PricewaterhouseCoopers
Washington National Tax Services

Tax policy in challenging times

2010 Tax Legislative Outlook

Table of contents

January 2010

Efforts to reduce high unemployment and address federal budget deficits are expected to be central domestic priorities for President Obama and the Democratic-controlled Congress during the run-up to the November 2010 mid-term Congressional elections.

Domestic priorities challenged by economic conditions

President Barack Obama took office last January with a broad domestic and international agenda and with the Democratic Party holding large majorities in the House of Representatives and the Senate. The new Administration identified health care and climate change legislation as its principal domestic policy priorities. At the same time, however, the Administration was confronted with the economic recession and financial market meltdown that began in 2007. In addition, the United States continues to fight wars in Afghanistan and Iraq and faces a continued threat from international terrorism.

Following enactment of economic recovery legislation in early 2009, debate over health care dominated the remainder of last year's Congressional calendar and remains at center stage in early 2010. The House passed its health care measure on November 7, and the Senate ended its 2009 session with a rare Christmas Eve vote, approving its version. At this writing, Congressional leaders and Administration officials are working to reach agreement on a final bill that can pass both chambers and be signed into law by President Obama. The election of Massachusetts Republican Senator-elect Scott Brown complicates the prospects for final action on health care legislation.

Congress last year did not complete action on several other tax legislative issues that also have carried over into 2010. The House passed a comprehensive climate control bill in 2009, but its fate in the Senate remains uncertain. The House also passed separate bills extending the estate tax and extending a number of popular business and individual tax provisions scheduled to expire at the end of 2009; however, given the year-end focus on health care legislation, the Senate did not act on these expiring tax provisions. As a result, Congress at some point in 2010 is expected to consider legislation that would reinstate the estate tax, possibly on a retroactive basis, as well as legislation expected to renew retroactively the research credit and other business and individual expired provisions.

Rising unemployment expected to dominate policy debates

Efforts to reduce high unemployment are expected to be a central domestic priority for President Obama and the Democratic-controlled Congress during the run-up to the November 2010 mid-term Congressional elections. While many economists believe that renewed economic growth in the second half of 2009 marked the end of the recession, unemployment rates increased significantly last year and are projected to remain high in 2010. Unemployment peaked at 10.2 percent by October 2009, up from the 4.9 percent rate at the start of the recession in December 2007. By late 2009, more than 17 percent of the American workforce was either unemployed or under-employed.

The recession has been the most severe and extended economic downturn since the Great Depression. Early in 2009, President Obama proposed a major economic stimulus package, and Congress responded by passing the $787 billion American Recovery and Reinvestment Act of 2009 (ARRA). This effort was in addition to the $700 billion Troubled Asset Relief Program (TARP) and an earlier $168 billion stimulus package, which were passed in 2008 under the Bush Administration.

The 2009 economic recovery legislation included a number of business tax provisions, including temporary accelerated "bonus" depreciation for business investments in plant and equipment, but the bulk of the package was composed of direct federal spending for infrastructure, clean energy, medical information technology, and other domestic programs. The Congressional Budget Office (CBO) estimated that only $185 billion of the total package was implemented last year. Nearly $400 billion of this package is expected to enter the U.S. economy in 2010, and the remainder will be spent in following years.

President Obama in December 2009 called on Congress to enact job creation legislation, including targeted tax and infrastructure spending policies identified as encouraging new hiring. The Administration's job creation tax proposals include a general extension of bonus depreciation for 2010 along with small business tax incentives and an expansion of select ARRA energy efficiency tax incentives. Additional proposals put forth by Congressional leaders include higher levels of spending on highways and other infrastructure programs along with expanded unemployment assistance and additional extension of the federal subsidy for COBRA health insurance benefits.

Fiscal burdens become a concern

While reducing unemployment is a top priority for many government officials, concerns about the dramatic growth in federal spending and budget deficits as well as the overall federal debt have increased significantly. The federal budget deficit reached a record high of $1.4 trillion at the end of fiscal year (FY) 2009, or 9.9 percent of gross domestic product (GDP), the largest federal deficit as a share of the U.S. economy since World War II. Since the beginning of the recession in 2007, the federal debt has grown by more than $2 trillion as a result of falling individual and business tax receipts and increased spending.

At the end of last year, Congress approved legislation increasing the national debt limit by $290 billion to $12.4 trillion. Another increase in the debt limit will be required in early 2010. There have been calls for a major focus on deficit reduction as part of any new debt ceiling increase legislation. The Obama Administration also may make deficit reduction a focus of its proposed federal budget for FY 2011 that should be released in early February.

Individual tax cuts sunset after 2010

President Obama is expected to renew his call for legislation making permanent most of the individual tax cuts enacted in 2001 and 2003. While President Obama has supported allowing tax cuts for upper-income individuals to expire as scheduled at the end of 2010, he has promised to maintain tax cuts for individuals with incomes below $200,000 and families with incomes below $250,000.

Congress will need to act on a major individual tax relief bill in 2010 so that some or all of the 2001 and 2003 tax cuts will be preserved. The Joint Committee on Taxation staff (JCT) last year estimated that President Obama's proposals to make permanent select 2001 and 2003 tax relief provisions, along with the estate tax at 2009 levels, would reduce federal revenues by more than $2.1 trillion through 2019. Extension of individual alternative minimum tax (AMT) relief was expected to reduce revenues by an additional $447 billion over the same period. Updated estimates through 2020 are expected to show significantly higher revenue costs.

The President's initial budget submission to Congress last year also featured significant changes in business tax laws. These included a dramatic tightening of U.S. international tax rules affecting companies doing business around the world, estimated to raise $149 billion over 10 years. At this writing, the Administration is expected to re-propose, with revisions, its international tax provisions as part of its FY 2011 federal budget. While business groups have urged that comprehensive changes in U.S. business tax policies should only be considered in the context of broad tax reform, it is becomingly increasingly unlikely that Congress will act on significant tax reform legislation during 2010 given the expected focus on unemployment, federal deficits, and other priority issues. This increases the possibility that business tax increases may be used to offset other tax legislation or spending decisions.

An in-depth discussion

This year’s tax legislative agenda will be influenced by election-year politics and budget constraints.

Balance of power

With a 258 to 177 majority, House Democrats last year were able to pass most legislation with at least the needed 218 votes, although a number of key bills, including health care reform and climate change legislation, passed narrowly. The Democratic leadership has to attract votes from various groups in its party, including a Progressive Caucus and the fiscally conservative "Blue Dogs." There also are a significant number of Democrats elected in 2006 and 2008 who occupy seats formerly held by Republicans.

In the Senate, Democrats last year attained a 60-vote majority when Senator Al Franken (D-MN) secured his seat in a recount and Senator Arlen Specter of Pennsylvania switched from the Republican to the Democratic Party. As long as they remained united and retained the support of two independents, Joe Lieberman of Connecticut and Bernie Sanders of Vermont, Senate Democrats had a filibuster-proof majority that allowed them to overcome Republican opposition.

The election of Massachusetts Republican Senator-elect Scott Brown, who will complete the term of the late Senator Edward Kennedy (D-MA), provides Senate Republicans with a 41-seat minority. The loss of a 60-vote majority complicates the ability of Senate Democrats to pass legislation to which Republicans object.

Thus, the Obama Administration and Senate Democrats this year generally will need the support of at least some moderate Senate Republicans to pass significant legislation in that chamber. Last year, for example, economic recovery legislation was passed with the support of Republican Senators Olympia Snowe (ME), Susan Collins (ME), and Arlen Specter (PA), who as noted above became a Democrat.

The Congressional budget process also could be used to overcome Republican opposition in the Senate to Democratic tax legislation. A budget reconciliation bill (discussed below) can be passed in the Senate by 51 votes.

Congressional elections

Historically, the party winning control of the White House has suffered a loss of some seats in the House and Senate during the election two years later. Another key political factor affecting the election outcome can be the number of open Congressional seats where an incumbent House member or Senator has decided to retire or run for a different office.

All 435 seats in the House of Representatives are subject to election in 2010. At this writing, there are 12 open Democratic seats and 14 open Republican seats in the House of Representatives. House Ways and Means Committee members who have announced plans to retire or run for other offices are Reps. John Tanner (D-TN), Kendrick Meek (D-FL), and Artur Davis (D-AL).

Roughly one-third of the Senate is up for election every two years. In 2010, 19 Democrat and 18 Republican seats are up for election, including five incumbents who sit on the 23-member Senate Finance Committee. Of the 37 Senate seats subject to election this year, at this time 10 are open due to retirements (four Democrats and six Republicans), including Senator Jim Bunning (R-KY), who is a member of the Finance Committee.

For the upcoming November elections, 34 Senates races are for six-year terms. Special elections will be held in November in both Delaware and New York to fill the seats previously held by Vice-President Joe Biden and Secretary of State Hillary Rodham Clinton, respectively. The Massachusetts and New York Senate seats will be up for election again in 2012, and the Delaware Senate seat will be up for election again in 2014.

Tax policymakers

A. Obama administration

President Obama begins 2010 with continuity in the key economic policy officials he nominated shortly after taking office. Members of his economic team include Treasury Secretary Timothy Geithner, White House National Economic Council Director Lawrence Summers, Office of Management and Budget (OMB) Director Peter Orszag, Council of Economic Advisers (CEA) Chair Christina Romer, and Domestic Policy Council Director Melody Barnes.

Shortly after his election, President Obama also created a temporary Economic Recovery Advisory Board (PERAB) to advise him and his economic team on the design and implementation of an economic recovery plan. This board is chaired by former Federal Reserve Chairman Paul Volcker. A PERAB task force on tax reform (discussed below) was directed to issue by December 4, 2009, a report on tax simplification, compliance, and options for closing individual and business tax "loopholes," but the report has been delayed until early 2010.

Other key economic and tax policy officials include William (Bill) Wilkins as IRS Chief Counsel and Michael Mundaca as acting Treasury Assistant Secretary for Tax Policy. The Senate Finance Committee approved Mundaca's nomination in late 2009 but the Senate recessed without voting to confirm him. Douglas Shulman continues in his position as IRS Commissioner; his term runs until 2013.

B. Congressional leadership

Nancy Pelosi (D-CA) continues as Speaker of the House and Harry Reid (D-NV) continues as Senate Majority Leader. John Boehner (R-OH) and Mitch McConnell (R-KY) remain House and Senate Minority Leaders, respectively. Eric Cantor (R-VA) is the new House Minority Whip. The table below lists the House and Senate leadership positions.

Note: Members who have announced plans to retire or run for other offices are in bold.

Figure 1. Key Members of the Obama Administration Economic and Tax Policy Team

Timothy Geithner	Treasury Secretary
Lawrence Summers	Director, National Economic Council
Peter Orszag	Director, Office of Management and Budget
Christina Romer	Chair, Council of Economic Advisers
Paul Volcker	Chairman, Economic Recovery Advisory Board
Austan Goolsbee	Member, Council of Economic Advisers; Staff Director and Chief Economist, Economic Recovery Advisory Board
Michael Mundaca	Acting Treasury Assistant Secretary for Tax Policy
Douglas Shulman	IRS Commissioner
William Wilkins	IRS Chief Counsel

Figure 2. House Leadership in the 111th Congress

Speaker of the House	Nancy Pelosi (D-CA)
Majority Leader	Steny Hoyer (D-MD)
Majority Whip	Jim Clyburn (D-SC)
Senior Chief Deputy Whip	John Lewis (D-GA)
Deputy Whips	G.K. Butterfield (D-NC), Joe Crowley (D-NY), Diana DeGette (D-CO), Ed Pastor (D-AZ), Janice Schakowsky (D-IL), **John Tanner (D-TN),** Debbie Wasserman (D-FL), Maxine Walters (D-CA)
Democratic Caucus Chair	John Larson (D-CT)
Democratic Caucus Vice Chair	Xavier Becerra (D-CA)
Democratic Campaign Committee Chair	Chris Van Hollen (D-MD)
Democratic Steering Committee Chair	George Miller (D-CA) and Rosa DeLauro (D-CT)
Minority Leader	John Boehner (R-OH)
Minority Whip	Eric Cantor (R-VA)
Deputy Minority Whip	Kevin McCarthy (R-CA)
Republican Conference Chair	Mike Pence (R-IN)
Republican Policy Committee Chair	Thaddeus McCotter (R-MI)
Republican Campaign Committee Chair	Pete Sessions (R-TX)

Figure 3. Senate Leadership in the 111th Congress

President of the Senate	Vice-President Joe Biden (D)
President pro tempore	Robert Byrd (D-WV)
Majority Leader	Harry Reid (D-NV)
Assistant Majority Leader	Richard Durbin (D-IL)
Democratic Conference Vice Chair	Charles Schumer (D-NY)
Democratic Senatorial Campaign Committee Chair	Bob Menendez (D-NJ)
Democratic Conference Secretary	Patty Murray (D-WA)
Democratic Policy Committee Chair	**Byron Dorgan (D-ND)**
Chief Deputy Whip	Barbara Boxer (D-CA)
Minority Leader	Mitch McConnell (R-KY)
Assistant Minority Leader	Jon Kyl (R-AZ)
Republican Conference Chair	Lamar Alexander (R-TN)
Republican Conference Vice Chair	Lisa Murkowski (R-AK)
Republican Senatorial Campaign Committee Chair	John Cornyn (R-TX)

House Ways and Means Committee

Rep. Charles Rangel (D-NY) continues as chairman of the Ways and Means Committee and Rep. Dave Camp (R-MI) remains as ranking minority member. The Ways and Means Committee membership continues as 26 Democrats and 15 Republicans.

