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In this issue:

President pushes middle-class tax cuts, upper-class tax hikes in State of the Union message

In his State of the Union address on January 20, President Obama called for tax relief and spending targeted at low- and middle-income workers and families, paid for by tax increases mainly on wealthy individuals and large financial institutions.

The president spoke of individual taxes only in very general terms, urging Congress to "close the loopholes that lead to inequality by allowing the top one percent to avoid paying taxes on their accumulated wealth" and instead "use that money to help more families pay for childcare and send their kids to college." But the White House fleshed out the proposals in a fact sheet released several days in advance of the president's speech.
URL: http://www.whitehouse.gov/the-press-office/2015/01/17/fact-sheet-simpler-fairer-tax-code-responsibly-invests-middle-class-fami

The proposals are expected to be included in the administration's fiscal year 2016 budget, which is set to be submitted to Congress on February 2, and additional details on these and other tax and spending provisions will be provided in the explanatory materials the administration sends to Capitol Hill.

Tax relief proposals: Some old, some new

The middle-class tax provisions include some new proposals and several others that the president has put forward in previous budget blueprints.

Retirement Savings: As he has in the past, the president is proposing to expand access to tax-preferred workplace savings plans by requiring employers with more than 10 employees and which presently do not offer a retirement plan to automatically enroll workers in an Individual Retirement Arrangement (the so-called “auto-IRA” proposal). Workers could opt out, or select a payroll deduction amount larger or smaller than a default rate. The president’s plan also would create a new tax credit for businesses to offset administrative costs associated with establishing auto-IRAs.

Education: The president’s plan would repeal – on a prospective basis – several tax breaks for higher education expenses (including the student loan interest deduction and the tax-free status of earnings on qualified distributions from section 529 plans) in favor of a permanent and expanded American Opportunity Tax Credit, which is otherwise set to expire after 2017.

Workers and Families: For the first time, the president is proposing to establish a “Second Earner” tax credit of up to $500 for two-earner households (phased out on joint income between $120,000 and $210,000). He would also increase the maximum Child and Dependent Care Tax Credit from $1,050 to $3,000 for each child under 5 years old.

Finally, the president reiterated his call to make permanent the stimulus-era enhancements to the Earned Income Tax Credit (EITC) and Child Tax Credit, both of which are set to lapse after 2017, and to expand the EITC for workers without dependent children.

Controversial offsets

To finance this tax relief – as well as certain other nontax proposals such as two years of free community college for qualifying students and mandatory paid sick leave for workers – the White House is proposing several revenue raisers targeted mainly at wealthy individuals and large financial institutions. The administration has indicated these proposals would raise about $320 billion over the next 10 years.

Impose a fee on large financial institutions: The president’s plan would impose a 7 basis point fee on the liabilities of financial firms with assets exceeding $50 billion. The White House has noted this component of the plan would raise about $110 billion over 10 years – roughly double the projected revenue gain of the 17 basis point fee included in the administration’s fiscal 2015 budget package – indicating the new fee may apply to a broader subset of firms. (Additional detail is expected in the administration’s forthcoming budget proposal.)

Increase the top rate on long-term capital gains, qualified dividends: The president’s plan would raise the total top rate on long-term capital gains and qualified dividends to 28 percent (inclusive of the 3.8 percent surtax on net investment income enacted as part of the Patient Protection and Affordable Care Act of 2010). According to the White House, the 28 percent rate would apply to couples with income in excess of about $500,000. (The income threshold for individual taxpayers is not specified.)

Eliminate stepped-up basis for appreciated assets at death: For the first time, the president is proposing to eliminate “stepped-up basis” under section 1014. As a result, unrealized capital gain attributable to a decedent’s appreciated property generally would be taxable at death.

The proposal includes several exemptions. For married couples, the provision would not apply until the death of the second spouse. The proposal also would exempt from tax the first $100,000 of capital gain per individual. This exemption would be portable between spouses – resulting in a total exemption of $200,000 per couple. Unrealized gain on personal residences also would be exempt (up to $250,000 per individual, $500,000 per couple). And notably, the elimination of stepped-up basis would not apply to bequests of appreciated property to charitable organizations. The proposal also provides that bequests and gifts of tangible personal property "other than expensive art and similar collectibles" would be tax-exempt; however, the summary materials the White House has released so far do not define the term "expensive."

