



Budget Brief 13-01, January 4, 2013

President Signs Fiscal Cliff Deal

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Summary

On January 2, 2013, the president signed the American Taxpayer Relief Act of 2012 (H.R. 8), addressing some of the issues debated during the recent fiscal cliff negotiations. The deal includes a number of tax provisions, an extension of unemployment benefits and farm programs, and certain health extensions and offsets. The package also delays sequestration (previously scheduled to take effect January 2, 2013) for two months and pays for those two months of cuts with a combination of other spending cuts and revenue increases. This *Budget Brief* provides details on the agreement.

Sequester Modification

H.R. 8 postpones the Budget Control Act (BCA) sequester from January 2, 2013 to March 1, 2013, and reduces the total across-the-board (ATB) cut in FY 2013 from \$109 billion to \$85 billion. The \$24 billion reduction is offset by lower discretionary spending caps (\$4 billion from FY 2013 and \$8 billion from FY 2014, split equally between security and nonsecurity) as well as new revenue related to retirement accounts. While the overall cut is reduced, the reduction is taken with seven months remaining in the fiscal year instead of nine months.

The new law does not modify the sequester process. For example, the \$85 billion in FY 2013 cuts is split equally between defense and nondefense, the reductions in these two categories are divided proportionately between nonexempt discretionary and mandatory programs, the major exemptions and special rules still apply, and the cuts are applied to annualized FY 2013 funding levels.

Table 1 estimates the impact of the modified sequester on FY 2013 funding levels for major discretionary and mandatory programs. FFIS did a rough calculation of the FY 2013 ATB percentages based on H.R. 8. FFIS estimates a 5.9% cut for nondefense discretionary programs and a 5.7% cut for nondefense mandatory programs subject to sequester. (For defense discretionary programs, FFIS estimates a 7.3% reduction).

These calculations rely on the methodology outlined in the Office of Management and Budget (OMB) sequester report from September 2012. In calculating the base subject to sequester, FFIS used OMB's estimates for mandatory spending but updated nondefense discretionary funding to reflect the six-month Continuing Resolution (CR). The final percentage cuts will be calculated by OMB on March 1, 2013, and will depend on the base subject to sequester at that time. The percentage reductions will then be

applied to FY 2013 spending in place as of March 1, 2013. For this analysis, FFIS assumes these funding levels will be the annualized funding included in the CR, which is in effect through March 27, 2013.

Program Extensions

Unemployment Insurance (UI). H.R. 8 extends the Emergency Unemployment Compensation (EUC) program by one year to January 1, 2014, with no phase-out date. In addition, the law applies the same tier structure for 2013 as was provided in the Middle Class Tax Relief and Job Creation Act of 2012 (P.L. 112-96). Details on the EUC tier structure can be found in [Issue Brief 12-08](#).

Furthermore, the law extends 100% federal financing of the Extended Benefits (EB) program. Specifically, the law provides 100% federal financing for EB through the week ending December 31, 2013, with a phase-out date of June 30, 2014. The law also extends the three-year EB look-back provision to December 31, 2013.

Finally, H.R. 8 provides a one-year extension through FY 2014 of the current provisions governing reemployment services and reemployment and eligibility assessments (REAs) enacted in P.L. 112-96. P.L. 112-96 requires states to provide reemployment services and REAs to long-term unemployed individuals who receive EUC benefits. H.R. 8 extends this provision and a provision specifying that states receive \$85 per EUC claimant for these services.

Farm Bill. H.R. 8 also contains an extension of the current farm bill (P.L. 110-246) to either September 30, 2013 or the date specified by a law reauthorizing the 2008 farm bill. While the authority for most farm bill programs and the funding for mandatory programs are extended, H.R. 8 does include several funding changes. Under the Supplemental Nutrition Assistance Program (SNAP), H.R. 8 provides \$79 million (a -\$11 million decrease) for the SNAP Employment and Training program. This cut reflects an ongoing trend, as the FY 2010, 2011, and 2012 budgets all included rescissions for this program.