Figure 4. House Ways and Means Committee Members, 111th Congress

Democrats	Republicans
Charles Rangel (D-NY), chairman	Dave Camp (R-MI) ranking minority member
Pete Stark (D-CA)	Wally Herger (R-CA)
Sander Levin (D-MI)	Sam Johnson (R-TX)
Jim McDermott (D-WA)	Kevin Brady (R-TX)
John Lewis (D-GA)	Paul Ryan (R-WI)
Richard Neal (D-MA)	Eric Cantor (R-VA)
John Tanner (D-TN)	John Linder (R-GA)
Xavier Becerra (D-CA)	Devin Nunes (R-CA)
Lloyd Doggett (D-TX)	Patrick Tiberi (R-OH)
Earl Pomeroy (D-ND)	Ginny Brown-Waite (R-FL)
Mike Thompson (D-CA)	Geoff Davis (R-KY)
John Larson (D-CT)	Dave Reichert (R-WA)
Earl Blumenauer (D-OR)	Charles Boustany (R-LA)
Ron Kind (D-WI)	Dean Heller (R-NV)
Bill Pascrell (D-NJ)	Peter Roskam (R-IL)
Shelley Berkley (D-NV)	
Joseph Crowley (D-NY)	
Chris Van Hollen (D-MD)	
Kendrick Meek (D-FL)	
Allyson Schwartz (D-PA)	
Artur Davis (D-AL)	
Danny Davis (D-IL)	
Bob Etheridge (D-NC)	
John Yarmuth (D-KY)	
Brian Huggins (D-NY)	
Linda Sanchez (D-CA)	

Senate Finance Committee

Senator Max Baucus (D-MT) continues as chairman and Senator Charles Grassley (R-IA) remains as ranking minority member of the Senate Finance Committee. The committee membership continues to be 13 Democrats and 10 Republicans.

Figure 5. Senate Finance Committee Members, 111th Congress

Democrats	Republicans
Max Baucus (D-MT), chairman	Charles Grassley (R-IA), ranking minority member*
John Rockefeller (D-WV)	Orrin Hatch (R-UT)
Kent Conrad (D-ND)	Olympia Snowe (R-ME)
Jeff Bingaman (D-NM)	Jon Kyl (R-AZ)
John Kerry (D-MA)	**Jim Bunning (R-KY)**
Blanche Lincoln (D-AR)*	Mike Crapo (R-ID)*
Ron Wyden (D-OR)*	Pat Roberts (R-KS)
Charles Schumer (D-NY)*	John Ensign (R-NV)
Debbie Stabenow (D-MI)	Michael Enzi (R-WY)
Maria Cantwell (D-WA)	John Cornyn (R-TX)
Bill Nelson (D-FL)	
Robert Menendez (D-NJ)	
Thomas Carper (D-DE)	

* Running for re-election in 2010.

Legislative schedule

This year's tax legislative agenda will be influenced by election-year politics and budget constraints. Early Congressional action is anticipated on health care legislation that carries over from 2009. Congress also will consider legislation to extend the estate tax and various other 2009 expiring tax provisions, climate change legislation, and job creation proposals. In addition, another increase in the statutory federal debt limit is likely to be considered early this year. Major new tax bills expected to require significant legislative debate in 2010 include action on the 2001 and 2003 tax cuts for individuals scheduled to expire after 2010.

The statutory deadline for the Administration's budget submission is the first Monday in February, i.e., February 1, 2010. By April 15, Congress typically adopts a "budget resolution" setting overall spending and revenue targets for the next fiscal year.

The midterm election will create significant pressure for Congress to adjourn in the early fall to allow Members to return home to campaign for re-election. However, Congress could reconvene after the November 2 election for a "lame duck" session to complete any unfinished business.

Figure 6. 2010 Congressional Schedule

House, Senate convene	January 12, January 19
President's State of the Union address	January 27
President's Day recess	February 15 - 19
Spring recess	March 29 - April 9
Memorial Day recess	May 31 - June 4
Independence Day recess	July 5 - 9
August recess	August 9 - September 10
FY 2011 begins	October 1
Target adjournment	TBD (early October)
Midterm Congressional Election	November 2

Economic update

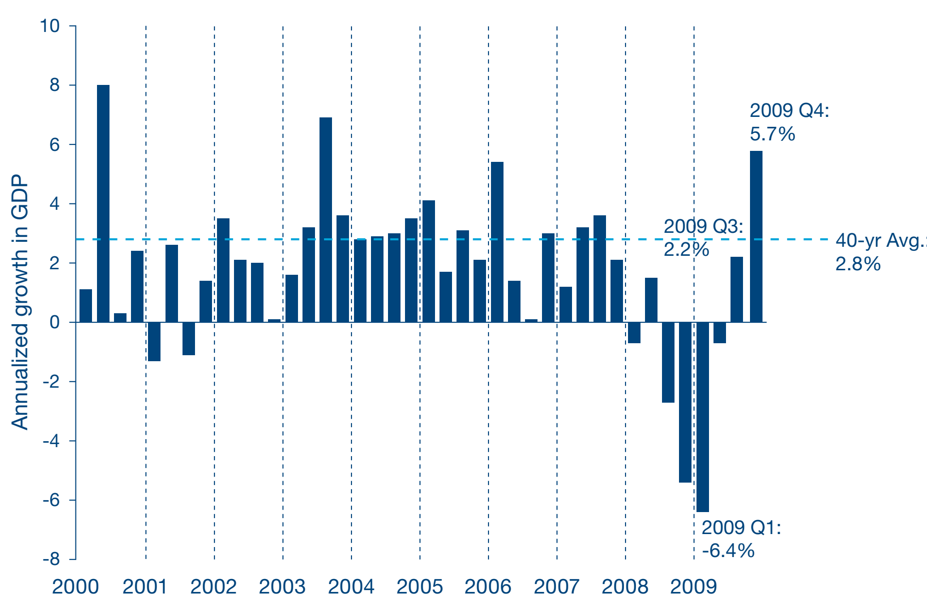
The economy has shown signs of recovery, and current expectations are that the recession will be declared to have ended in the second half of 2009. Gross domestic product (GDP), the value of output of the economy, increased by 5.7 percent in the fourth quarter of 2009, significantly higher than growth in the third quarter.

Overall, economists expect a modest recovery relative to historical experience, particularly relative to previous steep recessions. The forecasts of real GDP growth by participants in a recent Federal Reserve meeting clustered between 2.5 and 3.5 percent for 2010. These projections are close to the 40-year average growth in real GDP of 2.8 percent.

Several indicators of economic activity have shown improvement over the last several months, providing further evidence that the economy is climbing out of recession:

- Although December sales slipped, overall retail sales have been increasing since September. Given the importance of consumption to the overall economy, continued increases in consumer purchases could spur broader recovery.
- Orders and shipments of manufactured goods steadily increased over the second half of 2009. New orders in November 2009 increased by 1.1 percent, and shipments increased by 1.0 percent over the prior month.
- There are signs of improvement in the housing market. In November 2009, building permits increased by six percent over the October 2009 level, and housing starts were almost nine percent above the October 2009 level.

Figure 7. Quarterly Growth in Gross Domestic Product, 2000-2009



Source: U.S. Bureau of Economic Analysis, January 29, 2010

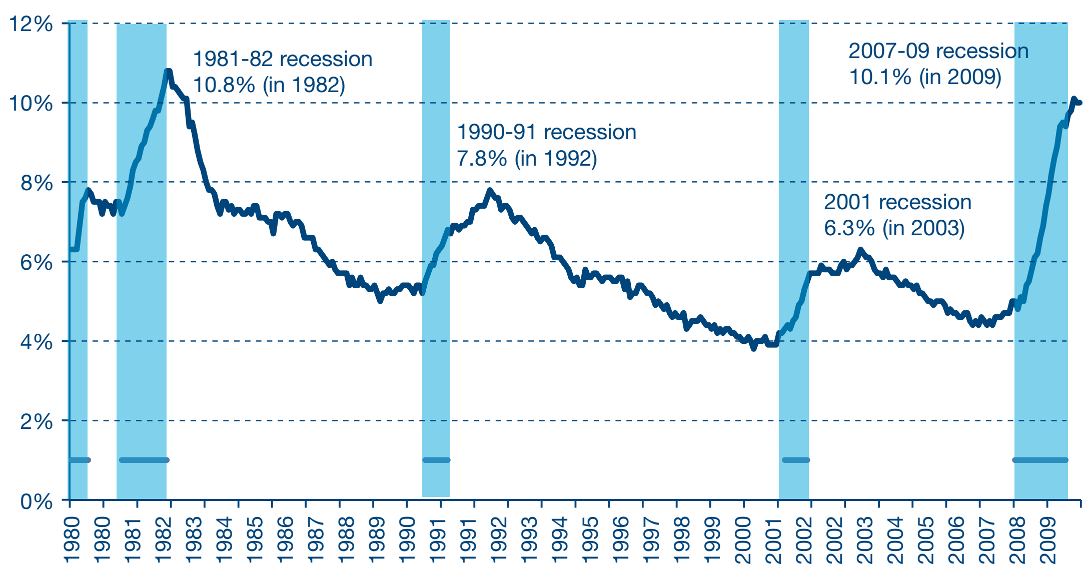
[1] The National Bureau of Economic Research is responsible for establishing the beginning and ending of recessions. It has not yet determined the end of the recession.

Economic recovery 2010

The public perception of the recovery will depend on the ability of the economy to generate new employment. The change in unemployment in the recession beginning in 1981 was relatively symmetric. The unemployment rate increased by approximately three percentage points over 17 months, peaked in the final months of the recession, and then fell over the subsequent 17 months by the same amount. In contrast, the unemployment rate in the 2001 recession increased by two percentage points over 10 months, remained high, and actually peaked 19 months after the official end of the recession. Unemployment fell slowly over the next six years.

During this recession, the unemployment rate increased by more than five percentage points between the beginning of the recession in December 2007 and November 2009, when the rate reached 10.2 percent. Projections for the current recovery show the unemployment rate falling slowly well after the recovery has begun. Participants in the November meeting of the Federal Reserve expected unemployment rates in 2010 to range between 9.3 and 9.7 percent in 2010, and between 6.8 and 7.5 percent in 2012. Similarly, the Congressional Budget Office expects unemployment to remain above 6 percent through late 2012.

Figure 8. Peak Unemployment Rates and Recent Recessions, 1980-2009



Source: US Bureau of Labor Statistics, National Bureau of Economic Research.

Recovery in Financial Markets

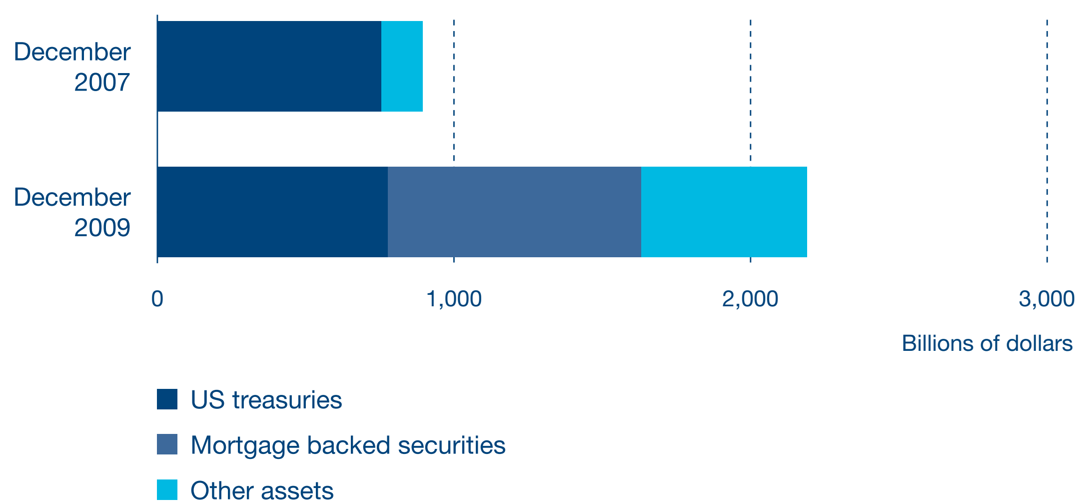
The downturn in the economy coincided with a significant financial crisis, and the recovery will depend in part on improvements in the financial sector. Actions of the Federal Reserve and lending in the commercial banking sector will shape recovery in the financial sector.