Under the proposal, no tax would be due on inherited small, family-owned and operated businesses unless and until the business was sold. Closely held-business would have the option to pay the tax on the gains over 15 years.

Limit tax benefits for high-balance, tax-favored retirement plans: Mirroring a budget proposal from last year, the president again proposes to disallow additional contributions to, and limit tax-deferred accruals within, certain tax-favored retirement plans when a taxpayer's total balance in such accounts exceeds the amount necessary to provide the maximum annuity permitted for a tax-qualified defined benefit plan under current law. According to the White House, the maximum balance allowed under the proposal presently would be about $3.4 million for a 62 year-old.

Unlikely to gain traction with Republicans

In selling its tax package, the White House argued that the proposed capital gains tax increases would affect only the top 1 percent of income earners, while the proposed tax relief would potentially benefit millions of low- and middle-income workers and families. It also drew comparisons between the president's proposed fee on large financial institutions and a broadly similar excise tax included in the tax reform plan put forward last year by former House Ways and Means Committee Chairman Dave Camp, R-Mich., although the administration's proposal likely would apply to a larger number of financial institutions than the proposal included the Camp plan.

But these arguments are unlikely to gain traction with congressional Republicans, who generally have contended that the president's proposals are antithetical to rate-lowering tax reform and further exemplify the obstacles to making progress on a rewrite of the individual tax rules during the president's last two years in office.

In a news release issued after the president's speech, House Speaker John Boehner, R-Ohio, remarked that "all the president offered tonight is more taxes, more government, and more of the same approach that has failed middle-class families. These aren't just the wrong policies, they're the wrong priorities: growing Washington's bureaucracy instead of America's economy.

House Ways and Means Committee Chairman Paul Ryan, R-Wis., called the president's proposals "misguided," adding that "[w]hat we really need is to make our tax code simpler, flatter, and fairer, so we can create more jobs."

Senate Finance Committee Chairman Orrin Hatch, R-Utah, commented that “[c]alling for expanding the death tax and raising the rates on capital gains, like the president did tonight, makes clear this White House is more about redistribution and populist class warfare than about actual bipartisan tax reform. In fact, if anything, these misguided proposals would only further clutter up the tax code and make it more confusing for taxpayers.”

Despite the apparent partisan gulf on individual tax issues, however, some prominent policymakers have expressed hope that near-term action on business tax reform may be possible. (See related story in this issue for details.).

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Lew optimistic business tax reform can happen this Congress

Treasury Secretary Jack Lew struck an optimistic tone on business tax reform this week, telling audience members at a Brookings Institution event January 21 that he believes there is a strong potential for the White House and congressional Republicans to find common ground.

“The fact is, there is a growing bipartisan consensus in Washington on how to achieve business tax reform, and we have a unique opportunity now to get this done,” Lew said in prepared remarks. He was even more positive in a later question-and-answer session, giving reform very good odds.

“I’m an optimist so I’ll always say better than 50-50,” Lew said.

But Lew cautioned that while there is bipartisan agreement on business tax reform, the Obama administration and congressional Republicans remain far apart on individual taxes. In response to a question, Lew commented on Republican individual proposals and said, “I don’t think lowering the top individual rate is the way to grow our economy or create a better future for middle-class workers or for the country at large.”

Close contact

Audience members asked Lew how the administration and congressional Republicans could come together on issues such as tax reform. Lew replied that he has been in “close touch” with House Ways and Means Committee Chairman Paul Ryan, R-Wis., and other taxwriters and, based on those conversations, he was encouraged that an agreement on business tax reform is possible.

“I wouldn’t say there is a path forward to getting things done if I didn’t see an opportunity for consensus,” he said.

For his part, Ways and Means Chairman Ryan, who appeared on MSNBC's "Morning Joe" shortly before Lew gave his speech, expressed similar optimism that in some areas, such as business tax reform, the White House and the GOP could find common ground.

"It's a screwed up tax code. We need to fix it. The great agreements in the past that have been done have been bipartisan," Ryan said, adding that he did not "want to waste two years waiting for another chance" to overhaul the tax code under a new president.

House taxwriters are expected to make decisions about whether to pursue tax reform – and, if so, whether it should be comprehensive or business-only – at a Ways and Means GOP member retreat scheduled for January 28-30.