Additionally, H.R. 8 modifies funding for the Nutrition Education and Obesity Prevention Program (NEOPP). Previously, the Healthy, Hunger-Free Kids Act of 2010 (P.L. 111-296) provided \$375 million for NEOPP in FY 2011 and the same amount indexed to inflation for FY 2012 and each subsequent fiscal year. H.R. 8 provides specified funding levels for NEOPP in FYs 2013-2015 (\$285 million, \$401 million, and \$407 million, respectively) and indexes funding to inflation for FY 2016 and each subsequent fiscal year. The FY 2013 funding set by H.R. 8 is a -\$111 million decrease from the estimated level under the old funding structure (\$396 million) included in the president's FY 2013 budget as well as in the House and Senate FY 2013 agriculture appropriation bills. This cut in FY 2013 is used as an offset for payments to dairy producers.

Moreover, the farm bill extension converts a number of mandatory programs into discretionary programs by authorizing appropriations for these programs rather than providing a direct appropriation as part of the legislation. For example, the current farm bill provides both mandatory and discretionary funding for the Specialty Crop Research Initiative (SCRI). For FY

2012, the 2008 farm bill provided \$50 million in mandatory funds and authorized an additional \$100 million in discretionary funds for the program. H.R. 8 does not include any additional mandatory funds for SCRI, but authorizes \$100 million in discretionary funds for FY 2013.

Finally, H.R. 8 excludes a handful of programs from the farm bill extension. As such, the authorization for these programs expired on September 30, 2012, with the 2008 farm bill, though some still receive discretionary funding under the current CR. These programs include: local and regional food aid procurement, the Supplemental Revenue Assistance Payments Program, the McGovern-Dole International Food Program, market loss assistance for asparagus producers, survey and reporting requirements regarding foods purchased by school food authorities, the Value-Added Agricultural Market Development Program, pending rural development loan and grant applications, the Rural Micro-entrepreneur Assistance Program, and the National Sheep Industry Improvement Center.

Health Provisions

Health Extensions. H.R. 8 extends for one year, through December 31, 2013, the Qualified Individual (QI) program. It provides \$485 million for January 1, 2013 to September 30, 2013, and \$300 million for October 1, 2013 to December 31, 2013. Combined with funding included in the last extension (P.L. 112-78), the QI program will receive \$765 million in FY 2013, a \$35 million increase from FY 2012 levels. The law also extends the Transitional Medical Assistance (TMA) program through December 31, 2013.

The agreement extends a number of Medicare and other health programs. Of particular interest to states, it extends and provides additional funding through a direct appropriation for the following programs in FY 2013: \$7.5 million for the State Health Insurance Assistance Program (SHIP), \$7.5 million for Area Agencies on Aging, and \$5 million for Aging and Disability Resource Centers. It also extends Family-to-Family Health Information Centers and funds the program at \$5 million in FY 2013. The Medicaid and Children's Health Insurance Program (CHIP) express lane eligibility option is extended from September 30, 2013 to September 30, 2014.

Finally, the law prevents the scheduled 27% reduction in the Medicare reimbursement rate for physician services that was set to occur on January 1, 2013, and, instead, maintains the current rate through December 31, 2013.

Health Offsets. The Affordable Care Act (ACA, P.L. 111-148 and 111-152) reduced disproportionate share hospital (DSH) allotments by specified amounts in FYs 2014-2020 (see [Issue Brief 12-30](#)). P.L. 112-96 extended the FY 2020 DSH reductions of \$4 billion to FY 2021. H.R. 8 further extends the reductions to FY 2022. However, the overall cut would be slightly smaller in FY 2021 and FY 2022 because the agreement increases allotments for those years by the percentage change in the consumer price index for all urban consumers. The impact of these DSH reductions on specific states is unclear because the Department of Health and Human Services (HHS) has yet to release a methodology for the DSH cuts included in ACA.

H.R. 8 also eliminates most of the remaining ACA funding for Consumer Oriented and Operated Plans (CO-OPs). Specifically, it redirects 10% of the remaining funds to a new CO-OP Program Contingency Fund, which will

provide assistance and oversight to the plans already approved. The remaining funds are rescinded.

