Distributed on:

JAN 2 2013

City Manager's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Betsy Shotwell

SUBJECT: SEE BELOW

DATE: January 2, 2013

Approved /s/ Ed Shikada

Date: January 2, 2013

SUBJECT: PATTON BOGGS UPDATE ON U.S. FISCAL CLIFF CRISIS

INFORMATION

Attached is a special update from the City's Federal lobbyist firm of Patton Boggs on the fiscal cliff debate and outcome. Late yesterday night, the House passed The American Tax Relief Act of 2012 following the Senate's passage of the bill in the early hours of January 1. The bipartisan compromise extended the majority of the Bush-era tax cuts, preserves unemployment benefits and includes a number of other tax provisions as identified in the update. The measure delays spending cuts in the defense budget and domestic programs, (the "sequester"), for two months which will also coincide with debate over raising the federal debt ceiling authority, and funding the federal government -- the current Continuing Resolution expires on March 27. Meanwhile as the debate over spending continues into the new year, local, state and national organizations will continue to advocate that the President and Congress work to avert sequestration and craft a balanced approach to deficit reduction and to preserve essential federal investments that drive growth and job creation for our communities.

Betsy Shotwell

BETSY SHOTWELL
Director, Intergovernmental Relations

Attachment: Patton Boggs LLP: Fixing the Debt: Update on U.S. Fiscal Cliff Crisis 1/1/13

PATTON BOGGS LLP

FIXING THE DEBT: UPDATE ON U.S. FISCAL CLIFF CRISIS

January 1, 2013

THE LEGISLATION

- Following a day of tumultuous House Republican caucus deliberations, at 11:00 pm, the House passed The American Tax Relief Act of 2012, a cliffhanger deal negotiated by Vice President Biden and Senate Republican Leader McConnell. This follows the Senate's passage of the bill at 2:00 am on January 1, 2013, and clears the way for the bill to be sent to President Obama for signature into law. The legislation includes the following:

  - Marginal Tax Rates: Permanent extension of current policy on income up to $400,000 for single filers and $450,000 for married couples filing a joint return.
  - Capital Gains & Dividends: Permanent maximum 15 percent long-term capital gains and qualified dividends rate for those with income up to $400,000 (singles), $450,000 (married); 20 percent rate for both for taxpayers above the threshold.
  - Estate Tax: Permanent extension of current policy on portability and unification, with a $5 million per-spouse exemption (indexed for inflation) and a 40 percent top rate for larger estates.
  - PEP & Pease: Permanent relief from PEP & Pease under $250,000 (single), $300,000 (married). (These provisions reduce how much upper-income earners can claim in personal exemptions and itemized deductions, effectively raising taxes on these taxpayers without explicitly raising marginal rates).
  - AMT: Permanently index AMT for inflation.
  - Tax Extenders: Extension of most of the business and individual tax "extenders," through 2013, as passed by the Senate Finance Committee in early August (two years for provisions that expired 12/31/11, one year for those that expired 12/31/12).
  - Bonus Depreciation: 1 year extension of 50 percent Bonus Depreciation.
  - Stimulus Bill Tax Credits: 5 year extension of the expanded refundable portions of the Child Tax Credit and the Earned Income Tax Credit, as well as extension of the American Opportunity Tax Credit.
  - Medicare Doc Fix: 1 year extension, paid for by reducing Medicare spending.
  - Medicare Extenders: Temporarily extends a host of Medicare provisions.
  - Expanded Unemployment Insurance: 1 year extension; not offset.
  - Farm Bill: One year extension of the Food, Conservation and Energy Act of 2008 (through FY13).
  - Sequester: Delays the spending sequester for two months, fully offset by a reduction in discretionary spending caps for 2013 and 2014, and expanding eligibility for Roth IRA conversions.
  - Temporary Payroll Tax Cut: Allowed to expire.
  - Debt Limit: No increase in debt ceiling authority.

THE VOTE DYNAMIC

- Despite seemingly tepid support for the agreement, the Senate passed the measure overwhelmingly by a vote of 89-8. The eight Senators who voted against the bill included 5 Republicans (Senators Grassley, Lee, Paul, Rubio, and Shelby) and 3 Democrats (Senators Carper, Bennet, and Harkin).

