

Tax Policy in Transition

By Lindy Paull and Andrew Prior

Expect the new Democratic-controlled Congress and White House to consider tax increases that will hit businesses as well as individual taxpayers.

The next presidential administration and Congress will be confronted by a weak economy and growing federal budget deficits. In addition, congressional “pay-as-you-go” budget rules require any new tax cuts or entitlement spending to be fully offset by tax increases or reductions in other entitlement spending.

As a result, there likely will be pressure to consider revenue-raising tax proposals that will impact business and individuals.

The 111th Congress is scheduled to convene Jan. 3, with newly elected members sworn in Jan. 6. President-elect Barack Obama will take office 14 days later. Obama has already announced key members of his economic team, including Timothy Geithner as secretary of the Treasury and Larry Summers to head the National Economic Council.

Though Democrats hold a majority in the Senate, it is not filibuster-proof and includes Independent Sens. Bernie Sanders of Vermont and Joseph Lieberman of Connecticut. The increased Democratic majorities in the House and Senate may make it more difficult for Republicans to block controversial legislation, because some moderate Republicans may vote with Democrats on certain issues.

The congressional budget process also could be used to overcome Republican opposition to Democratic tax legislation. A budget “reconciliation” bill cannot be filibustered in the Senate and therefore only requires a majority for passage. (Budget reconciliation has been used in the past to prevent a filibuster on tax increases.)

‘Lame Duck’ Session

Congress reconvened during the week of Nov. 17 to begin the process of organizing for the next session. Both chambers filled House and Senate leadership positions. House Democrats also selected committee chairs. Charles Rangel (D-N.Y.) was re-elected as chairman of the Ways and Means Committee. Ways and Means Ranking Member Jim McCrery (R-La.) is retiring. A decision on his replacement is expected shortly. In the Senate, Sens. Max Baucus (D-Mont.) and Charles Grassley (R-Iowa) will continue as chairman and ranking member of the Finance Committee, respectively.

With two Senate races and five House races still undecided, decisions on committee ratios and assignments have been postponed. Republicans are likely to lose committee seats in both the House and Senate as a result of the increased Democratic majorities in both chambers.

Economic Stimulus

The new Congress is expected to consider a major economic stimulus package when it convenes in early January, with the goal of sending a bill to the White House soon after President-elect Obama is sworn in. Obama has directed his economic team to develop recommendations for an economic recovery package in consultation with Congress, the Federal Reserve and others.

The new president is expected to release details of his economic team’s initial recommendations in the coming weeks; notably, he has said the package will include infrastructure spending and energy-independence programs. Democratic leaders have also expressed support for aid to state and local governments as well as federal nutrition assistance. Congress already has passed an extension of unemployment benefits.

Though the focus may be on spending programs, the economic stimulus bill could also include tax relief. During the election campaign, Obama proposed a \$500 (\$1,000 for couples) refundable tax credit for individuals; a business tax credit for new hires; enhanced small business expensing; tax-free unemployment benefits; and relaxed rules on individual retirement account and 401(k) withdrawals.

Other economic-stimulus tax proposals under discussion include extension of “bonus” depreciation and expansion of the net operating loss carry-back period. There also are proposals to relax pension-funding rules and enhance the ability of companies to access foreign earnings in response to the current economic crisis.

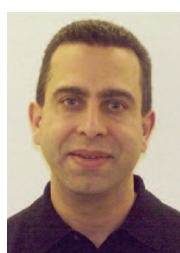
Presidential Tax Plan

Unlike recent years when presidential budget submissions were considered “dead on arrival” in Congress, Obama’s budget is likely to drive the tax legislative agenda next year. The White House typically submits a budget in early February. But because of the change in administration, this process could be delayed. Tax-policy proposals will have to be balanced against other administration priorities, including health-care reform, energy independence and climate change.

Beyond economic stimulus, Obama has proposed permanently extending the 2001 and 2003 tax cuts for most individuals. (He has proposed increasing taxes on individuals with annual income over \$250,000.)

His proposals include raising the top individual income-tax rate to 39.6 percent (from 35 percent) and increasing the capital gains and dividend tax rate for such individuals to 20 percent (from 15 percent). In addition, Obama has proposed maintaining the estate tax at the levels scheduled for 2009 (\$3.5 million exemption and 45 percent top rate).

On business taxes, the new president has proposed making the research tax credit permanent and a one percentage point reduction in tax for certain companies. Obama has also proposed reforming U.S. international tax rules to address provisions that “reward corporations that retain their earnings overseas” and that encourage companies to “ship jobs overseas.” The resulting revenue may be used to lower corporate tax rates for companies that “expand or start operations in the United States.”



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