



# From the Desk of Dean Zerbe.



## The President's Tax Proposals: A Reality Check

by Dean Zerbe

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The administration, Congress and the media have, like a child at Christmas, gone through the whirlwind of unwrapping all the proposals in the President's budget. Now, a reality check for which of these tax proposals will actually become law.

### Proposals That Will Go Forward

#### Jobs/Hiring Credit

High marks to the President for perseverance. He campaigned on a hiring credit, and Congress first rejected the proposal in the stimulus bill last year. Now Congress is revisiting his idea. However, the likelihood is that you will see Congress significantly change the concept of the President's proposed hiring credit, to the benefit of the unemployed and business owners. Look for a credit more along the lines of that outlined by Senators Schumer and Hatch that will provide immediate payroll tax relief for hiring new workers (who have been unemployed for more than 60 days). House Democrats in the Ways and Means Committee did not give the President's proposal for a jobs credit a warm reception the other day, so the administration has some work to do. Congress needs to ensure that the hiring credit is simple and provides immediate relief (cash-in-hand to business owners) if it is going to have a real impact.

#### Section 179, Bonus Depreciation, COBRA, and Unemployment Benefits

Expect a continuation of these expanded policies. All will be included in a jobs bill. It would be helpful to small business if Congress increased the phase-out point for Section 179. The current \$800K is too low for many small businesses. Still to be seen is whether Senator Grassley will successfully push for inclusion of his proposals for small business tax relief included in S. 1381, easily the most comprehensive tax relief for small business that is before the Senate.

#### Extenders/AMT

Along with continuation of the current "hold-harmless" provision on the individual alternative minimum tax (AMT), there will be a strong effort to include business and individual tax extenders in the jobs bill, with an expanded R&D tax credit as the main engine driving the effort. A key provision of the bill would allow small-medium size businesses to take the general business credits, such as the R&D tax credit, without being limited by the AMT. This assumes that the House/Senate haven't reached a compromise yet on the separate extenders package. The main fight was on the offsets, with the House now agreeing to drop carried interest – more on that to follow.

#### Estate/Death Tax

Expect the Senate to add to the jobs bill a \$5 million exemption (\$10 million/couple) with rates somewhere in the 35%-40% range. Then the fight will be with the House to accept the Senate provision. Treasury Secretary Geithner's comments about wanting to see the estate tax retroactive to January 1st is a helpful push for an early resolution of estate tax (if the estate tax isn't resolved by Spring, look for problems in making the estate/death tax retroactive to January 1). There are three possible scenarios:

1. Likely: Two-year extension of 2009 law
2. Possible: The Senate position prevails
3. Hard to imagine, but why not -- they've screwed it up enough already:  
Congress does nothing for the year on estate/death tax

#### Top Rates/Capital Gains/Dividends/PEPS/Pease

Despite a trial balloon from the administration that the slated increase in top rates would be delayed for one/two years, the administration has stated clearly that it wants the rates for the top two levels to be increased from 33/35% to 36/39.6% and capital gains and dividends to go to 20%. While a month ago the chances of the top rates and capital gains/dividends going up was certain,

I view that as down slightly thanks to the Massachusetts election and several Democrat members of Congress writing to the President their support for keeping the current rates in place. In addition to the rates going up, the hidden tax increases caused by limitations on personal exemptions (PEPS) and itemized deductions (Pease) will also be brought back. This is a huge tax increase that gets very little notice, hitting higher income families to the tune of more than \$200 billion over ten years. Note: the significant tax benefits of the IC-DISC for small and medium business manufacturers who export will stay in place under the administration's proposal, despite the dividend rate going up.

#### Expanded 1099 Reporting – for Payments to Corporations for Property or Services

Both the House and Senate included this tax gap proposal in the Health bill. Look for it to show up sometime as a "payfor" this year.

#### LIFO Accounting

The administration, to its credit, did listen to business and proposed to extend the phase-out period for LIFO accounting to ten years. I expect this to be included in legislation as a "payfor" as needed.

#### Proposals With an Uncertain Outlook

##### Health Bill

Despite the chattering by some in D.C. political circles, the health bill in its current form has the look of a zombie: walking (barely) but dead.

##### Independent Contractor v. Employee Status

Lost in much of the discussion of the budget is the administration's sweeping changes to current practice on independent contractor/employee status. The law will allow Treasury/IRS to issue guidance on who is or isn't an independent contractor, something they have been barred from doing by law since 1978. Space doesn't allow me to do this justice,



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but if independent contractor/employer questions are an area of interest for you and your business, this is a world-changing proposal. There haven't been the votes in the Senate to get through other union-supported policies. This proposal will likely have a rough road as well, but it's too early to see where the votes are.

## **Carried Interest**

Congress and the administration's policy as to changing taxation of carried interest seems to be like heaven: everybody wants to go there, just not today. Carried interest was included for the umpteenth time in a House bill (most recently as an extenders "payfor") and was dropped in discussions with the Senate. When there is a public mark-up, carried interest is included. Then there is a closed door meeting, and the carried interest provision is dropped. Color me skeptical that changes to carried interest happen this year.

## **Fees on Banks**

It remains to be seen what Congress does with this proposal. The administration proposal isn't detailed and seems primarily a political exercise. It might be something for the jobs bill (doubtful – not ready), but if not that legislation, the number of tax bills that Congress will act on will be very few in number for the rest of the year. Congress, overall, doesn't appear completely sold on this proposal at the moment.

## **Proposals That Will Never See the Light of Day**

### **FLPs and GRATs**

The administration's proposals to limit estate planning of family limited partnerships and the use of GRATs has zero interest on the hill.

### **Cap of 28% on Itemized Deductions – Charities and Mortgage**

This didn't go anywhere as a revenue raiser for health care, so it's hard to see it going anywhere this year.

### **Cap and Trade**

Like health care but deader.

### **Energy**

The proposals regarding oil/gas and offshore that were proposed last year and

went nowhere seem destined for a similar journey to nowhere this year.

## **The Impact of the Massachusetts Senate Election**

The Massachusetts Senate election had a big impact on D.C., especially in the area of tax policy. It's not only the fact that Brown's victory greatly strengthens the ability of Senate Republicans to prevent legislation from going forward (but watch out for reconciliation), but the loss of a Senate seat in a state with a strong Democrat voting tradition, coupled with the wide margin of Brown's victory, has done much to provide focus to many Senators on both sides of the aisle to be more hard-eyed about possible tax increases – and views towards the administration's tax proposals.

## **Bottom Line**

The outlook for business owners is that no one in Washington is going to be cutting your taxes for you. Businesses will continue to have to work with their trusted financial advisors to take full advantage of federal and state tax incentives if they want to see their taxes cut.

Please feel free to email me at [dean.zerbe@alliantgroup.com](mailto:dean.zerbe@alliantgroup.com) if you have any questions about the administration's budget or Washington in general.

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Dean Zerbe is alliantgroup's National Managing Director. Dean was formerly Tax Counsel and Sr. Counsel on the Senate Finance Committee and was a key player in all the major tax legislation passed during his tenure. Dean speaks throughout the country and meets with accounting firms and their clients to discuss the outlook for short-term and long-term changes in tax policy as well as ways accounting firms can help their clients lower their tax bill.

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