Medicaid to pay the Medicare Part B premium for certain low income beneficiaries ($800 million/ten years); the Transitional Medical Assistance (TMA) Program which provides up to 12 months of medical coverage for families who lose Medicaid eligibility due to increased earnings or child support; Medicare ground ambulance reimbursement rates for "super rural" areas ($100 million/ten years); the Medicare-Dependent Hospital and Low Volume Hospital programs for certain small rural hospitals ($400 million/ten years) and Medicare Advantage Special Needs Plans for beneficiaries with severe or disabling chronic conditions, who are living in an institution like a nursing home or who are eligible both for Medicare and Medicaid ($300 million/ten years).

The fiscal cliff deal extends through the end of FY2013 most provisions of farm policy as they were in effect on September 30, 2012, under the 2008 Farm Bill (P.L. 110-246), but fails to extend mandatory funding for NACo supported programs for renewable energy, rural development, drought disaster assistance and beginning farmers and ranchers.

- **Repeals ACA's CLASS Act; Establishes commission on long term care.** The deal repeals the Community Living Assistance Services and Supports (CLASS) program which was part of the ACA and was designed to provide a cash benefit for people with disabilities to pay for services which would allow them to stay at home. It was to be funded by voluntary payroll deductions. In late 2011, the Administration notified Congress that the program would not be actuarially sound and that it would not proceed with implementation.

Recognizing the need to address the cost of long term care – currently about half of all health care spending – the bill calls for a Commission on Long Term Care to develop a plan "for the establishment, implementation and financing of a comprehensive, coordinated, and high-quality system that ensures the availability of long-term services and supports for individuals in need of such services and supports," including the elderly and disabled – and those who want to plan for their future long-term care needs.

The President, Senate Majority Leader, Senate Minority Leader, Speaker of the House and House Minority Leader each would name three Commission members. The Commission is directed to produce a report with recommendations for legislative or administrative action within six months. If approved by a majority of the Commission, legislative recommendations would be introduced as a bill in both chambers of Congress, but without any mechanism to force action.

NACo supports policy and programs that allow individuals to access services which enable them to live in the least restrictive environment that is right for their needs.

- **Parity for employer-provided mass transit and parking benefits.** The deal includes a provision that restores benefits for one year for transit riders and vanpool users who may now receive up to $240 in benefits monthly from an employer, the same as the parking benefit. The transit benefit had been reduced to $125 in 2012 while the parking benefit remained at the $240 level in 2012. This change benefits counties that operate transit systems as it is likely to encourage greater transit ridership and also benefits transit users who are likely to see a decrease in their transportation costs.

- **One-year Extension of Unemployment Insurance (UI) Benefits.** The measure extends for one year, long term federal UI benefits for laid- off workers. The restructured benefit tiers enacted under last February's benefit extension are maintained, including a reduction in the maximum number of weeks an individual is entitled to receive benefits, as well as job search requirements. The measure extends the availability of railroad extended unemployment benefits. The measure also extends the current authorization for federal aid to help states carry out re-employment services through FY2014.

- **Deeply Flawed Farm Bill Extension.** The fiscal cliff deal extends through the end of FY2013 most provisions of farm policy as they were in effect on September 30, 2012, under the 2008 Farm Bill (P.L. 110-246), but fails to extend mandatory funding for NACo supported programs for renewable energy, rural development, drought disaster assistance and beginning farmers and ranchers.

  For the duration of the extension under the fiscal cliff Farm Bill extension, the measure ends mandatory funding for a number of programs that used to be entirely mandatory or a combination of discretionary and mandatory funding. While these programs remain authorized in the extension, the elimination of mandatory funding effectively kills many of these programs.

The extension discontinues mandatory funding for the Rural Development Title for nine months. This title received $150 million in funding in the 2008 Farm Bill for the Rural Microenterprise Assistance Program (RMAP – at $15 million), Value-Added Producer Grant Program (VAPG – at $15 million) and Water/Wastewater Backlog ($120 million). RMAP, utilized by counties for microlending programs, will effectively end without mandatory funding. The majority of USDA Rural Development programs utilized by counties are funded through the yearly appropriations process, therefore water/wastewater, housing, broadband, community facility and other business programs will continue at their appropriated levels.

However, the Farm Bill's Renewable Energy Programs, which received $1 billion in mandatory funding in the 2008 Farm Bill and have limited appropriations, will be hamstrung by the extension. These programs include the Rural Energy for America Program, Biorefinery Assistance, Repowering Assistance and other bioenergy and bio product development programs critical to rural counties. The innovative Beginning Farmer and Rancher Development Program will also end as the extension does not continue mandatory funding.

Registration Open for the 2013 NACo Legislative Conference

Register now for NACo's 2013 Legislative Conference, slated for March 2-6 at the Washington Hilton Hotel! This annual event brings 2,000 elected and appointed county officials from across the country to our nation's capital to focus on legislation and policies impacting county government. Attendees will hear from key Administration officials and members of Congress and are offered a myriad of educational opportunities addressing current issues. A day of lobbying on Capitol Hill rounds out an information-packed conference that should not be missed! Visit www.naco.org to register today.

The Farm Bill extension does include a five year reauthorization of the nutritional education program and a nine-month extension of the Supplemental Nutrition Assistance Program (SNAP) employment program. The SNAP entitlement and benefits didn't require an extension because they don't expire.

The measure extends current commodity terms and conditions for all commodities for the 2013 crop year, including sugar cane, sugar beets and peanuts. It also extends through December 31, 2013 the Dairy Product Support Program and the Milk Income Loss Contract Program.

For questions or more information, Please feel free to contact us below:

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