The measure fully repeals the Community Living Assistance Services and Supports (CLASS) Act, which has been suspended since 2011 and, instead, establishes a Commission on Long-Term Care Commission. The commission is tasked with developing a plan to establish, implement, and finance a comprehensive system for long-term care. It will be composed of 15 appointed members who must represent the interests of several groups, including state insurance departments and state Medicaid agencies.

Tax Provisions

The Joint Committee on Taxation (JCT) [estimates](#) that H.R. 8 will reduce tax collections by \$3.9 trillion over 10 years. This large loss in revenue results from extending numerous tax cuts that were set to expire December 31, 2012. However, relative to tax policy in effect during 2012, the White House estimates that H.R. 8 will increase tax collections by \$620 billion over 10 years.

Tax Rates. Beginning with the 2013 tax year, the individual income tax rates established in 2001 and 2003 are made permanent, with one exception: rates will increase from 35% to 39.6% on incomes of more than \$400,000 for single taxpayers, \$425,000 for heads of household, \$450,000 for joint filers, and \$225,000 for married taxpayers filing separately. In addition, all these income levels will be indexed for inflation.

H.R. 8 does not extend the two percentage point payroll tax reduction, which has been in effect the past two years.

Several changes were also made to capital gains and dividends taxation.

- The tax rate for capital gains and dividend income for taxpayers with more than \$400,000 in adjusted gross income (AGI) for single filers and \$450,000 for joint filers increases from 15% to 20%.
- Taxpayers whose ordinary income is subject to a 25% or higher rate, but whose income levels fall below the \$400,000/\$450,000 thresholds, will continue to be subject to a 15% rate on capital gains and dividends.
- Taxpayers whose ordinary income is taxed at a rate of less than 25% (roughly \$80,000 for a single filer) will be permanently subject to a 0% rate on capital gains and dividends.

Furthermore, the measure permanently extends the current exemption amount from the estate tax. Estates will be taxed at a top rate of 40%, with the first \$5 million exempted for individual estates and \$10 million for family estates. In 2012, such estates were subject to a top rate of 35%. The \$5 million and \$10 million limits will be indexed for inflation. Lastly, the state estate tax credit was not reinstated.

Alternative Minimum Tax. H.R. 8 includes a permanent extension of the Alternative Minimum Tax (AMT) patch for 2012 and beyond.

Deductions and Credits. Previous limitations on itemized deductions have been restored. These limitations will affect AGI over \$250,000 for individuals and over \$300,000 for couples. The limitations are adjusted for inflation for tax years after 2013.

Several tax credits that were expanded under the American Recovery and Reinvestment Act (ARRA) were also extended. The expanded child tax credit and the expanded eligibility for the Earned Income Tax Credit are both extended for five years. The \$2,500 tax credit for college tuition (American Opportunity) is extended for five years.

The measure also extends several other education-related credits and deductions enacted in 2001, including the increased arbitrage rebate exception for school construction government bonds and issuance of tax-exempt private-activity bonds for qualified education facilities.

H.R. 8 also includes a number of other tax extenders, such as federal tax deductibility of state and local sales taxes and the investment and production tax credits for wind energy.

Depreciation. Accelerated bonus depreciation of business investments in new property and equipment is extended for one year. The law extends and modifies the bonus depreciation provisions with respect to property placed in service after December 31, 2012.

Retirement Income. As a way to pay for a portion of the two-month sequestration delay, H.R. 8 makes it easier for individuals with certain tax-deferred retirement accounts to transfer those funds to a Roth IRA. Individuals switching from traditional tax-deferred IRAs to a Roth IRA must pay tax on the funds transferred since eventual distributions from Roth IRAs are not taxable, unlike distributions from traditional IRAs. By allowing individuals with tax-deferred IRAs to switch to a Roth IRA at any time, rather than in limited circumstances as under previous law, more people are expected to make such taxable transactions.

Next Steps

Though the deal signed by the president averted a combination of spending cuts, program expirations, and tax hikes that were set to take place at the start of the new year, debate is likely to continue some of these issues. Specifically, the two-month delay in the sequester means that spending cuts will be a major issue for Congress over the next several months, along with expiration of the current CR and the need to increase the debt ceiling. However, the prospect of any major reform to the tax code has dimmed as Congress extended numerous tax provisions through the fiscal cliff agreement.