Across the Capitol, Senate Finance Committee Chairman Orrin Hatch, R-Utah, told reporters that his panel was working on a comprehensive tax reform plan. Regarding business tax reform, Hatch remarked that "[w]e're flexible. We can roll with the punches." (See separate coverage in this issue for additional discussion of Hatch's plans to move tax reform legislation through the Finance Committee this year.)

Corporate framework

Lew's prepared remarks focused largely on the proposals in the Obama administration's business tax reform framework released in February 2012, which proposes lowering the corporate tax rate to 28 percent while eliminating or revamping many current-law business tax expenditures, creating an even lower rate to promote domestic manufacturing, overhauling the international tax rules, and imposing a new "minimum tax" on multinationals. It also lays out other options for policymakers to consider – such as addressing depreciation schedules, examining debt versus equity, possibly reducing the deductibility of interest expense, and establishing greater parity between large corporate and noncorporate taxpayers. The framework does not address taxes on individuals, however. (For prior coverage, see *Tax News and Views*, Vol. 13, No. 8, Feb. 22, 2012.)
URL: http://newsletters.usdbriefs.com/2012/Tax/TNV/120222_1.html

Lew said in his prepared remarks that the framework was "carefully constructed and provides the basis for winning bipartisan support," noting that many of the proposals overlap with provisions in the tax reform discussion draft that former House Ways and Means Committee Chairman Dave Camp, R-Mich., released last February.

Lew did not say whether the administration would elaborate on the framework by releasing a more detailed tax reform document.

In addition, Lew said lawmakers should be careful to use the one-time revenue gains from business tax reform for deficit reduction or a one-time investment in infrastructure. "We must not blow a hole in the budget by using one-time revenues to finance permanent spending on new items or to provide permanent tax cuts. Instead, we should use these one-time revenues to make responsible, one-time investments in our nation's infrastructure," Lew said.

Inversions

In response to audience questions about administrative action on inversions, Lew explained that Treasury continues to work on the regulations announced last September in Notice 2014-52, but he declined to specify when any further guidance might be released. (For prior coverage of Notice 2014-52, see *Tax News & Views*, Vol. 15, No. 33, Sep. 23, 2014.) While Treasury will continue to pursue administrative action, Lew said that congressional action is required if inversions are to be shut down altogether.
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140923_1.html

"The real answer is business tax reform that addresses the root causes of this problem," he emphasized.

Earlier this week, several Democratic lawmakers, including Sen. Richard Durbin, D-Ill., and House Ways and Means ranking member Sander Levin, D-Mich., introduced legislation in their respective chambers to curb corporate inversions. Similar bills were introduced in the 113th Congress by Rep. Levin and his brother, former Sen. Carl Levin, D-Mich., but were not taken up in either chamber. Republicans generally oppose addressing the inversion issue outside of tax reform that lowers the corporate rate and moves toward a territorial system for taxing the income of US multinationals. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 20, May 23, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140523_2.html

Dynamic scoring

Lew criticized the recently approved House rule that requires the Joint Committee on Taxation staff and the Congressional Budget Office to use dynamic scoring to measure the budgetary impact of certain "major" revenue and direct spending legislation. (For details on the House-approved rule, see *Tax News & Views*, Vol. 16, No. 1, Jan. 9, 2015. Senate Finance Committee member Rob Portman, R-Ohio, introduced a similar proposal in the Senate on January 21.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150109_1.html

In his speech, Lew specifically questioned the use of dynamic scoring for business tax reform proposals.

"We think this is unwise given the uncertainty involved in dynamic scoring, the assumptions that have to be made, and the unequal treatment of tax cuts versus pro-growth investments funded through appropriations," he said. Responding to a later question, Lew acknowledged that dynamic scoring could be useful, but he stressed that there was a big difference between using it for analysis and using it to score proposals.

— Victoria Glover & Jon Almeras
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Expect Finance Committee tax reform bill this year, Hatch says

The Senate Finance Committee will mark up tax reform legislation in 2015, Chairman Orrin Hatch, R-Utah, said January 20. Hatch made his comment during a speech at the US Chamber of Commerce in Washington outlining the taxwriting panel's agenda for the coming year.