In the coming months and years, the Federal Reserve will have to begin unwinding the programs it implemented in response to the financial crisis. Between 2007 and 2009, the Fed provided unprecedented support to financial markets through its typical policy tools, such as setting the federal funds rate, as well as several new forms of intervention, including direct investment in private institutions. During this period, the Fed's balance sheet more than doubled, from $900 billion in December 2007 to $2.2 trillion in December 2009. A large portion of the increase was attributable to the Fed's purchase of mortgage-backed securities.

By taking ownership of these assets, the Fed increased liquidity in the economy in an effort to encourage stability in financial markets.

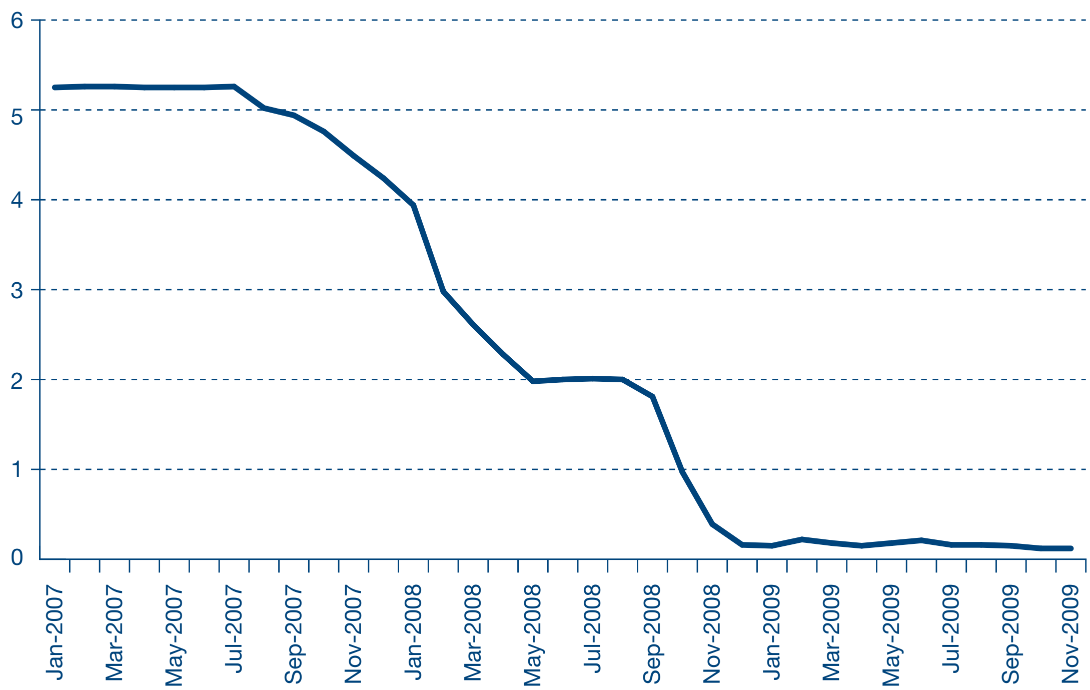
During this same period, the Fed cut its federal funds rate essentially to zero in an effort to stimulate lending by commercial banks and other institutions.

Figure 9. Assets on Federal Reserve Balance Sheet



Source: Federal Reserve Board.

Figure 10. Effective Federal Funds Rate



Source: Federal Reserve Board.

Despite these aggressive actions by the Fed, bank lending remains constrained. Commercial and industrial loans on the balance sheets of commercial banks were 17 percent smaller in November 2009 than in November 2008. Smaller businesses tend to be more dependent on commercial banks for financing, and any decline in the availability of credit will hinder the ability of these businesses to expand.

At some point, the Fed will have to begin pulling some of the liquidity out of the market to protect against the risk of inflation. Given the modest levels of projected economic growth, inflation should not become an issue in the near future. Authority for most of the Fed's liquidity programs expires in early 2010, at which point it would stop purchasing new assets. The Fed's next step will be to liquidate assets it currently holds. As its balance sheet shrinks toward more typical levels, the Fed will begin to raise the federal funds rate. Most projections are for interest rate increases to begin in late 2010 or 2011.

Federal budget

FY 2009 results

The deficit for the fiscal year ended September 30, 2009, reached $1.417 trillion, $960 billion larger than the FY 2008 deficit and $231 billion larger than the FY 2009 levels projected in January 2009. The increased federal budget deficit is attributable to the economic recession and subsequent stimulus legislation enacted in early 2009.

The FY 2009 deficit as a share of GDP, at 9.9 percent, was the highest level since World War II. Over the past 50 years, average budget deficits were 2.4 percent of GDP. The previous post-war high was 6.0 percent in 1983.

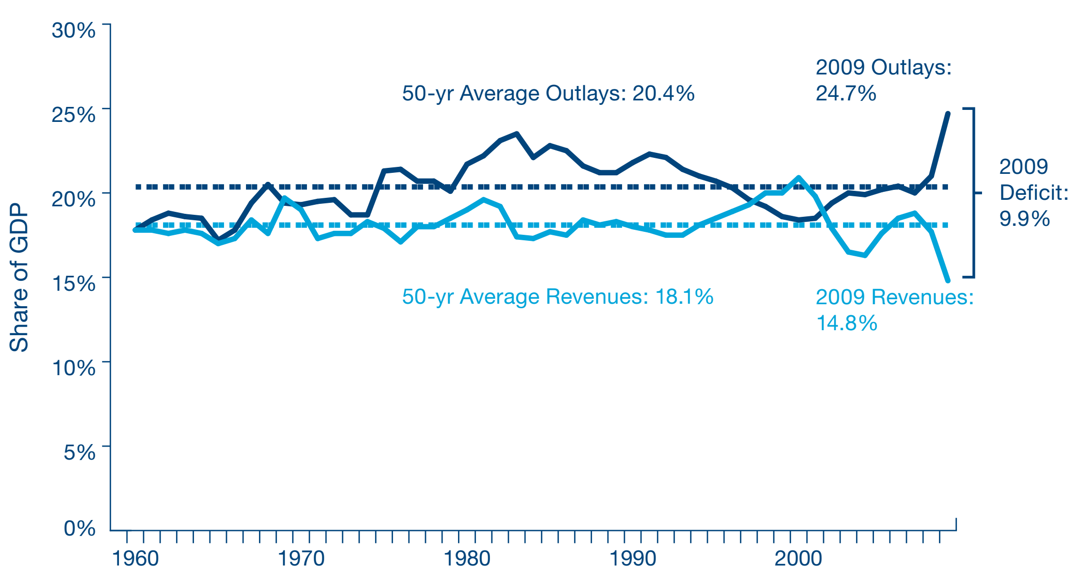
The stimulus legislation, the American Recovery and Reinvestment Act of 2009, was responsible for a small portion of the overall 2009 deficit. The Congressional Budget Office (CBO) estimated that the legislation increased the deficit by $185 billion. This figure excludes any positive impact attributable to changes in the economy in response to the new federal spending and tax cuts.

FY 2010 and beyond

The budget outlook for FY 2010, which began October 1, 2009, appears only slightly better. CBO budget projections to be released in January 2010 are expected to show that modest economic recovery and federal stimulus spending will keep budget deficits high in 2010.

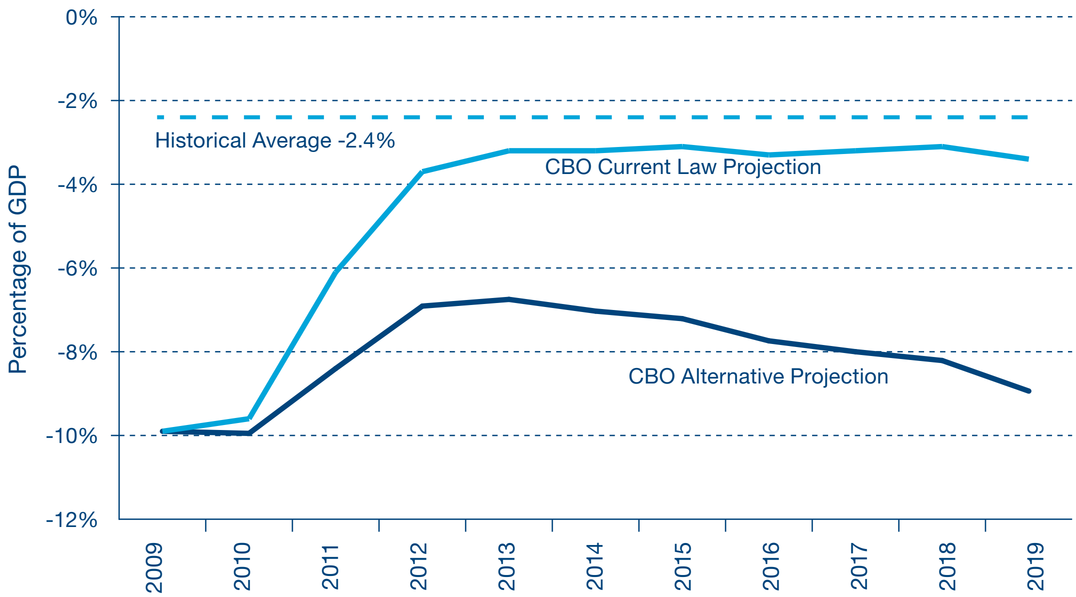
In August 2009, CBO estimated that the 2010 budget deficit under current law would reach $1.381 trillion in 2010, or 9.6 percent of GDP. Additional economic recovery legislation and slower-than-expected economic growth could push the deficit higher.

Figure 11. Federal Revenues and Spending, 1960-2009



Source: Office of Management and Budget.

Figure 12. Federal Budget Deficit Projections, 2009-2019



Source: CBO, August 2009 (2009 deficit from October 2009).

Beyond 2010, CBO projected the budget deficit under current law, as required by Congressional budget scorekeeping rules. CBO's projection assumes expiration of the 2001-2003 individual tax cuts at the end of 2010, slow growth in discretionary spending, and a continuation of the Iraq and Afghanistan conflicts.

To provide an alternative view of the deficit situation, CBO also projected deficits under the following assumptions: extension of all individual tax cut provisions scheduled to sunset after 2010; extension of the individual AMT relief, indexed for inflation; extension of various annual expiring tax provisions; future discretionary spending that increases with the size of the economy rather than being held fixed in real terms; and a reduction in spending through troop reductions in Iraq and Afghanistan (reducing the number of troops to 30,000 by 2013). Figure 12 shows the 10-year deficit outlook under these projections.

Under the alternative assumption, the deficit would exceed eight percent of GDP toward the end of the 10-year projection period. Federal government debt held by the public would reach 100 percent of GDP by 2019. High debt levels could impose significant economic harm, leading to increased interest rates, less private investment, and lower GDP growth.

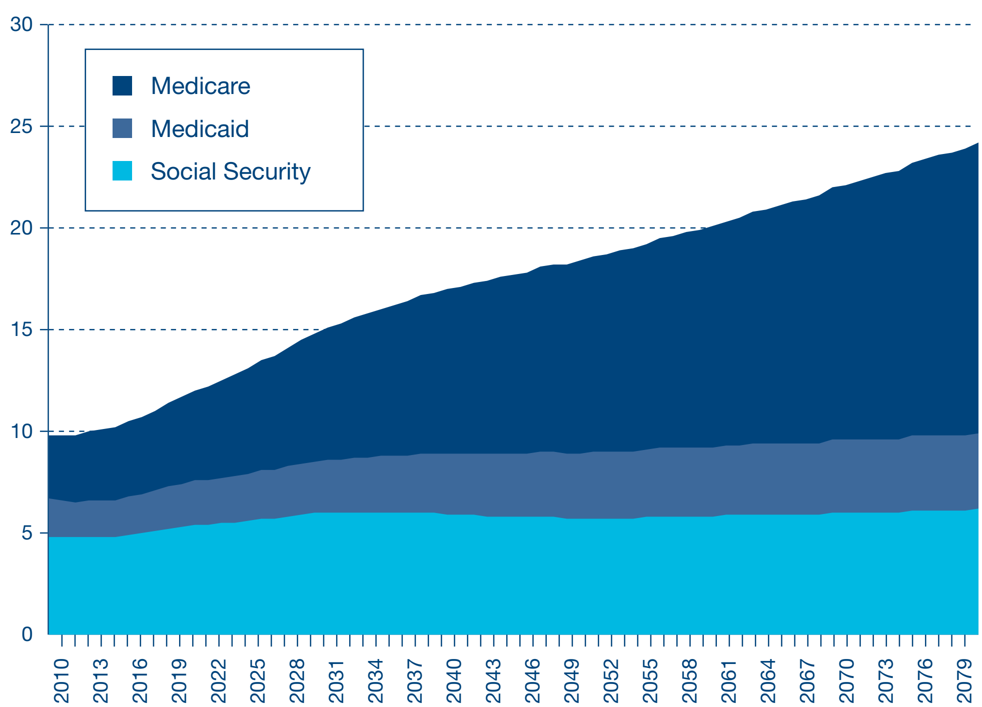
As described above, the federal budget deficit under current policies will continue to grow through 2019. Beyond 2019, the budget will come under even greater pressure as spending accelerates under the primary federal entitlement programs: Medicare, Medicaid, and Social Security. Federal spending on these three programs is projected to increase from approximately 10 percent of GDP in 2009 to approximately 15 percent in 2030 and 20 percent by 2060. Other federal spending represented another 15 percent of GDP in 2009.