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Table 1

Major Discretionary and Mandatory Program Funding (dollars in millions)

Major Discretionary	FY 2011	FY 2012	FY 2013				
			President's Budget	Latest House	Latest Senate	CR Level	CR after Sequester 1/
Department of Agriculture	\$6,981	\$6,861	\$7,295	\$7,159	\$7,295	\$6,913	\$6,516
Commodity Assistance Program	247	242	254	237	254	254	250
Women, Infants & Children (WIC)	6,734	6,618	7,041	6,922	7,041	6,659	6,266
Department of Commerce	246	220	182	182	200	221	208
Economic Development Assistance	246	220	182	182	200	221	208
Department of Education 9/ 12/	37,191	37,273	37,743	28,797	37,473	37,501	35,289
Title I: Education for the Disadvantaged 11/	14,443	14,516	14,516	14,516	14,616	14,605	13,744
Title I: School Improvement Grants	535	534	534		534	537	505
Striving Readers	0	160	0	160	160	161	151
Even Start	0	0	0		0	0	0
Current School Improvement Programs	27	27	0		27	27	26
Effective Teaching - Literacy	0	0	187		0	0	0
Mathematics and Science Partnerships	175	150	150		150	151	142
English Language Acquisition	734	732	732	732	732	737	693
Improving Teacher Quality 11/	2,465	2,467	2,467		2,467	2,482	2,335
Teacher Incentive Fund	399	299	400		299	301	283
Educational Technology State Grants	0	0	0		0	0	0
Impact Aid	1,273	1,291	1,224	1,311	1,291	1,299	1,222
21st Century Community Learning Centers	1,154	1,152	1,152		1,152	1,159	1,090
State Assessments	389	389	389		389	392	368
Special Education State Grants (Part B-611) 11/	11,466	11,578	11,578	12,078	11,678	11,649	10,961
Career and Technical Education State Grants 11/	1,122	1,123	1,123		1,123	1,130	1,063
Adult Basic and Literacy Education State Grants 5/	596	595	580		595	599	563
Federal Supplemental Ed. Opportunity Grants	736	735	735		735	739	695
Work Study	979	977	1,127		977	983	925
Race to the Top 1/	699	549	850	0	549	552	520
Department of Health and Human Services 2/ 9/ 12/	25,858	25,180	24,712	20,576	25,479	25,461	23,959
Substance Abuse Block Grant	1,783	1,800	1,793		1,820	1,811	1,704
Mental Health Block Grant	420	460	460		480	463	436
Maternal & Child Health Block Grant 7/	656	639	640		640	643	605
Community Health Centers 7/	1,581	1,567	1,562	1,567	1,567	1,577	1,484
Preventive Health Block Grant	80	80	0	100	80	80	76
Family Planning 7/	299	294	297	0	294	296	278
Ryan White AIDS Grants 7/	2,337	2,392	2,472	2,345	2,422	2,407	2,265
Hospital Preparedness	378	375	255		325	377	355
CDC-State & Local Capacity (Bioterrorism)	654	657	642		657	661	622
Head Start	7,560	7,969	8,054	8,014	8,039	8,017	7,544
Child Welfare Services	281	281	281		281	282	266
Community Services Block Grant	679	677	350	677	677	682	641
Child Care & Development Block Grant	2,223	2,278	2,603	2,303	2,438	2,292	2,157
Low-Income Home Energy Assistance 8/	4,701	3,472	3,020	3,472	3,472	3,493	3,287
Refugee Assistance	729	768	805	658	805	900	847
Administration On Aging	1,497	1,471	1,478	1,440	1,482	1,480	1,393
Department of Housing and Urban Development	41,982	40,812	41,503	41,808	42,949	41,062	38,639
Community Development Block Grant - Entitlement	2,321	2,071	2,064	2,341	2,170	2,084	1,961
Community Development Block Grant - Nonentitlement	984	878	884	1,003	930	883	831
Homeless Assistance Grants	1,901	1,901	2,231	2,000	2,146	1,913	1,800
HOME Program	1,607	1,000	1,000	1,200	1,000	1,006	947
Public Housing Operating Fund	4,617	3,962	4,524	4,524	4,591	3,986	3,751
Public Housing Capital Fund	2,040	1,875	2,070	1,985	1,985	1,886	1,775
Tenant-Based Rental Assistance (Section 8)	18,371	18,914	19,074	19,134	19,396	19,030	17,907
Project-Based Rental Assistance (Section 8)	9,257	9,340	8,700	8,700	9,876	9,397	8,842
Housing for the Elderly	399	375	475	425	375	377	355
Housing for Person with AIDS	335	332	330	330	330	334	314
Housing for Persons with Disabilities	150	165	150	165	150	166	156
Department of Energy and EPA	2,709	2,502	2,213	1,598	2,579	2,518	2,369
DOE Weatherization Assistance Program	174	68	139	55	145	68	64
DOE State Energy Program	50	50	49	25	50	50	47
EPA Clean Water State Revolving Fund 10/	1,522	1,466	1,175	689	1,466	1,475	1,388
EPA Drinking Water State Revolving Fund 10/	963	918	850	829	918	924	869

