Bigger Tax Bite for Most Under Fiscal Pact

The New York Times
By BINYAMIN APPELBAUM and CATHERINE RAMPELL | New York Times

Associated Press - The lights of the U.S. Capitol remain lit into the night as the House continues to work on the "fiscal cliff" legislation proposed by the Senate, in Washington, on Tuesday, Jan. 1, 2013. (AP Photo/Jacquelyn Martin)

WASHINGTON — Only the most affluent American households will pay higher income taxes this year under the terms of a deal that passed Congress on Tuesday, but most households will face higher payroll taxes because the deal does not extend a two-year-old tax break.

The legislation, which was forged in the Senate and overcame resistance in the House late Tuesday will grant most Americans an instant reversal of the income tax increases that took effect with the arrival of the new year. Only about 0.7 percent of households will be subject to an income tax increase this year, according to the Tax Policy Center, a nonpartisan research group in Washington. The increases will apply almost exclusively to households making at least half a million dollars, the center estimated in an analysis published Tuesday.

But lawmakers' decision not to reverse a scheduled increase in the payroll tax that finances Social Security, while widely expected, still means that about 77 percent of households will pay a larger share of income to the federal government this year, according to the center's analysis.

The tax this year will increase by two percentage points, to 6.2 percent from 4.2 percent, on all earned income up to $113,700.

Indeed, for most lower- and middle-income households, the payroll tax increase will most likely equal or exceed the value of the income tax savings. A household earning $50,000 in 2013, roughly the national median, will avoid paying about $1,000 more in income taxes — but pay about $1,000 more in payroll taxes.

Sabrina Garcia, a 35-year-old accounting assistant from Quincy, Mass., who together with her husband made about $102,000 last year, said the payroll tax increase equated to "about $200 a month for my family."

“That’s a lot of money for us,” Ms. Garcia said. “It means we will have to cut back.” She said in an e-mail exchange that she will most likely will postpone buying a new computer. “And forget about being able to save money,” she added.

The deal will impose larger tax increases on those who make the most. It will raise taxes in two ways: by restoring limits on the amount of income affluent Americans can shelter from federal taxation, and by returning to a top marginal tax rate of 39.6 percent. The current rate is 35 percent.

For married couples filing jointly, the deduction limits apply to income above $300,000, while the top tax rate kicks in above $450,000. But both numbers are somewhat misleading, because “income” in this context is a technical term, referring only to the portion of income subject to taxation after exemptions and deductions.

Few households with actual incomes of less than half a million dollars will face a tax increase. The Tax Policy Center calculated that less than 5 percent of families earning $200,000 to $500,000 will actually pay more.

The size of those increases will be much smaller than President Obama originally proposed. The net effect, according to the center’s estimates, is that the top 1 percent of households will see an average income tax increase this year of $62,000 rather than $94,000. “The high-income people really are doing very well in this compared to what the president wanted to do,” said Roberton Williams, a senior fellow at the Tax Policy Center.

The deal passed by the Senate and the House will impose fewer limits on deductions than the White House plan. It will also tax income from dividends at a flat rate of 20 percent, rather than the same marginal rate as earned income. And there is another important point, often misunderstood: Affluent households will pay the new 39.6 percent rate only on income above $450,000. They and everyone else will still will pay lower rates on income below that threshold.

Households making $500,000 to $1 million will pay an additional $6,700 in taxes on average. Those making more than $1 million will pay an additional $123,000 on average.

Changes in the estate tax will also benefit affluent families. The tax will not apply to the first $5 million of an inheritance, extending the current exclusion rather than reverting to the $3.5 million threshold that President Obama initially favored. However, wealth above that amount will be taxed at a rate of 40 percent rather than the previous rate of 35 percent.

The Obama administration did win a five-year extension of tax breaks for lower-income families, including the child tax credit and earned-income tax credit. Those credits eliminate income tax liability for many lower-income families. In many cases, the government actually makes a direct payment to the family to help offset the burden of payroll taxation — up to $1,000 a child under the child credit and up to $5,900 total under the earned income credit.

The deal will also restore unemployment benefits for about two million Americans. People who can’t find work, and have already received government checks for the standard period of 26 weeks, have been able to stay on the rolls for up to an additional 47 weeks. But financing for that program, which is aimed at the states with the highest unemployment rates, expired Saturday. Under the terms of the deal, people who are eligible will receive any missed benefits retroactively.

The deal also includes new rules for the alternative minimum tax, which threatened this year to impose higher taxes on roughly 30 million households. The tax was created in the 1960s to set a lower limit on the taxes paid by the most affluent households, but the eligibility threshold was not indexed to inflation, so it theoretically encompasses a larger share of households with each passing year. Congress has repeatedly passed short-term increases in the threshold; the deal will make those increases automatic, obviating the annual ritual.

That is small consolation for middle-income Americans like Joe Interlandi, 61, a long-haul trucker who on Tuesday was driving a load of tomatoes from Florida to Los Angeles.

Mr. Interlandi, writing from a rest stop, said he understood the need for higher taxes. He will rather pay more now than impose higher taxes on his children and grandchildren, he said.

But Mr. Interlandi, who estimated that he worked 100 hours many weeks, added that the payroll tax increase still meant he will need to spend even more time on the road. Describing things he will have to cut back on, he wrote, “Family outings like vacations, and time together.”

Related Articles

- Divided House Passes Tax Deal in End to Latest Fiscal Standoff
- Senate Passes Legislation to Allow Taxes on Affluent to Rise

An average of $1,000 more for a household at the national median income.