To put these amounts in perspective, total federal revenue from all sources—including individual, corporate, payroll, and excise taxes—has averaged 18.3 percent of GDP over the past 40 years. Federal entitlement spending alone would exceed that level in 2049. By 2050, total federal spending, including interest on the debt, would reach 42 percent of GDP, more than twice the amount of historical revenues. Hence, a sustainable federal budget will require significant cuts in federal spending, significant increases in federal revenues, or a combination of both.

About half of the growth in entitlement spending is attributable to the aging of the U.S. population. The remaining half is attributable to the disproportionate growth in health care costs relative to the rest of the economy. Health care spending has outpaced real per-capita economic growth by 2.5 percentage points over the past several decades.

If Congress enacts legislation that succeeds in slowing the growth in health care spending, the long-term budget pressures would ease. However, demographic changes alone will increase entitlement spending by approximately three percentage points of GDP by 2030, four percentage points by 2050, and five percentage points of GDP by 2080. These increases by themselves would require an adjustment to spending or revenues to avoid unsustainable deficits.

Figure 13. Entitlement spending as a share of GDP, 2010–2080



Source: Congressional Budget Office (July 2009).

Congressional Budget Process

Congressional hearings on the President's budget proposals typically take place in February and March, after which Congress generally adopts a budget plan ("budget resolution") that provides an overall framework for consideration of subsequent tax and spending legislation for the budget period. The statutory deadline for Congress to pass a budget resolution for FY 2011 is April 15, but this date often has slipped in the past. Because a budget resolution binds only Congress, it does not require the President's approval.

Budget reconciliation process

If Congress attempts to undertake significant action to address the deficit in 2010, it most likely will rely on the reconciliation process. Originally intended to apply to legislation that would reduce federal budget deficits, the reconciliation process at times has facilitated consideration of other legislation that would be faced with filibusters or other procedural delays. Reconciliation bills receive expedited consideration and have special procedural protections that facilitate passage. In the Senate, reconciliation bills cannot be filibustered and require a simple majority (i.e., 51 votes) to pass.

At the same time, there are important limitations associated with budget reconciliation bills. Tax cuts enacted as part of a reconciliation bill generally must "sunset" at the end of the budget period unless offset in future years.

PAYGO

This could be a significant year for "pay-as-you-go" (PAYGO) budget rules because of the current economic environment and election-year political concerns. The PAYGO rules require any tax cuts to be offset with either tax increases or reductions in mandatory (entitlement) spending. This offset requirement can be waived in both the House and Senate, but a three-fifths majority (i.e., 60 votes) is required in the Senate.

The House last year approved statutory PAYGO budget legislation (H.R. 4154), which would require most new tax cuts or spending to be fully offset. Failure to do so would trigger automatic, across-the-board cuts in mandatory spending. However, the requirement would not apply to permanent extension of 2009 estate tax law, certain individual tax cuts enacted in 2001 and 2003, and individual alternative minimum tax (AMT) relief. The Senate did not act last year on the House bill.

Deficit reduction task force

Senate Budget Committee Chairman Kent Conrad (D-ND) and Ranking Minority Member Judd Gregg (R-NH) have proposed a national deficit reduction task force that would provide recommendations on spending, entitlement programs (such as Medicare and Social Security), and tax incentive provisions; Congress then would consider these recommendations under a fast-track legislative process. Key Congressional leaders have opposed the establishment of a deficit reduction task force that would bypass House and Senate committees, including the tax-writing panels.

The Obama Administration has discussed with Congressional leaders the option of establishing a Presidential deficit reduction commission that would propose changes to the tax code and federal entitlement programs. Congress would vote on the commission's recommendations later this year. At this writing, the details of a possible deficit reduction commission and procedures that would be used to ensure consideration of the commission's recommendations by Congress remain uncertain.

A. Health Care Reform

Early last year, President Obama and Democratic leaders in Congress identified reform of the health care system as a primary goal for the 2009 legislative session. Reform was intended to make insurance available to the 15 percent of the population who do not have health insurance, improve the quality of health care in the United States, and slow the growth of health care costs.

The health bills cleared by the House and Senate generally have taken a similar approach to providing coverage by requiring individuals to purchase coverage, and by providing subsidies and expanding the Medicaid program for those who cannot afford it. New insurance exchanges would be created to facilitate the health insurance market, and new requirements would be imposed on insurers.

The major differences between the packages include the imposition of coverage requirements on employers, the creation of government-sponsored insurance plans, and the funding mechanisms used to offset the costs of the new subsidies.

Employer mandate: The House bill would require employers to offer coverage to their employees and make a minimum contribution toward that coverage. The Senate bill does not include a similar mandate, but would require employers to pay a portion of the cost of federal subsidies provided to employees.

Public option: The House bill would create a government plan to compete with private insurance plans offered through the insurance exchange. The Senate bill would not create a government plan.

Figure 14. Revenue Provisions in House and Senate Health Care Bills (H.R. 3962, Senate Amendment to H.R. 3590)

	FY 2010–2019 Total ($billions)	
	House	Senate
Health-related sources		
40% excise tax on high-cost employer health plans	NA	$149
Fees on providers (pharma, device, insurers)	22	102
Increase HI tax by 0.5% for wages over $200K/$250K	NA	54
Eliminate deduction for Medicare Part D subsidy	2	5
Limit FSA contributions	13	15
Individual/Employer Mandates	168	36
Raise 7.5% AGI floor for itemized deduction to 10%	NA	15
Other health-related provisions	6	13
Other		
AGI surtax	461	NA
Corporate information reporting	17	17
Repeal worldwide interest allocation	6	NA
Codification of economic substance	6	NA
Tax treaty withholding limitation	8	NA
Limit cellulosic biofuel producer credit	24	NA

Source: Joint Committee on Taxation

Funding mechanisms: The Senate bill would fund its subsidies through funding sources within the health care sector, but the House bill would rely to a greater degree on broader parts of the economy. Figure 14 (shown on page 19) summarizes the 10-year budget impact of the primary revenue provisions in the House and Senate bills.

The House bill is estimated to cost more than $1 trillion over the FY 2010 to 2019 budget period; the Senate bill would cost approximately $850 billion. Adding the new revenues included above and decreased spending under the Medicare and Medicaid programs, both bills are projected to result in a net decrease in the federal budget deficit over the 10-year period.

While controlling the growth in health spending significantly was identified as one of the primary goals of reform, the impact of the provisions on overall public and private sector spending is less clear. Both the House and Senate bills include provisions that seek to change the operation of the health care market and improve efficiency and outcomes. However, the net impact of the current reform proposals on overall health spending is uncertain.

At this writing, Congressional leaders and Administration officials are working to reach agreement on a final bill that can pass both chambers and be signed into law by President Obama. The election of Massachusetts Republican Senator-elect Scott Brown complicates the prospects for final action on health care legislation.

B. Economic Growth/Job Creation

In response to concerns about the state of the economy, Congress this year is expected to consider new provisions to spur economic growth and job creation.

The Administration is reluctant to boost spending significantly or propose significant new tax reductions in the face of high federal budget deficits. As a result, it is focusing on more modest proposals that could provide a focused boost to the economy. In early December, the White House held a "jobs summit" and identified policy proposals that may encourage new hiring, including:

- Small business provisions such as zero capital gains rate for certain businesses, extension of section 179 expensing, and a new hiring tax credit;
- Extension of bonus depreciation;
- Additional investment in transportation infrastructure;
- New incentives for household energy efficiency projects; and
- Expansion of ARRA tax incentives for clean manufacturing jobs and industrial energy efficiency.

Before leaving in December, Members of Congress discussed increases in infrastructure spending ranging from $75 billion to $150 billion. Given the amount of time necessary to identify and fund projects, only a portion of those amounts would be spent in 2010. Other proposals—such as extension of unemployment insurance, subsidies to help cover COBRA health insurance costs for the uninsured, and bonus depreciation—also are under consideration and could be implemented more quickly. In late 2009, the House approved a bill (H.R. 2847) to extend unemployment benefits, the COBRA premium subsidy, and other ARRA provisions through June 30, 2010. The Senate did not act on this legislation before the end of last year. A two-month extension of these provisions through February 28, 2010, was enacted last December as part of the FY2009 Defense Department appropriations act (H.R. 3326).

The impact of any new legislation would be in addition to the American Recovery and Reinvestment Act of 2009 (ARRA), enacted last February. Much of the spending increases under ARRA are only now having an impact on the economy. Of the $787 billion in total tax cuts and spending increases under ARRA, $400 billion of the total is expected to occur in fiscal year 2010 and an additional $200 billion will be expended in following years.

Congress also may consider extending other ARRA tax provisions that are set to expire at the end of 2010. For example, ARRA modified the Work Opportunity Tax Credit to cover certain unemployed veterans and disconnected youth; this expanded coverage is set to expire on December 31, 2010.

C. Individual Tax Relief/Estate Tax

While President Obama has supported allowing tax cuts for upper-income individuals to expire as scheduled at the end of 2010, the President's budget proposals for FY 2010 included a permanent extension of key tax cuts enacted in 2001 and 2003 for individuals with incomes below $200,000 and families with incomes below $250,000.

If no action is taken this year, the individual tax code would largely revert to its pre-2001 status beginning in 2011. More than 116 million individual taxpayers would be affected by the scheduled termination of tax relief after 2010, and federal taxes would grow by more than $2 trillion over the next decade.

More specifically, unless Congress acts:

- The current individual ordinary income tax schedule would revert to the pre-2001 rates, resulting in higher tax rates for most taxpayers beginning in 2011. The 10-percent bracket for low-income taxpayers would revert to 15 percent. A portion of the 15-percent bracket for married couples filing joint returns would be taxed at 28 percent. Other brackets would increase, with the top tax rate reaching 39.6 percent.
- The current capital gains tax rates of zero and 15 percent would revert to 10 and 20 percent, respectively.
- Dividends—currently taxed at zero and 15 percent—would be taxed as ordinary income and therefore would be subject to a top rate of 39.6 percent.
- The estate tax would return in 2011 with a 55-percent top rate and a $1 million exemption.
- The increased $1,000 child tax credit would be halved. The increased standard deduction providing tax relief for married filers would decline by more than 15 percent. In addition, many education tax incentives would expire after 2010.

The Administration's FY 2010 budget assumes reinstatement of a top rate of 39.6 percent, and reinstatement of the 36-percent bracket for individuals with AGI over $200,000 and families with AGI over $250,000. The Administration also has proposed that taxpayers at these income levels be subject to a 20-percent top tax rate on capital gains and qualified dividends.

In March 2009, Senate Finance Chairman Max Baucus (D-MT) introduced "The Taxpayer Certainty and Relief Act of 2009," which would make permanent many tax relief provisions for lower- and middle-income taxpayers. The bill (S. 722) also proposes to retain the estate tax at 2009 levels with a per-spouse exemption of $3.5 million and a 45-percent maximum tax rate. In addition, the bill would allow surviving spouses to increase their estate and gift tax unified credit by any unused credit amounts of a deceased spouse.

The House on December 3, 2009, passed a bill (H.R. 4154) to extend permanently the estate and gift taxes at 2009 levels, without any revenue offsets. The JCT estimated that this bill would reduce federal revenues by $233 billion through 2019. The Senate did not act on estate tax legislation last year. As a result, Congress at some point in 2010 is expected to consider legislation that would reinstate the estate tax, possibly on a retroactive basis to January 1, 2010. Estate tax legislation this year may be considered as a separate bill or as part of a larger individual tax bill.

It is expected that Congress will act during the Spring or Summer of 2010 to maintain tax relief for individuals with adjusted gross income of less than $200,000 ($250,000 for joint filers). In early 2009, Congress approved a budget resolution that would not require revenue offsets for legislation making the middle-class tax relief permanent and freezing the estate tax at 2009 levels.

D. International Taxes

The potential for tax reform and President Obama's FY 2010 budget proposals dominated the international tax landscape last year, but Congress did not actively consider these issues during 2009 (see page 28 below for more on tax reform). Given the compressed Congressional election-year calendar and an already crowded legislative agenda, the prospects for significant international tax legislation are uncertain.