- The House passed the measure by a vote of 257-167. 85 Republicans and 172 Democrats voted in favor, while 151 Republicans and 16 Democrats voted against. Eight Members did not vote.

- The House Republican majority did not easily arrive at the conclusion that they should allow the Senate bill to pass without amendment today. The decision to put the bill on the floor for a vote followed hours of internal caucus deliberation, and came only after Republican leaders determined there was not enough caucus support to pass an amendment that would have added an additional $300 billion in spending cuts to the Senate bill.

A LOOK AHEAD

- This fiscal cliff outcome reinforces the notion that on matters of deficit reduction, Congress and the Administration are resigned to incremental steps rather than deals of the grand bargain variety. Therefore, the Biden/McConnell compromise represents the second step in what many now see as a likely three-step deficit reduction process.

- The first step, the Budget Control Act, agreed to in August 2011, was prompted by significant disagreement as to how to approach the last debt ceiling increase, and resulted in approximately $1 trillion in discretionary spending cuts along with the now much-discussed spending sequester cuts to defense and other domestic spending programs. (If implemented, the sequester, which will now be delayed for two months, would save another $1.2 trillion).

- The Biden/McConnell compromise constitutes a second step of deficit reduction, and is almost exclusively focused on increased tax revenue of over $600 billion according to the Administration's scorekeeping. In actuality, the Biden/McConnell deal made permanent $3.9 trillion of tax cuts, but when measured against $4.5 trillion of current tax policy, the legislation yields roughly $600 billion in "savings." This $600 billion is roughly $1 trillion below the President's initial revenue demand made shortly after the 2012 election, and is even below Speaker Boehner's proposal to raise $800 billion in additional revenue through comprehensive tax reform (as part of a major spending reform package).

- We may know whether there will be a third phase of deficit reduction relatively quickly as debt ceiling authority must be raised in the next few months. The need to raise the debt ceiling could provoke a fiscal fight that may result in similarly contentious negotiations. Congressional Republicans are promising they will insist upon significant long-term entitlement spending cuts in order to allow new debt ceiling authority, while the President, as he said in Monday's mid-afternoon fiscal cliff speech, will insist that additional tax revenue will be a part of any further deal.

- While the fate of comprehensive tax reform may in part depend upon agreement between the President and Congress on the proper mix of spending cuts and revenue increases moving forward, the next step of deficit reduction presents an opportunity for bipartisan reform that has eluded the President and Congressional negotiators to date. It continue to be the case that both parties want a tax reform process, though they have not yet agreed to a revenue target that is critical for reform to become a reality. Republicans will also argue that because of where the line was drawn for what constitutes “upper income” ($400,000 individual/$450,000 family), which was lower than most Republicans wanted, there may actually be a bit more “wiggle room” to horse trade credits, deductions, and exclusions to not only raise net revenue, but also potentially to lower rates in the context of a comprehensive tax reform process.\

- In his remarks yesterday, the President said he plans to reform the tax code by removing loopholes and deductions that favor corporations and wealthy individuals in order to secure additional revenue for deficit reduction, while also lowering the corporate tax rate. For their part, Congressional Republicans would very much like to embark on tax reform, but, having now agreed to $600 billion in tax revenue, would prefer to do so on a revenue-neutral basis. It is entirely possible that in the next two months a revenue target for reform might be established as part of a third step of deficit reduction.

FOR MORE INFORMATION

For up to-the-minute fiscal cliff updates, please contact a member of the Patton Boggs Tax Policy team:

Rosemary Becchi
202-457-5255
rbecchi@pattonboggs.com

Micah Green
202-457-5258
msgreen@pattonboggs.com

Aubrey Rothrock
202-457-5620
arothrock@pattonboggs.com

Manny Rossman
202-457-5664
mrossman@pattonboggs.com

Daris Meeks
202-457-5205
dmeeks@pattonboggs.com

Erin McGrain
202-457-5344
emcgrain@pattonboggs.com

Joe Urso
202-457-5349
jurso@pattonboggs.com