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Fiscal Cliff: Not over for Nebraskans

The American Taxpayer Act (ATRA), the legislation passed by Congress at the first of the year in response to the "fiscal cliff," fundamentally failed to address the spending side of the fiscal equation. America's unsustainable deficit spending has a profound impact on individual states. Further, the implications of the ATRA legislation leave states such as Nebraska with a great deal of uncertainty and discussion must continue on the state consequences. Federal and state budgets are inextricably linked, and decisions at the federal level about taxes and spending have a direct impact on Nebraska taxpayers.

ATRA: The tax side of the fiscal equation.

The ATRA makes some of the Bush-era tax cuts permanent:

- Preserved tax cuts for income levels less than \$400,000 per person or \$450,000 per couple.
- Extended the Earned Income Tax Credit and the Child and Dependent Care Credit.
- Permanently fixed Alternative Minimum Tax (AMT) to avoid middle class earners by increasing exemption thresholds and, most importantly, indexing the ATM to inflation - like Social Security benefits. [\[1\]](#)
- Secured expiring estate tax reductions, preventing the amount that can be passed on tax-free from reverting back to \$1 million per person - a move that would have increased the actual rate for most estate taxes to 55 percent. [\[2\]](#)

But the ATRA also allows some tax relief to expire and raises taxes on others:

- Allowed payroll tax cuts to expire, a tax increase on 77 percent of Americans. The nonpartisan Tax Policy Center estimates the average American's tax bill, regardless of income, will climb \$1,257. [\[3\]](#)
- Increased income tax rates to 39.6 percent for earners above the \$400,000 per person and \$450,000 per couple.
- Increased tax rates on long-term capital gains and qualified dividends from 15 to 20 percent rate for those in the top bracket. [\[4\]](#)

ATRA: The spending side of the fiscal equation. The spending side of the equation is the biggest problem with this legislation, as it failed to address spending cuts in any meaningful way. It delayed the "sequester" - the across-the-board automatic spending

cuts - until March 1^[5], kicking the proverbial can down the road.

ATRA: Creates uncertainty for States. Among issues the legislation simply delayed are sequester, Medicare fee cuts for doctors, expiry of extended unemployment benefits and others - creating fiscal uncertainty for states.^[6]

The ATRA reduced automatic spending cuts to \$85 billion and uncertainty remains about how these cuts will impact state budgets. For example, grants to states represent approximately one third of overall state revenue,^[7] which varies from state to state. Federal grants are 30 percent of Nebraska's budget. Roughly 18 percent of federal grant dollars flowing to the states would be subject to the fiscal year 2013 across-the-board cuts under the sequester. This decrease includes funding for education, nutrition, public housing and various other programs.^[8] As this relates to Nebraska's budget, seven percent of total revenue would be at risk for the across-the-board sequestration. Based upon calculations by the Platte Institute, this equates to \$546 million of revenue from Nebraska's budget is at risk for sequestration cuts. According to the Office of Management and Budget, cuts will range from 8.2 to 9.4 percent of this total, or \$44 to \$51 million for Nebraska. This is a significant number that illustrates why a state level discussion is critical.

Another area where federal spending will directly impact states, disparately depending on economic composition, is defense spending. Defense spending is 3.5 percent of state gross domestic product (GDP) with a wide variation among states - 15 percent of Hawaii's GDP compared to only two percent in Nebraska.^[9]

But the ATRA has other consequences to Nebraska taxpayers at the state level. For example, Nebraska links personal income deductions to the federal code, which means as personal exemptions phase out and limits are placed on itemized deductions, Nebraska can expect *higher* revenue. But Nebraska also links corporate income tax deductions relating to depreciation to the federal code meaning Nebraska will see *lower* revenues as a result of ATRA's generous expensing rules. ^[10]

Beyond the consequences of linking to the federal tax code, the on-going federal deficit uncertainty puts Nebraska's budget and Nebraska taxpayers at risk. While there is no doubt that spending cuts at every level are necessary for America's long-term financial stability, these much-needed reductions will have a broad impact. Federal spending cuts may lead to less revenue for Nebraska, which could lead to higher taxes if the state can't make up the shortfall with reductions in state spending.

With the delay of sequester and the next debt ceiling debate looming for Congress in the near future, the public interest is best served by policy debate that includes all levels of government. As March 1 approaches, we hope debate will focus on deficit reduction and spending cuts. But Nebraskans should be cognizant that the federal outcome will also impact us locally.

[1] TIME, Business & Money, "At long last, a permanent patch for a dreaded tax" by Dan Kadlac, <http://business.time.com/2013/01/03/at-long-last-a-permanent-patch-for-a-dreaded-tax/#ixzz2JO39w2Xt>

[2] Forbes, Personal Finance, "After the Fiscal Cliff Deal: Estate and Gift Tax Explained," by Deborah L. Jacobs, <http://www.forbes.com/sites/deborahljacobs/2013/01/02/after-the-fiscal-cliff-deal-estate-and-gift-tax-explained/>

[3] <http://www.taxpolicycenter.org/taxtopics/American-Taxpayer-Relief-Act.cfm>

[4] Ibid

[5] Update: Fiscal Cliff Deal Poses Uncertainty for States, The PEW Charitable Trusts, <http://www.pewstates.org/news-room/press-releases/update-fiscal-cliff-deal-poses-uncertainty-for-states-85899441596>

[6] The Economist, "The Fiscal Cliff: Nothing to be proud of," <http://www.economist.com/news/united-states/21569058-barack-obama-wrings-11th-hour-deal-taxes-john-boehner-and-republicans>

[7] The Impact of the Fiscal Cliff on the States, The PEW Charitable Trusts <http://www.pewstates.org/research/reports/the-impact-of-the-fiscal-cliff-on-the-states-85899430339>

[8] Ibid

[9] Ibid

[10] The Impact of the Fiscal Cliff on the States, The PEW Charitable Trusts <http://www.pewstates.org/research/reports/the-impact-of-the-fiscal-cliff-on-the-states-85899430339>



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