As discussed in on page 30, the House-passed "extenders" bill (H.R. 4213) includes one-year extensions of the subpart F exception for active financing income and "look-through" treatment of payments between related controlled foreign corporations (CFCs), which expired December 31, 2009. The chairman and ranking member of the Senate tax-writing committee have said these and other 2009 expired tax provisions are to be renewed on a retroactive basis to January 1, 2010.

Legislation extending unemployment benefits (H.R. 3548) that was enacted in late 2009 also delayed worldwide interest expense allocation until 2018. The House-passed health care bill (H.R. 3962) would permanently repeal worldwide interest expense allocation. If made part of any final health care legislation, this tax simplification provision could be repealed before it ever comes into effect.

The following are among the most significant Obama Administration international tax proposals from last year's budget.

Modifications to the check-the-box rules

The 2009 Administration proposal would restrict rules that allow certain unincorporated business entities and foreign entities to determine whether to be taxed as a partnership, corporation, or disregarded entity. The Administration argued that, as applied to foreign eligible entities, the entity classification rules may result in the unintended avoidance of current U.S. tax, particularly if a foreign eligible entity elects to be treated as a disregarded entity. The Administration proposal would continue to allow the use of disregarded entities that are directly owned by a U.S. company or by another company incorporated in the same country, as well as eligible foreign entities electing to be treated as partnerships and U.S. disregarded entities that are managed and controlled in another country. In its September 14, 2009 analysis of the Administration's international tax proposals, the JCT suggested that the proposal should be modified in order to prevent tax planning that could circumvent the stated purposes.

Restrict the use of foreign tax credits

The Administration's 2009 proposal would restrict a U.S.-based multinational corporation's deemed-paid foreign tax credits (FTCs) to the average rate of total foreign tax actually paid on total foreign earnings, thus eliminating the cross-crediting of high- and low-tax foreign income.

The Administration's "blended foreign tax pool" approach would fundamentally change the existing rules, which treat each foreign subsidiary of a U.S. taxpayer as having its own pool of earnings and taxes. The U.S. parent can claim an indirect foreign tax credit for foreign taxes paid by those subsidiaries; if each subsidiary has its own pool, the U.S. parent can often choose when to claim the credits for the respective high- or low-tax foreign income. Under the Administration proposal, that flexibility would be lost with respect to these "deemed-paid" foreign tax credits for taxes paid by foreign subsidiaries, but the proposal would permit continued flexibility with foreign taxes paid directly by a U.S. taxpayer.

The JCT analysis suggested that a 2007 tax reform bill introduced by Ways and Means Chairman Rangel in the last Congress (discussed below) may be a more effective way to address deemed-paid FTCs because it would include direct FTCs in the deemed-paid FTC blended pool. This would prevent the conversion of high-taxed CFCs into entities such as partnerships and branches that generate direct FTCs that otherwise would not be subject to blending. In addition, the JCT staff noted that the proposal lacks a transition rule for blending, with the result that all pre-effective date earnings and taxes apparently would be included in the blended pools.

The Administration also proposed to address situations in which a U.S. taxpayer claims FTCs paid on income that is not treated as currently earned by that taxpayer under U.S. tax principles (the so-called "technical taxpayer" rule). Specifically, the Administration proposed to "adopt a matching rule to prevent the separation of creditable foreign taxes from the associated foreign income." This issue was the subject of regulations proposed in 2006.

Limit deductions allocable to unremitted foreign earnings

Under the Administration's 2009 proposal, "foreign-related deductions" would be allowed only to the extent that expenses and losses are properly allocable or apportionable to foreign-source income ("FSI") earned by the U.S. taxpayer or its foreign subsidiaries that is currently taxed in the U.S. Any such deductions (except for research expenses) that are properly allocable or apportionable to FSI that is not currently taxed in the U.S. would be deferred until an equivalent amount of deferred FSI becomes taxable in the U.S. As proposed, the largest affected deductions for most companies would include interest, general and administrative (G&A) costs, and directly allocable expenses such as stewardship costs. The JCT suggested that research expenses also should be included, citing concerns that existing transfer pricing rules do not result in adequate foreign royalties for U.S.-developed intangibles.

Limit shifting of income through intangible property transfers

The Administration's 2009 proposal would prevent what it considers inappropriate shifting of income outside the United States by "clarifying" the definition of intangible property subject to an outbound toll tax, by expressly including workforce-in-place, goodwill, and going concern value. The proposal also would authorize the IRS to value intangible property on an aggregate basis in the case of the transfer of multiple intangibles, and provide that intangible property must be valued at its highest and best use. The JCT suggested additionally tightening the transfer pricing rules governing cost-sharing and the commensurate-with-income standard.

Transfer Pricing

In connection with its analysis of the Obama Administration's 2009 international tax proposals, the JCT suggested additional legislative proposals that would limit the ability of U.S. multinationals to transfer valuable intangible assets outside the United States in an effort to shift income to low-tax foreign jurisdictions. These proposals would fundamentally change in many respects the application of existing transfer pricing rules as they relate to intangible property. The proposals would:

- Limit the use of the comparable uncontrolled transaction method to situations in which exact comparable uncontrolled transactions exist, and expand the use of income-based methods.
- Make periodic adjustments under the commensurate-with-income standard more automatic when there are significant variances between projected and actual profits.
- Eliminate cost sharing as a framework for transfer pricing, except in very limited circumstances.

While it is not clear whether these proposals will be included in the Obama Administration's FY 2011 budget, they likely will be a part of any broader international tax debate.

Note: The JCT analysis observed that the Administration's international proposals, taken together, might discourage U.S. multinationals from being resident in the United States and might discourage some U.S.-based multinationals from repatriating foreign earnings. Although a Treasury report on corporate inversions is still outstanding, the IRS has released anti-inversion guidance intended to deter U.S. multinationals from moving offshore.

E. Climate change

The prospects for climate change legislation in 2010 will depend on whether Congress will seek to build upon the momentum gained in 2009. The House on June 26, 2009 passed the American Clean Energy and Security Act of 2009 (H.R. 2454), which would establish a federal "cap-and-trade" program to address climate change by regulating carbon and other greenhouse gas emissions. The Senate Environment and Public Works Committee on November 5, 2009 approved the Clean Energy Jobs and American Power Act (S. 1733).

The House-passed and Senate Committee-approved climate change bills generally are similar. Both bills would establish a federal cap-and-trade system under which facilities subject to the program would be required to submit annual allowances for greenhouse gas emissions. Covered facilities principally would include producers of electricity, refiners of petroleum, distributors of natural gas, and others in the industrial sector. Up to 85 percent of the required emissions allowances would be provided free in the early years of the program, but over time the program would approach a full auction requiring that entities purchase their allowances. The limited allowance auctioning is projected to raise as much as $280 billion over the first 10 years of the program.

Both bills also include provisions beyond cap-and-trade, including a national renewable energy portfolio standard that would require a certain percentage of the nation's energy to be derived from renewable resources. These non-cap-and-trade provisions could form the basis for a separate energy bill that could be considered in 2010.

President Obama cited this legislative progress during the United Nations climate change conference held in Copenhagen in December 2009. The UN conference represents the first step in efforts to negotiate a new international climate change treaty to replace the Kyoto Protocol that expires in 2012. However, some senior Senate Democrats have stated recently that Senate action on climate change legislation may be delayed until after the November Congressional elections.

Separately from Congressional action, the Administration through the Environmental Protection Agency is proceeding with regulatory approaches to climate change. The EPA last year finalized a rule requiring reporting of greenhouse gas emissions. The reporting rule, which became effective on December 29, 2009, applies to facilities that annually emit 25,000 metric tons or more of greenhouse gases, manufacturers of vehicles and engines, and suppliers of fossil fuels or industrial greenhouse gases.

Further, on September 30, 2009, the EPA proposed a permitting rule for greenhouse gas emissions. Under the Clean Air Act, owners and operators of stationary sources of air pollution are required to obtain permits before constructing or modifying those sources. The EPA rule holds greenhouse gases to be air pollution and thus subject to the Clean Air Act requirements. As a result, these entities will be required to install "Best Available Control Technology" upgrades to limit those emissions. However, as with the new reporting requirement noted above, the EPA rule would limit its impact to those entities emitting 25,000 metric tons or more per year. The comment period for this proposed rule closed on December 28, 2009, and the rule could be finalized in 2010.

In response to EPA regulatory proposals, some Members of Congress have introduced legislation to block the EPA from regulating greenhouse gases. Rep. Earl Pomeroy (D-ND), a senior member of the House Ways and Means Committee, introduced a bill (H.R. 4396) that would exclude greenhouse gas emissions from the Clean Air Act. Senator Lisa Murkowski (R-AK) has proposed a measure that would prohibit the EPA from implementing its regulatory emissions plan for one year.

At the state level, the Regional Greenhouse Gas Initiative now requires utilities in 10 Northeastern and mid-Atlantic states to participate in a carbon dioxide cap-and-trade program. California is moving ahead with implementation of its Global Warming Solutions Act, which calls for a statewide cap-and-trade program by 2012.

Finally, Congress may consider additional renewable energy tax incentives separately from climate change legislation. The Senate Energy and Natural Resources Committee on July 16, 2009 approved The American Clean Energy Leadership Act of 2009 (S. 1462), which addresses a variety of non-tax energy issues regarding the development, security, and transmission of energy including from renewable resources. This bill could serve as a vehicle for a tax title in legislation expanding or extending new and existing renewable energy incentives.

F. Global Tax Compliance

There were a number of legislative proposals last year to promote global tax compliance and prevent offshore tax evasion by U.S. taxpayers, principally by enhancing information reporting and strengthening penalties. Both Congress and the Obama Administration are expected to continue to pursue these and other global tax compliance initiatives this year.

The Foreign Account Tax Compliance Act of 2009

On October 27, 2009, House Ways and Means Chairman Charles Rangel (D-NY) and Senate Finance Committee Chairman Max Baucus (D-MT) introduced the Foreign Account Tax Compliance Act of 2009 (“FATCA”) to combat offshore tax evasion by individual taxpayers (H.R. 3933, S. 1934). The House on December 9, 2009, approved a revised version of the FATCA legislation as part of the Tax Extenders Act of 2009 (H.R. 4213), but the Senate did not act on that legislation (discussed below) before the end of last year.

In general, FATCA would require foreign financial institutions, foreign trusts, and foreign corporations to provide information reporting about their U.S. account holders, grantors, and owners. New withholding taxes would apply in cases where foreign financial institutions or foreign corporations do not comply with the proposed reporting requirements. The FATCA bill also would double the current three-year statute of limitations to six years for certain underreporting of income in connection with foreign financial assets and failure to comply with certain new information return reporting requirements.

Any individual or entity with foreign accounts or financial instruments worth more than $50,000 in the aggregate would be required to file an information return with the taxpayer's annual tax return. A 40-percent penalty would apply under FATCA for underpayments attributable to undisclosed foreign financial assets. In addition, the legislation would impose a withholding tax on dividend-equivalent amounts on notional principal contracts, including equity swaps.

FATCA follows up on several legislative proposals made earlier in the year to combat offshore tax evasion by the Obama Administration, Chairman Baucus, Senator Carl Levin (D-MI), and Rep. Lloyd Doggett (D-TX).

Tax Sharing Information and Compliance Efforts

The United States and many foreign countries have engaged in a concerted effort to cooperate through sharing tax information and coordination of compliance efforts. In the past year, for example, the United States has entered into information exchange agreements with Switzerland, Luxembourg, Liechtenstein, Gibraltar, and Monaco.

One group spearheading international tax cooperation and global compliance efforts has been the OECD's Forum on Tax Administration, led by IRS Commissioner Douglas Shulman. The group consists of 41 tax commissioners, who are focused on improving tax administration and compliance. The increased information sharing and compliance coordination between the United States and foreign countries is likely to increase this year as it is considered an effective way to raise tax revenue without imposing a direct tax increase on taxpayers during difficult economic times.

In addition, Commissioner Shulman has reached out to corporate boards of directors to emphasize the importance of their oversight of tax compliance as part of their governance process and a way to address tax risk management. Such efforts are likely to continue this year as part of his efforts to promote tax transparency and compliance.

Tax Reform

With important individual income tax provisions expiring at the end of 2010, and AMT relief having expired December 31, 2009, there will be significant pressure on Congress to address at least those individual issues this year. Business tax reform also may be considered in Congressional hearings in 2010, although with other significant issues already dominating the Congressional agenda, legislative action is likely to continue into 2011.

Business tax reform drivers

Many observers view the U.S. corporate tax system as providing a less competitive playing field for U.S.-headquartered companies than the tax systems of their foreign-headquartered counterparts. As shown in Figure 15, the U.S. combined statutory corporate tax rate is the second highest of the advanced economies of the OECD. Including state and local income taxes, the 39.1-percent U.S. tax rate is 50 percent greater than the average rate in the rest of the OECD.