cont.

Major Discretionary	FY 2011	FY 2012	FY 2013				
			President's Budget	Latest House	Latest Senate	CR Level	CR after Sequester 1/
Department of Justice	1,662	1,251	1,232	1,176	1,337	1,259	1,184
Violence Against Women	418	413	413	420	413	415	391
COPS/21st Century Policing	495	199	290	199	248	200	188
State Criminal Alien Assistance Program (SCAAP)	273	240	70	165	255	241	227
Byrne Justice Assistance Grants (JAG)	430	370	430	392	392	372	350
Juvenile Accountability Block Grant (JABG)	46	30	30	0	30	30	28
Department of Homeland Security	1,816	1,254	1,991	1,956	1,592	1,262	1,188
REAL ID 3/	45	0	0	0	0	0	0
State Homeland Security Grant Program (SHSGP)	579	294	0	1,486	415	296	278
Citizen Corps 3/	10	0	0	0	0	0	0
Urban Area Security Initiative	724	490	0	0	677	493	464
National Preparedness Grant Program	NA	NA	1,541	NA	NA	NA	NA
Emergency Food and Shelter	120	120	100	120	150	121	114
Emergency Management Performance Grants	339	350	350	350	350	352	331
Department of Labor 9/ 12/	6,726	6,579	6,436	3,301	6,389	6,619	6,229
Dislocated Worker Assistance 4/ 11/	1,065	1,008	1,007	1,007	1,008	1,014	954
Adult Training 4/ 11/	770	771	769	769	771	776	730
Youth Training 4/	826	824	824	824	824	829	780
Workforce Innovation Fund Programs 5/	125	50	100	0	50	50	47
Employment Service State Administration 4/	702	701	731	701	731	705	664
Unemployment Insurance State Administration	3,239	3,225	3,005		3,005	3,245	3,053
Department of Transportation	55,920	54,098	57,764	53,912	54,287	54,185	54,027
Airport Obligation Limitation	3,515	3,350	3,350	3,350	3,350	3,371	3,371
Highway Obligation Limitation	41,107	39,144	41,830	39,144	39,144	39,144	39,144
Highway Funding Exempt from Ceiling	739	739	739	739	739	739	697
Highway Traffic Safety Obligation Limitation	620	550	643	502	550	554	554
Capital Assistance for High Speed Rail Corridors	0	0	1,000	0	100	0	0
Formula and Bus Grants Obligation Limitation	8,343	8,361	4,759	8,361	8,361	8,412	8,412
Bus and Rail State of Good Repair Program	0	0	3,207	0	0	0	0
Capital Investment Grants (New Starts)	1,597	1,955	2,236	1,817	2,044	1,967	1,851
Subtotal: Discretionary	\$181,092	\$176,031	\$181,070	\$160,465	\$179,581	\$177,001	\$169,608