Tax reform

Stating that "comprehensive tax reform is essential if we're going to get our economy moving again," Hatch explained that Finance Committee legislation to reshape the tax code would build on the efforts of the five bipartisan tax reform working groups – addressing international taxation, business taxation, individual taxation, savings and investment, and community development and infrastructure issues – that he and ranking member Ron Wyden, D-Ore., announced last week.

The working groups are expected to analyze current law and examine policy trade-offs and available reform options in their respective policy areas and work with the Joint Committee on Taxation staff to develop potential legislative solutions. The findings and recommendations of each group will be compiled into a comprehensive report that is expected to be completed by the end of May. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 2, Jan. 16, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150116_1.html

"My hope is that the committee members in these five bipartisan working groups will use this opportunity to uncover real tax reform solutions and give us real ideas that aid us in reform. … They're all committed to this process and I believe it's going to work," Hatch said during his speech. "I don't want to just release a framework or a proposal that doesn't go anywhere. … The purpose of this endeavor with the working groups is to produce bipartisan tax reform legislation that will be introduced and marked up in the Finance Committee later this year."

Although he did not offer specifics on his vision of what a reformed tax code should look like, Hatch cited the seven principles – economic growth, fairness, simplicity, permanence, promoting US competitiveness, promoting savings and investment, and revenue neutrality – that he believes should guide the upcoming tax reform effort.

White House tax proposals

In the context of those seven principles, Hatch also offered his critique of President Obama's proposals to bankroll a package of middle-class tax relief through a combination of new rules for determining a taxpayer's basis in certain inherited assets, a higher capital gains rate on upper-income individuals, and a new fee on large highly leveraged financial institutions. (The White House released the proposals on January 17 in anticipation of the president's State of the Union address, which took place several hours after Hatch's speech.)

According to Hatch, the president's proposals would "undo tax policies that have been successful in helping to expand the economy, promote savings, and create jobs" and "would send a bad signal to American businesses and their workers who want us to actually help promote the health of our economy."

"The plan…appears to be more about redistribution, with added complexity, and class warfare, directed at job-creating businesses, than about tax reform, which is unfortunate, because we're going to need real leadership from the White House – not just liberal talking points – if tax reform is going to be successful," Hatch said. (For more on the White House proposals and the reaction of congressional Republicans see separate coverage in this issue.)

Dismantling the PPACA

Turning to other issues the Finance Committee will take on this year, Hatch acknowledged that repealing the Patient Protection and Affordable Care Act (PPACA) would be impossible while President Obama remains in the White House, but said Senate taxwriters would "continue to strike away at it, piece by piece if we have to." To that end, Hatch pledged to hold mark-ups on Finance Committee versions of two House-passed bills that would permit employers to exclude certain veterans from their headcount of full-time employees in determining if they are subject to the PPACA's employer mandate (H.R. 22) and define a "full-time employee" for purposes of the mandate as an employee that works on average 40 hours per week (H.R. 30). (For details on the House legislation, see *Tax News & Views*, Vol. 16, No. 1, Jan. 9, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150109_1.html

Hatch announced his intention to introduce legislation that would repeal the employer mandate outright. (He followed through on January 21 when he introduced the American Liberty Restoration Act (S. 203) with Senate Health, Education, Labor, and Pension Committee Chairman Lamar Alexander, R-Tenn.) He also touted his recently introduced proposal (S. 149) to repeal the PPACA's 2.3 percent excise tax on certain medical device manufacturers. (House Ways and Means Committee member Erik Paulsen, R-Minn., introduced a medical device excise tax repeal bill in that chamber earlier this month. For additional details, see *Tax News & Views*, Vol. 16, No. 2, Jan. 16, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150116_3.html

Infrastructure

Noting that the current Highway Trust Fund authorization is set to expire in May, Hatch said that the Finance Committee would "work to find a long-term funding solution to pay for our highways." He indicated that infrastructure issues could be addressed as part of tax reform or in stand-alone legislation, but dismissed the idea of paying for infrastructure spending with a gas tax increase as "very unlikely."

Pension reform

Hatch also cited pension reform as a priority for Senate taxwriters and indicated that he would re-introduce the SAFE Retirement Act – legislation he sponsored in the 113th Congress that would, among other things, create a "starter 401(k)" plan to make it easier for small businesses and start-ups to set up retirement savings vehicles for their employees, encourage the purchase of fixed annuity contracts for retirement, and address the funding problems of state and local defined benefit pension plans.