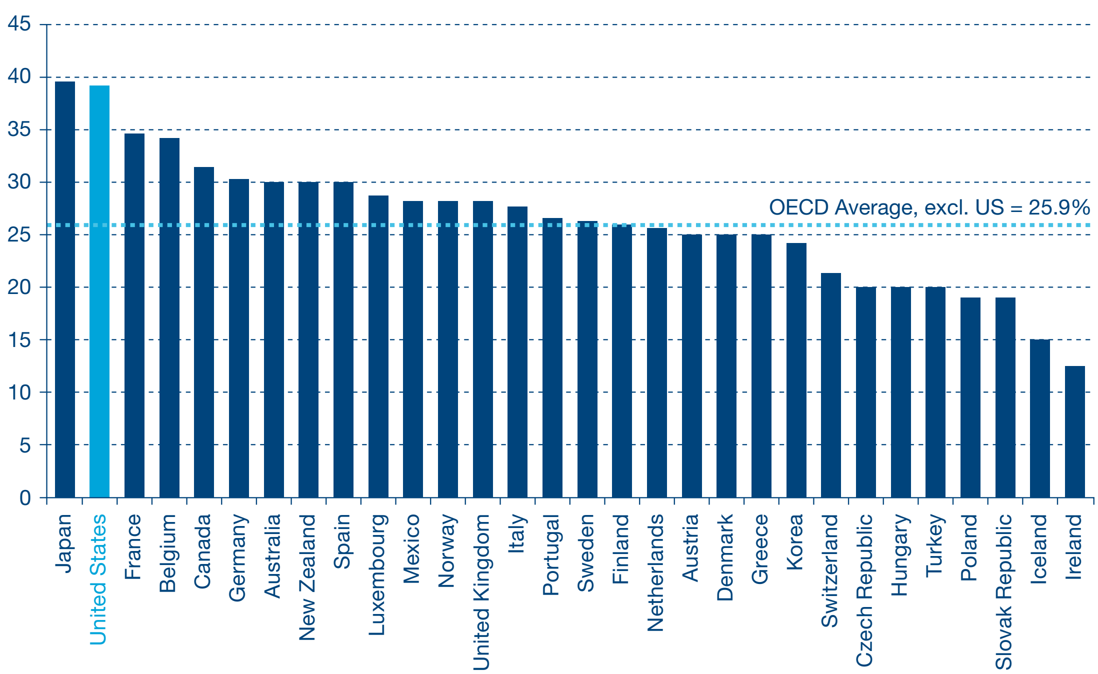
At the start of the 1990s, the U.S. corporate rate generally was competitive with the rate in most OECD countries. Since 1990, however, every other OECD country has lowered its corporate tax rate—an average of 15 percentage points—while the U.S. combined federal and State rate has increased.

The tax treatment of foreign income is another area in which the U.S. corporate tax system is viewed by many as providing a less competitive environment. Most OECD countries—25 of the 30—have so-called "territorial" tax systems under which foreign earnings remitted as a dividend are not subject to domestic taxation. In contrast, the United States has a worldwide tax system that taxes these foreign earnings upon remittance.

Tax reform legislation

Both the House Ways and Means Committee and the Senate Finance Committee are expected to hold hearings this year to lay the groundwork for tax reform. However, it

Figure 15. Combined (Federal and State) Corporate Tax Rates, OECD, 2009



Source: OECD.

appears unlikely that Congress will act on major tax reform legislation this year.

In December of last year, Ways and Means Chairman Rangel expressed his interest in taking up broad tax reform in 2010. During the previous Congress, Chairman Rangel introduced a bill (H.R. 3970, 110th Cong.) that proposed to lower the corporate tax rate to 30.5 percent. The legislation was revenue-neutral within the business sector, i.e., the corporate rate reduction would be offset by raising business taxes through base broadening. The primary base broadening measures in the 2007 bill were repeal of the domestic manufacturing deduction, international tax increases (deferral of deductions and pooling of foreign tax credits similar to those provisions proposed by the Administration last year), and repeal of the last-in first-out (LIFO) method of inventory accounting. It is believed that Chairman Rangel this year may introduce a revised version of his earlier bill, which could reduce corporate rates to as low as 28 percent, but would require further base broadening in order to be revenue-neutral.

The international tax proposals in last year's Administration's budget (discussed above) were not closely examined by Congress in 2009. However, these proposals may receive more attention in the context of any consideration of tax reform in 2010, especially if the Administration re-proposes revised versions of them in this year's budget. It is expected that the business community will strongly oppose international proposals similar to those in last year's budget on the ground that they would reduce the ability of U.S. companies to expand into foreign markets and compete against companies subject to generally more favorable tax rules.

Other tax reform options may be offered by the President's Economic Recovery Advisory Board (PERAB), chaired by former Federal Reserve Chairman Paul Volcker. The PERAB was directed last year to establish a tax reform subcommittee to study and recommend tax reform options to the President. The PERAB tax reform subcommittee was asked to consider simplification, compliance, and "loophole closing," specifically with the aim of reducing "corporate welfare" without "considering policies that would raise taxes on families making less than $250,000." The subcommittee initially was charged with reporting back to the full PERAB on its recommendations and having the PERAB approve these recommendations for reporting to the President by December 4, 2009.

Chairman Volcker announced in late November that the tax reform subcommittee would request an extension of its original deadline until after the December holidays to permit it to continue its work. Chairman Volcker further clarified that the subcommittee would not be providing its own tax policy recommendations to the Administration; instead, the final report will "be an almanac of options from a broad range of viewpoints."

The ultimate impact of the PERAB tax reform subcommittee's recommendations on tax reform discussions in 2010 is uncertain. One criticism of a tax reform panel's work under President George W. Bush was that there was no follow-through by the Bush Administration after completion of that panel's report. It remains to be seen whether the Obama Administration will choose to endorse any of the specific options that will be presented by the PERAB tax reform subcommittee.

To the extent the PERAB tax reform subcommittee identifies "loopholes" and revenue-raisers—especially those raising revenue from corporations—these may be of interest beyond their value to tax reformers and potentially come into play immediately if Congress and the Administration attempt to address significant projected budget deficits.

The research credit and other business and individual tax incentives expired at the end of last year. The House on December 9, 2009, passed the Tax Extenders Act of 2009 (H.R. 4213), which would extend the research credit, CFC look-thru, Subpart F exception for active financing income, and other selected expired business and individual tax provisions for one year through the end of 2010. However, the Senate did not act on this legislation before recessing last year, and these provisions expired on December 31, 2009. As a result, Congress in 2010 is expected to consider a retroactive extension of these provisions.

The House bill is estimated to cost approximately $31 billion over 10 years. While most of the bill's tax provisions, such as the research credit, apply to businesses, about $5 billion would apply to individuals. The cost of the House bill would be offset primarily by a proposal to tax the "carried interest" of investment services managers as ordinary income instead of capital gains, generally effective for distributions after December 31, 2009; this proposal is estimated to raise $24.6 billion over 10 years. While the House has approved carried interest legislation as part of extender bills in 2007, 2008, and 2009, the Senate has not voted on this issue. The other revenue offset proposed as part of the House extenders bill is offshore tax compliance legislation, which is estimated to raise $7.6 billion over 10 years (see FATCA discussion above).

Chairman Rangel also has stated that the list of tax extenders needs to be reviewed. The House-passed tax extenders bill includes a provision that directs the JCT to study the effectiveness of the dozens of provisions that routinely are scheduled to expire but as a matter of practice are extended, often on a retroactive basis.

The study, which under the House bill is due by November 30, 2010, is to analyze whether the tax incentives are the most cost-effective way to achieve Congress' goals and whether there are unintended beneficiaries. In addition, the study is to offer suggestions for modifying each provision. It should be noted that separately there are bills pending to modify some of these provisions. For example, Senate Finance Chairman Baucus on June 6, 2009, introduced a bill (S. 1203) to modify and make permanent the research credit.

The timing for possible Senate action on tax extenders legislation is uncertain. Senate Finance Chairman Baucus and Ranking Republican Grassley at the end of 2009 issued a statement that noted their commitment to enactment of a seamless extension of expired business and individual provisions. However, Chairman Baucus has noted that the Senate likely will consider alternative revenue offsets to those in the House-passed bill.

Figure 16. Selected Expiring Tax Provisions (H.R. 4213)

	Estimated Revenue Effect ($ billions, over 10 years)
Research tax credit	-6.9
Subpart F active financing provisions	-3.9
Look-thru of payments between related CFCs	-0.5
15-year recovery of leasehold, restaurant, and retail improvements	-5.3
Deduction for state and local sales taxes	-1.8
Various energy tax incentives	-1.1
Other extenders	-5.9
Community assistance provisions	-3.4
Disaster relief provisions	-2.4
Total	-31.2

Source: Joint Committee on Taxation

Potential Revenue Raisers

In addition to international tax proposals from 2009, President Obama is expected to re-propose other revenue raisers as part of his FY 2011 federal budget. For example, the Administration is expected to renew its support for codification of the economic substance doctrine. This provision was included in the House-passed health care bill and may be enacted as part of any final health legislation. In addition, the Administration continues to support taxing of "carried interest" received by hedge fund and private equity managers as ordinary income, rather than capital gain.

Last year, President Obama proposed that most of the tax increases included in his budget would be effective in 2011. In the case of last-in, first-out (LIFO) inventory accounting method repeal, the Administration supported making this provision effective in 2012. The Administration proposed that codification of the economic substance doctrine would be effective for transactions entered into after the date of enactment.

Additional significant business tax increases that may be re-proposed as part of the FY 2011 budget include:

- Reinstate Superfund taxes.
- Eliminate oil and gas company provisions, including repeal of the manufacturing deduction, expensing of intangible drilling costs, and percentage depletion.
- Repeal the lower of cost or market inventory accounting method.
- Deny the deduction for punitive damages.
- Require ordinary treatment of income from day-to-day dealer activities.
- Modify the definition of "control" for purposes of the limit on deductions related to repurchase of debt.
- Modify the dividends-received deduction for life insurance company separate accounts.
- Expand the pro rata interest expense disallowance.

The Administration also may propose new revenue raisers as part of the FY 2011 budget. For example, Administration officials have announced that the budget will include a new fee on banks, insurance companies, and certain other financial businesses with more than $50 billion in assets. The proposed fee would apply to both U.S. businesses and U.S. subsidiaries of foreign firms. Administration officials have indicated that the fee is projected to raise $90 billion over 10 years.

Revenue-raising tax bills introduced last year may continue to attract support. For example, House Ways and Means member Lloyd Doggett (D-TX) and Senator Carl Levin (D-MI) continue to urge action on corporate "tax haven" legislation, including a corporate residency "management and control" test, included in bills (H.R. 1266, S. 506) that they introduced last year. Senator Byron Dorgan (D-ND) may renew efforts to pass his "runaway plant" legislation (S. 260), which would tax the foreign income of certain U.S. controlled foreign corporations selling products in the United States. There also continues to be some discussion among House and Senate Democrats of possible restrictions on executive compensation.

Some Members of Congress also have expressed support for legislation to impose a tax on securities transactions. While Treasury Secretary Geithner has stated that the Administration opposes such legislation, a securities transaction tax bill (H.R. 4191) introduced by Rep. Peter DeFazio (D-OR) has been estimated by its sponsors to raise $150 billion over 10 years. The bill generally would impose a 0.25-percent tax on stock transactions and a 0.2-percent tax on futures contracts, swaps, credit default swaps, and options. Similar legislation (S. 2927) has been introduced in the Senate by Senator Tom Harkin (D-IA). There also have been proposals by officials in the United Kingdom and France to impose a securities transactions tax on a world-wide basis.

Other potential sources of revenue that might be considered by Congress include past Administration budget proposals as well as recent or pending reports and investigations on particular tax issues. Senate Finance Chairman Baucus and Ranking Member Grassley have urged Treasury to examine foreign-source income reporting, and a long-overdue Treasury report on corporate inversions is still pending. Senator Grassley also is expected to continue to focus on tax-exempt issues, including nonprofit hospitals and universities. Separately, the Senate Permanent Subcommittee on Investigations has issued questionnaires on financial statement tax reserves, "tax haven" subsidiaries, and repatriation of foreign earnings; the subcommittee is expected to issue reports that may suggest tax law changes.

For a list of potential revenue-raising tax provisions proposed in past bills, Administration budgets, or CBO or JCT staff reports, see the Appendix at the end of this report.

Other Legislation

A. Tax Treaties

New tax treaties and protocols in process

New treaties and protocols: More than 10 years after it was signed, a new U.S.-Italy income tax treaty and an accompanying protocol entered into force on December 16, 2009, replacing the prior tax treaty between the United States and Italy. The Italian tax treaty was ratified with a reservation by the U.S. Senate in 1999, but Italy did not accept the U.S. reservation until last year. One week later, Treasury announced the entry into force of the French protocol, following Senate approval of the new agreement with France in late 2009. The entry into force of the French protocol means that its addition of an elimination of the dividend withholding tax on qualifying parent/subsidiary dividends is effective retroactive to dividends paid on or after January 1, 2009.