Major Mandatory	FY 2011	FY 2012	FY 2013				
			President's Budget	Latest House	Latest Senate	CR Level	CR after Sequester 1/
Child Nutrition	17,324	18,151	19,694	19,657	19,658	19,658	19,657
Supplemental Nutrition Assistance - State Administration	3,243	3,742	3,867	3,867	3,867	3,867	3,867
Social Services Block Grant (SSBG)	1,700	1,700	1,700	1,700	1,700	1,700	1,603
Child Care Entitlements to States	2,917	2,917	3,417	2,917	2,917	2,917	2,917
Temporary Assistance to Needy Families (TANF) 6/	16,802	16,589	16,909	16,589	16,589	16,589	16,589
Child Support Enforcement Administrative Costs	4,409	4,317	4,137	4,126	4,126	4,126	4,126
Foster Care	4,375	4,110	4,398	4,146	4,146	4,146	4,146
Adoption Assistance	2,266	2,415	2,537	2,537	2,537	2,537	2,537
Independent Living	185	185	185	185	185	185	185
Promoting Safe and Stable Families (PSSF)	443	423	423	423	423	423	399
Child Health Insurance (CHIP)	13,504	15,027	17,451	17,451	17,451	17,451	17,451
Medicaid Vendor Payments	252,503	247,369	265,938	265,053	265,053	265,053	265,053
Medicaid Administration	14,083	14,885	14,735	14,735	14,735	14,735	14,735
Vaccines for Children	3,953	4,009	4,271	4,271	4,271	4,271	4,271
Payments from States for Medicare prescription drugs	-7,923	-8,077	-8,096	-8,096	-8,096	-8,096	-8,096
Vocational Rehab. State Grants 5/	3,085	3,122	3,157	3,231	3,231	3,231	3,047
Subtotal: Mandatory/Entitlement	\$332,868	\$330,884	\$354,723	\$352,791	\$352,792	\$352,792	\$352,486
Total: Selected Grants-In-Aid	\$513,960	\$506,915	\$535,793	\$513,256	\$532,373	\$529,793	\$522,094

Footnotes:

- 1/ FY 2013 CR funding levels after sequester are based on FFIS's calculations of the across-the-board percentage cut based on the fiscal cliff agreement (H.R. 8). Specifically, FFIS approximates a 5.7% cut for nondefense mandatory programs and a 5.9% cut for nondefense discretionary programs.
- 2/ Amounts exclude funds appropriated in the Affordable Care Act (ACA), either directly or through the Prevention and Public Health Fund.
- 3/ In FY 2012, REAL ID and Citizen Corps could be funded through SHSGP and/or UASI allocations.
- 4/ Data reflect program years rather than fiscal years.
- 5/ The president's FY 2013 budget uses \$15 million from the Adult Basic and Literacy Education State Grants appropriation and \$10 million from the Vocational Rehabilitation State Grants appropriation to fund the Workforce Innovation Fund (WIF).
- 6/ Amounts exclude contingency funds. TANF is authorized through March 27, 2013. The president's budget proposes \$319 million for supplemental grants in FY 2013. Supplemental grants were not funded in FY 2012.
- 7/ FY 2012 funds reflect transfers by the secretary of HHS in accordance with the appropriations language.
- 8/ FY 2012 budget does not provide funding for contingency funds. The president's FY 2013 budget proposes \$2.8 billion for formula grants and \$200 million for contingency funds. The Senate includes \$3.4 billion for formula grants and \$100 million for contingency funds.
- 9/ The FY 2012 enacted budget includes a 0.189% rescission to discretionary funding in the departments of Labor, HHS, and Education.
- 10/ The FY 2012 enacted budget includes a 0.16% rescission to discretionary funding in the Environmental Protection Agency.
- 11/ This program receives an advance appropriation. The 0.189% rescission included in the FY 2012 budget does not apply to the FY 2013 advance portion for these programs.
- 12/ The House appropriations committee has yet to approve a FY 2013 Labor-HHS-Education bill or release a full report. Thus, many of the House FY 2013 funding levels for these programs remain unknown. Any funding levels listed are taken from the House's draft bill text or the subcommittee's press release.

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