Reconciliation remains in play

Hatch stated his preference for working "toward bipartisan solutions" on tax issues but did not rule out the possibility of using budget reconciliation for moving "some of the more high-profile" bills through Congress.

"[W]e should not – and in my opinion cannot – take any tool off the table. The stakes are just too high to limit ourselves like that," Hatch said.

House Ways and Means Committee Chairman Paul Ryan, R-Wis., struck a similar tone on reconciliation last November shortly after he was officially tapped to take over as the House's chief taxwriter. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 35, Nov. 21, 2014.)
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/141121_1.html

Budget reconciliation instructions would provide a fast-track procedure that would limit debate in the Senate and allow for passage of legislation in that chamber by a simple majority vote, as opposed to the 60 votes normally required to clear procedural hurdles. But legislation considered under reconciliation is subject to other procedural and substantive limitations, leading many to question whether it could be used for tax reform.

In a related development, Senate Budget Committee Chairman Mike Enzi, R-Wyo., told reporters January 22 that Republicans will not decide on how – or whether – to use reconciliation in the fiscal year 2016 budget until his panel formally begins the budgeting process in mid-March.

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Finance Committee hearing examines jobs and the economy

Senate Finance Committee members and witnesses testifying at a January 22 hearing agreed that tax reform will play a critical role in boosting employment rates and reinvigorating the economy.

In his opening statement, Finance Committee Chairman Orrin Hatch, R-Utah, called tax reform his "highest legislative priority" and observed that "[o]ur current tax code creates numerous unnecessary roadblocks that stand between us and sustained economic prosperity."

Finance Committee ranking member Ron Wyden, D-Ore., expressed a similar commitment to tax reform in his opening statement and emphasized that any reform of the tax code should address one fundamental question: "How will this grow the paycheck?"

Increasing take-home pay

Wyden asked witnesses to identify the single policy that, in their view, would have the largest impact on increasing take-home pay for American workers.

John Engler of the Business Roundtable replied that a number of interrelated issues – including "getting the tax system right" – play a role in economic expansion. In his written testimony, Engler suggested that "business tax reform that results in a modern tax system with competitive rates and competitive international tax rules may be the single most effective means of accelerating business investment, boosting job creation and wages, and providing greater opportunity for America's working families." He also noted that the Business Roundtable's key recommendations for fundamental tax reform include lowering the statutory corporate tax rate to 25 percent and adopting a "territorial-type" system for taxing the income of US multinationals.

Robert E. Hall of Stanford University's Hoover Institution told Wyden that integrating personal and business income to eliminate double taxation would improve economic performance.

Justin Wolfers of the University of Michigan argued that the key to bolstering household income was to increase the number of paychecks in each household by getting more people back to work; but he added that expanding the Earned Income Tax Credit to childless workers would "be a great way of ensuring that those who work get the rewards they deserve."

Other issues

In response to a question from Finance Committee member John Thune, R-S.D., Engler suggested that the Business Roundtable would support addressing the tax treatment of passthrough entities as a part of comprehensive tax reform but noted that overhauling the entire tax code doesn't seem politically possible in the short term. In his written testimony, Engler stressed that "reforming the corporate tax code should not be paid for by tax increases on individuals or non-corporate businesses." (He reiterated his concerns about the treatment of passthroughs in response to a subsequent question from Finance Committee member Johnny Isakson, R-Ga.)

Sen. Tim Scott, R-S.C., asked the witnesses about the high US corporate tax rate and the recent uptick in corporate inversion transactions. Engler responded that permanency and predictability was needed in the tax code to improve job growth. He noted in his opening statement that comprehensive tax reform that reduces rates and makes the international tax rules more competitive could result in increased US exports and more US companies becoming acquirers rather than targets in cross-border mergers.

Wolfers noted in his opening statement to the panel that most of the economic gains over the last 30 years have accrued to the wealthiest 10 percent of the population and that policymakers need to look at the distribution of the tax burden. He argued in his written testimony that "higher taxes on the few who have enjoyed unusually strong returns, if it leads to lower taxes on many other workers, may even enhance overall incentives for productive activity, while also reducing inequality."

Wolfers also argued for investing in education and enhancing tax incentives such as the American Opportunity Tax Credit, but stressed in his written testimony that these expensive education tax credits should be "tightly tailored to families most in need."

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Have a question?
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