Pending agreements: In November, the Senate Foreign Relations Committee held hearings on the three agreements that had been sent by Treasury to the Senate for its approval: protocols to U.S. treaties with France and New Zealand and a new tax treaty with Malta. The Foreign Relations Committee cleared the new protocol with France for Senate approval, as noted above, but the agreements with Malta and New Zealand were not reported out by the committee; it is understood that priority was given to bringing the French protocol into force before year-end because of its retroactive elimination of the withholding tax on qualifying parent/subsidiary dividends.

Other agreements nearing completion include signed protocols with Switzerland and Luxembourg, primarily aimed at updating the exchange of information provisions of those two treaties; agreement with Hungary on a new or revised treaty, which should reach signature stage soon; and agreement with Norway, which is complete except for one issue which apparently has been resolved but not reduced to writing.

It has been widely reported that the United States and Switzerland have agreed to return to the negotiating table within the next two years. The focus of those negotiations will be on the prospect of including a zero withholding tax on parent/subsidiary dividends and a revision to the Limitation on Benefits article, to be more in line with recent U.S. tax treaties that have tightened the requirements for eligibility.

Agreements in negotiation: Treasury is actively pursuing renegotiation of the U.S. treaty with Poland, the only remaining U.S. tax treaty with a jurisdiction often used as an intermediary jurisdiction for holding and finance companies that lacks a robust anti-treaty shopping article. U.S. officials had been saying that they expected the negotiations to be completed by the end of 2009, although Polish sources say completion of the negotiations may take some additional time. The goal of the U.S. is to have the new or revised treaty in effect simultaneously with the new or revised treaty with Hungary, which is expected to be fully effective by 2011.

Other treaties under negotiation include Israel, South Korea, Vietnam, Brazil, Chile, and Columbia. Preliminary discussions reportedly have been held with Venezuela and Singapore. Spain has also expressed an interest in negotiations.

Trends in U.S. tax treaty policy

The United States is expected to continue to strive for strong anti-treaty shopping protection in its treaties. Such policies include Limitation on Benefits (LOB) articles; policing the use of U.S. tax treaties by inverted companies; strong exchange of information commitments; and modernization of the treatment of cross-border retirement plans and the personal services articles of treaties (mainly, the policy of eliminating the independent personal services article as being redundant of the business profits article). In addition, Treasury likely will continue the new policy of including binding arbitration as means of deciding competent authority cases that are otherwise unresolved.

Tax treaty uncertainties include:

- Whether there will be further expansion of the controversial deemed permanent establishment (PE) rule for services performed in the host country for more than 183 days (as in the recent Canadian protocol and the new treaty with Bulgaria),
- Further refinements and clarity on the attribution of profits to a PE, and
- Possible treaty provisions addressing the cross-border treatment of business restructurings.

Other possibilities are that:

- Treasury will continue its effort to eliminate U.S. tax treaties that do not have LOB articles or comparable limitations on treaty shopping (an agreement in principle has been reached with Hungary, and Poland is next in line).
- There will be a continued effort to address the small number of U.S. tax treaties with Latin American countries and Asian countries, although it is not clear this Treasury will be any more successful than its predecessors in persuading the target countries to conform to OECD treaty standards (which has been the roadblock).
- There will be a continued effort to expand the network of countries that have adequate tax information exchange agreements with the United States.

Finally, the IRS priority guidance plan includes a regulation project regarding treaties. Currently, the only guidance on treaty interpretation equivalent to a regulation is the Treasury Technical Explanation that accompanies the submission of a treaty or protocol to the U.S. Senate during the ratification process. There is no procedure for amending a treaty explanation to correct errors or reflect the most recent thinking of the IRS and Treasury. Treasury Technical Explanations are accorded limited weight by the courts, although more so in the exceptional cases where the treaty partner has indicated its acceptance of the U.S. interpretations (such as in the case of the Fifth Protocol to the US/Canada income tax treaty). It is expected that the regulations project will focus on the beneficial ownership rules, which have been subjected to varying interpretations in private letter rulings.

B. State Tax Legislation

Virtually every major state tax issue addressed in proposed legislation during the 110th Congress was reintroduced in 111th Congress. State and local governments in general, and state tax administrators in particular, remain opposed to the general concept of increased federal preemption of state tax authority. At the same time, with legislative, judicial, and administrative developments in the states turning against taxpayers on these issues, often producing non-uniform results, businesses press their case for multistate relief. However, because of the crowded docket of state tax-specific legislation in the committees of jurisdiction (generally, either the Senate Commerce or Finance Committee, and the House Judiciary Committee), moving such bills may continue to be a difficult prospect in 2010.

Nexus (jurisdictional) issues

State courts have upheld "economic nexus" by approving imposition of direct (e.g., income or franchise) taxes on businesses regardless of a physical presence in the state, while state legislatures and tax administrators have adopted economic nexus in their tax imposition statutes and implementing regulations. Over the past several Congresses, federal legislation has been introduced that would reverse this trend by establishing a bright-line physical presence standard and expanding existing federal protections under Public Law 86-272 for sales solicitation activities. While this legislation advanced the furthest in 2006, being approved by the House Judiciary Committee and scheduled for a House vote, similar legislation failed to move out of either the House Judiciary Committee or the Senate Finance Committee in the 110th Congress. In February 2009, the "Business Activity Tax Simplification Act of 2009" (H.R. 1083) was introduced. The prospects for action on this bill remain uncertain.

Regarding sales and use taxes, states have joined with certain industry proponents in seeking federal authorization for the imposition of tax on "remote sales" made by non-nexus entities such as Internet and catalog sellers. Similar to the business activity tax issue, however, legislation has failed to move out of committee in prior Congresses; unlike business activity tax, no bill was introduced in 2009.

The primary reason for failure to introduce the legislation has been ongoing negotiations between state, local, and business stakeholders over a small number of issues with major ramifications, such as vendor compensation for collecting the tax, collection exemptions for "small sellers," local tax simplification for telecommunications and other services, and governance of the multistate streamlined organization. Disagreement among the stakeholders and continuing opposition from certain business and advocacy groups may delay Congressional action in 2010.

Nonresident withholding

During the 110th Congress, proponents of legislation that would provide a standard threshold for withholding on wages of nonresident employees and for the personal income tax liability of such employees worked to build consensus with state governments. While credit for tax paid in nonresident states ultimately results in relatively little revenue loss to the states from such a withholding or liability threshold, certain adversely affected states such as New York have not agreed to the proposal, as embodied in the "Mobile Workforce State Income Tax Fairness and Simplification Act." The legislation was reintroduced in April 2009 as H.R. 2110, with a reduced threshold from 60 to 30 days of in-state presence. Negotiations between business and state stakeholders continue over specifics of the proposal, and certain state organizations have taken up a parallel effort to craft a "state solution" to the problem through model legislation to be adopted by state legislatures and applied on a reciprocal basis.

Industry "nondiscrimination"

A number of proposals have been reintroduced in the 111th Congress that would bar certain deemed "discriminatory" taxation by state and local governments. Most of these proposals, which would apply to "new" forms of discriminatory taxation adopted by states and localities, generally impact specific industries. Examples include the Cell Tax Fairness Act (H.R. 1521); the Mobile Wireless Tax Fairness Act (S. 1192); the State Video Tax Fairness Act (H.R. 1019); and the End Discriminatory State Taxes for Automobile Renters Act (H.R. 4175). These bills could be joined by legislation regarding natural gas pipeline and oil pipeline property taxation, similar to legislation introduced in the 110th Congress.

In each case, states have maintained uniform opposition to restrictions on their sovereignty to tax. In some cases, businesses within an industry are divided on the proposals, while others enjoy general support within the affected industries.

Other state issues

Because states continue to push toward expanded tax authority in a changing economy, businesses continue to seek redress in a variety of forums, including the ultimate arbiter on interstate commerce, the U.S. Congress. Examples of new areas for which federal intervention may be sought include the taxation of digital goods and services and the sourcing of Voice over Internet Protocol receipts. It is likely that an already crowded field of state tax issues being brought before Congress will continue to grow, both in the remainder of the 111th Congress and in future years.

C. Other Legislation

Tax Technical Corrections

On December 2, Ways and Means Committee Chairman Rangel and Ranking Member Dave Camp (R-MI) introduced H.R. 4169, the Tax Technical Corrections Act of 2009. As of this writing, Finance Committee Chairman Baucus and Ranking Member Charles Grassley (R-IA) were expected to introduce identical legislation in the Senate. Technical corrections bills typically are considered as part of other tax legislation.

The technical corrections bill clarifies Congressional intent with respect to certain tax law changes enacted as part of the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), the Emergency Economic Stabilization Act of 2009 (P.L. 110-343), the Heroes Earnings Assistance and Relief Tax Act (P.L. 110-245), the Economic Stimulus Act of 2008 (P.L. 110-185), and the Tax Technical Corrections Act of 2007 (P.L. 110-172).

FAA Reauthorization

A short-term extension of the current aviation program and taxes is scheduled to expire on March 31, 2010. Congress passed the short-term extension to give more time to consider a multi-year reauthorization of the Federal Aviation Administration (FAA). As part of reauthorization, Congress is considering changes to the aviation trust fund taxes that fund the FAA program.

The House last year passed a three-year FAA reauthorization bill (H.R. 915) that would extend the current aviation taxes until September 30, 2012. The House bill also would increase the tax on general aviation jet fuel from 21.8 to 35.9 cents per gallon, and increase the tax on general aviation gasoline from 19.3 to 24.1 cents per gallon.

The Senate Commerce Committee last year approved a two-year FAA reauthorization bill (S. 1451) that would not change existing aviation taxes. The Senate Finance Committee, which has jurisdiction over aviation taxes, has not acted yet.

Highway Reauthorization

A short-term extension of the fuel excise taxes that fund the highway trust fund is scheduled to expire on April 1, 2010. Last year, the Obama Administration and Senate leaders proposed extending the current highway program and taxes until March 2011. House Transportation and Infrastructure Committee Chairman James Oberstar (D-MN) has called for action on a six-year reauthorization bill.

Retirement Security

The House Ways and Means Committee this year may consider legislation addressing 401(k) fee disclosure, investment, and advice, and pension funding relief. The Ways and Means bill is expected to differ from a pension bill (H.R. 2989) approved on July 31, 2009, by the House Education and Labor committee. Pension funding relief could move as part of legislation addressing unemployment insurance, job creation, and tax extenders. Because it would reduce business deductions for pension contributions, pension funding relief is estimated to raise federal revenue.

Mutual Fund Modernization

On December 16, 2009, the Regulated Investment Company Modernization Act of 2009 (H.R. 4337) was introduced by Ways and Means Committee Chairman Rangel and three other co-sponsors from the committee. The bill represents the culmination of efforts in recent years to modernize various tax rules applicable to regulated investment companies (RICs). The bill includes a provision removing the prohibition of direct RIC investments in commodities. The bill has an estimated cost of $188 million over 10 years.

The stakes for the business community are high at a time when support for economic growth policies may be tempered by a push for increased taxes on business and upper-income individuals to address concerns over high federal budget deficits.

While the U.S. economy is expected to grow in 2010, future economic growth would be negatively affected by unsustainable increases in federal deficits and the national debt. Further growth in public debt levels could impose significant economic harm, leading to increased interest rates, less private investment, and lower GDP growth. In the face of such economic pressures, there may be a growing push for Congress to consider adjustments to spending or revenue that could affect your business, industry, or customers.

The stakes for the business community are high at a time when support for economic growth policies may be tempered by a push for increased taxes on business and upper-income individuals to address concerns over high federal budget deficits. There remains a strong concern that the Administration may continue to propose significant international tax changes to raise revenue, rather than as part of a comprehensive overhaul of U.S. tax laws designed to improve the global competitiveness of American companies. Efforts to strengthen tax compliance also may lead to increased administrative burdens.

It will be critical for the business community both to monitor and participate in the legislative process as it unfolds in 2010. Business leaders should have an active voice in shaping legislation and share their knowledge of how best to promote economic growth.

Appendix

Proposed revenue-raising tax provisions

Provision	Source	10-Year Revenue Estimate ($ millions)
Health Care		
Impose a 5.4% surtax on AGI in excess of $500,000 ($1,000,000 for joint returns)	House	460,500
40% excise tax on high-cost health care coverage	Senate	148,900
Additional 0.9% hospital insurance tax on wages over $200,000 ($250,000 joint)	Senate	86,800
Annual fee on health insurance providers	Senate	59,600
Annual fee on prescription drug manufacturers	Senate	22,200
Annual fee on medical device manufacturers	House Senate	20,000 19,200
Raise 7.5% AGI floor on medical expenses to 10%	Senate	15,200
Limit health FSAs in cafeteria plans to $2,500	House Senate	13,300 13,300
Eliminate expense deduction for Medicare Part D subsidy	House Senate	2,200 5,400
Limit qualified medical expenses under HSA, MSA, FSA, HRA	House Senate	5,000 5,000
Impose 10% excise tax on indoor tanning services	Senate	2,700
Increase penalty for nonqualified HSA distributions to 20%	Senate	1,300
Limit executive compensation deduction for health providers	Senate	600
Modification of section 833 treatment of certain health organizations	Senate	400
International		
Allocate expenses and taxes on the basis of foreign income repatriation	Rangel	106,390
Exempt active foreign dividends from U.S. taxation	CBO	76,200
Tax the world-wide income of U.S. corporations as it is earned	CBO	65,200
Eliminate the source-rules exception for exports	CBO	53,700
Defer deduction of expenses, except R&E expenses, related to deferred income	Treasury	51,525
Reform foreign tax credit: determine the credit on a pooling basis	Treasury	45,552
Reform business entity classification rules for foreign entities	Treasury	31,053
Reform foreign tax credit: prevent splitting of foreign income and foreign taxes	Treasury	10,216

Provision	Source	10-Year Revenue Estimate ($ millions)
Foreign Account Tax Compliance Act	House	7,668
Limit treaty benefits for certain deductible payments	House	7,500
Modify tax rules for dual capacity taxpayers	Treasury	7,211
Repeal worldwide interest allocation rules	House	6,000
Limit earnings stripping by expatriated entities	Treasury	1,453
Prevent the avoidance of dividend withholding taxes	Treasury	1,218
Limit shifting of income through intangible property transfers	Treasury	1,039
Terminate special DISC rules	Rangel	881
Repeal 80/20 company rules	Treasury	850
Prevent repatriation of earnings in certain cross-border reorganizations	Treasury	410
Combat under-reporting of income through the use of accounts and entities in offshore jurisdictions	Treasury	51
Tax Shelters		
Codify economic substance doctrine	House	5,700
	Treasury	7,081
Tax Accounting and Corporate		
Extend the period for recovering the cost of equipment purchases	CBO	267,500
Repeal section 199 deduction	CBO	136,200
Repeal "last-in, first-out" method of accounting	Treasury	79,526
End the expensing of exploration and development costs for extractive industries	CBO	44,900
Set the corporate tax rate at 35 percent for all corporations	CBO	30,500
Repeal the low-income housing credit	CBO	29,200
Increase section 197 amortization from 15 to 20 years	Rangel	20,700
Tax large credit unions in the same way as other thrift institutions	CBO	12,600
Repeal "lower of cost or market" inventory valuation method	CBO	9,500
Tax the income earned by public electric utilities	CBO	6,200
Modify dividends received deduction	Rangel	4,600
Require information reporting for rental property expense payments	Treasury	2,287
Disallow tax-free conversions of large C Corporations to S Corporations	CBO	500
Clarify gain recognized on certain spin-offs	Rangel	235
Prohibit C corporations from using rule for accrual service providers	Rangel	225

Provision	Source	10-Year Revenue Estimate ($ millions)
Passthroughs		
Tax "carried interest" income of partners for performing investment management services treated as ordinary income	House Treasury	24,616 23,064
Recognize ordinary income from certain S corporation stock options	Rangel	606
Financial Services		
Charge transaction fees to fund the commodity futures trading commission	CBO	1,255,000
Charge for examinations of state-chartered banks	CBO	1,037,000
Tax the federal home loan banks under the corporate income tax	CBO	13,500
Employee Benefits		
Tax Social Security and railroad retirement benefits like defined-benefit pensions	CBO	373,200
Include employer-paid benefits for income-replacement insurance in employees' taxable income	CBO	225,900
Eliminate the tax exclusion for employment-based life insurance	CBO	25,200
End the preferential treatment of dividends paid on stock held in employee stock ownership plans	CBO	13,300
Increase Federal employee's contributions to pension plans	CBO	8,900
Consolidate and simplify different types of defined-contribution retirement plans	CBO	1,200
Employment Tax		
Increase the maximum taxable earnings for the Social Security payroll tax:	CBO	
Tax 92 percent of earnings		688,500
Tax 91 percent of earnings		588,500
Tax 90 percent of earnings		503,400
Modify determination of amounts subject to employment or self-employment tax for partners and S corporation shareholders	Rangel	9,410
Require self-employed people and employees to pay the same amounts in payroll taxes	CBO	2,900
Expand the Medicare payroll tax to include all state and local government employees	CBO	2,400

Provision	Source	10-Year Revenue Estimate ($ millions)
Energy		
Impose fees for use of the inland waterway system	CBO	4,712,000
Exclusion of unprocessed fuels from the cellulosic biofuel producer credit	House	23,900
Repeal domestic manufacturing deduction for oil and gas production	Treasury	10,832
Repeal percentage depletion	Treasury	7,123
Levy tax on certain offshore oil and gas production	Treasury	5,300[1]
Repeal expensing of intangible drilling costs	Treasury	4,056
Increase the amortization period for geological and geographical costs to seven years	Treasury	791
Repeal deduction for tertiary injectants	Treasury	69
Repeal passive loss exemption for working interests in oil and gas properties	Treasury	49
Excise Taxes		
Impose an 'upstream' price on emissions of greenhouse gases	CBO	881,800
Increase excise taxes on motor fuels:	CBO	
50 cent increase		604,800
25 cent increase		305,100
Reinstate the superfund taxes	CBO	19,800
	Treasury	17,733
Impose a tax on emissions of nitrogen oxides	CBO	18,400
Impose a tax on the emissions of sulfur dioxide	CBO	3,000
Tax Administration		
Use an alternative measure of inflation to index some portions of the tax code	CBO	89,600
Require information reporting on payments to corporations	House	17,100
	Senate	17,100

[1] Treasury revenue estimate used: JCT staff indicated that the Administration proposal to levy a tax on certain offshore oil and gas production required additional specification for JCT revenue estimate.

Provision	Source	10-Year Revenue Estimate ($ millions)
Individual		
Limit the tax benefit of itemized deductions to 15 percent	CBO	1,320,700
Eliminate the current itemized deduction for state and local taxes	CBO	861,900
Raise all ordinary tax rates, AMT rates, and dividend and capital gain rates by 1 percentage point	CBO	626,000
Cap the deduction for state and local taxes at 2 percent of adjusted gross income	CBO	625,700
Raise all ordinary tax rates and AMT rates by 1 percentage point	CBO	608,900
Raise all tax rates on ordinary income by 1 percentage point	CBO	454,800
Convert the mortgage interest deduction to a credit	CBO	387,600
Limit the tax rate at which itemized deductions reduce tax liability to 28 percent	Treasury	269,174
Reinstate the 39.6% rate	Treasury	289,145
Raise the tax rate on ordinary taxable income over $1 million for joint filers ($500,000 for others) by 5 percentage points	CBO	222,600
Curtail the deduction for charitable giving	CBO	221,500
Raise the top four ordinary tax rates by 1 percentage point	CBO	200,000
Reinstate the limitation on itemized deductions for taxpayers with income over $250,000 (married) and $200,000 (single)	Treasury	135,275
Raise the top three ordinary tax rates by 1 percentage point	CBO	119,400
Impose a 20% rate on dividends and capital gains for taxpayers with income over $250,000 (married) and $200,000 (single)	Treasury	117,790
Eliminate the child tax credit	CBO	113,700
Raise the top two ordinary tax rates by 1 percentage point	CBO	98,800
Raise the top ordinary tax rate by 1 percentage point	CBO	73,500
Include all income earned abroad by U.S. citizens in taxable income	CBO	71,200
Reinstate the personal exemption phaseout (PEP) for taxpayers with income over $250,000 (married) and $200,000 (single)	Treasury	42,752

Provision	Source	10-Year Revenue Estimate ($ millions)
Reduce gradually the maximum mortgage on which interest can be deducted from $1.1 million to $500,000	CBO	41,400
Reinstate the 36% rate for taxpayers with income over $250,000 (married) and $200,000 (single)	Treasury	30,415
Eliminate tax subsidies for child and dependent care	CBO	23,600
Lower the age of dependent eligibility for the child tax credit to 13	CBO	23,500
Limit deductions for charitable gifts of appreciated assets to the gifts' tax basis	CBO	22,500
Replace the tax exclusion for interest income on state and local bonds with a tax credit	CBO	19,800
Consolidate tax credits and deductions for education expenses	CBO	16,400
Eliminate the earned income tax credit for people who do not live with children	CBO	15,100
Eliminate the additional standard deduction for elderly and blind taxpayers	CBO	12,500
Include Social Security benefits in calculating the phase-out of the earned income tax credit	CBO	7,900
Tax-Exempt Organizations and Bonds		
Tax qualified sponsorship payments to postsecondary sports programs	CBO	207,600
Limit the tax exemption for new bonds	CBO	23,000
Cap nonprofit organizations' outstanding stock of tax-exempt bonds	CBO	2,100
Modify UBTI rules for certain investment partnerships	Rangel	1,340
Eliminate the indexation of the volume cap for tax-exempt private-activity bonds	CBO	200
Insurance		
Include investment income from life insurance and annuities in taxable income	CBO	265,000
Eliminate the tax exclusion for employment-based life insurance	JCT	25,200

Source: Joint Committee on Taxation revenue estimates, except where noted.

References

House

- Joint Committee on Taxation, JCX-53-09, "Estimated Revenue Effects of the Revenue Provisions Contained in H.R.3962, The 'Affordable Health Care for America Act,'" November 6, 2009
- Joint Committee on Taxation, JCX-59-09, "Estimated Revenue Effects of H.R.4213, The 'Tax Extenders Act of 2009,'" December 7, 2009

Senate

- Joint Committee on Taxation, JCX-61-09, "Estimated Revenue Effects Of The Manager's Amendment To The Revenue Provisions Contained In 'The Patient Protection And Affordable Care Act,'" December 19, 2009

Treasury

- Joint Committee on Taxation, JCX-28-09, "Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal As Described by the Department of the Treasury," May 2009

CBO

- Congressional Budget Office, "Budget Options, volume 2," August 2009

Rangel

- H.R. 3970, the "Tax Reduction and Reform Act of 2007," introduced by House Ways and Means Chairman Charles Rangel (D-NY), October 25, 2007

PwC Legislative and Regulatory Services Team

Washington National Tax Services

Lindy Paull
Principal
lindy.paull@us.pwc.com
(202) 414-1579

Bill Archer
Senior Policy Advisor
bill.archer@us.pwc.com
(202) 414-1510

Don Longano
Principal
don.longano@us.pwc.com
(202) 414-1647

Ed McClellan
Principal
ed.mcclellan@us.pwc.com
(202) 414-4404

Brian Meighan
Partner
brian.meighan@us.pwc.com
(202) 414-1790

Don Carlson
Managing Director
donald.g.carlson@us.pwc.com
(202) 414-1385

Larry Campbell
Director
larry.campbell@us.pwc.com
(202) 414-1477

Scott McCandless
Director
scott.mccandless@us.pwc.com
(202) 414-4460

Andrew Prior
Director
andrew.prior@us.pwc.com
(202) 414-4572

National Economics and Statistics

Peter Merrill
Principal
peter.merrill@us.pwc.com
(202) 414-1666

Drew Lyon
Principal
drew.lyon@us.pwc.com
(202) 414-3865

Jessica Pollner
Principal
jessica.pollner@us.pwc.com
(202) 414-1380

Jack Rodgers
Managing Director
jack.rodgers@us.pwc.com
(202) 414-1646

Lin Smith
Managing Director
linden.c.smith@us.pwc.com
(202) 414-4687

John Stell
Director
john.l.stell@us.pwc.com
(202) 312-7583

Acknowledgments

This report represents the analysis and efforts of many individuals within PricewaterhouseCoopers' Washington National Tax Services and other offices. This publication was produced under the direction of Larry Campbell. The text was prepared by a team of professionals, including Larry Campbell, Drew Lyon, John Stell, Ed Geils, Scott McCandless, Geoff Jacobi, Steve Nauheim, Ferdinand Hogroian, Kyle Bybee, Tara Ferris, and Lisa Wamboldt.

Special thanks to Lindy Paull, Brian Meighan, Don Longano, Drew Lyon, Ed McClellan, Dick Ruge, Andrew Prior, Don Carlson, and Carolyn Singh. We also would like to thank Roberta Cordova and Roberto Rojas for their assistance.

pwc.com/wnts

Solicitation

This document was not intended or written to be used, and it cannot be used, for the purpose of avoiding U.S. federal, state or local tax penalties.

This document is provided by PricewaterhouseCoopers LLP for general guidance only and does not constitute the provision of legal advice, accounting services, investment advice, or professional consulting of any kind. The information provided herein should not be used as a substitute for consultation with professional tax, accounting, legal, or other competent advisers. Before making any decision or taking any action, you should consult a professional advisor who has been provided with all pertinent facts relevant to your particular situation. The information is provided "as is," with no assurance or guarantee of completeness, accuracy, or timeliness of the information, and without warranty of any kind, express or implied, including but not limited to warranties of performance, merchantability, and fitness for a particular purpose.