Possible Tax Effects of Budget Control Act of 2011

By Robert Verzi, Partner

On August 2, 2011, President Obama signed the *Budget Control Act of 2011* (P.L. 112-25). The *Budget Control Act* cuts approximately $1 trillion in federal spending, raises the federal debt ceiling and creates a bipartisan joint committee of Congress to weigh additional deficit reduction measures. This article describes the work of the joint committee, its short timeline for making recommendations, some tax measures the joint committee may consider, and possible effects on tax planning.

Joint committee

The Joint Select Committee on Deficit Reduction, as the joint committee is officially known, is charged with the goal of reducing the federal government deficit by at least $1.5 trillion over 10 years. How the joint committee will achieve that goal remains to be seen. Some lawmakers want the joint committee to focus solely on spending cuts; other lawmakers want the joint committee to recommend a mix of spending cuts and tax increases. President Obama has repeatedly called for a "balanced" approach.

The 12-member joint committee is evenly split between Democrats and Republicans (six lawmakers from each party). The even split has some Washington observers predicting that the joint committee will ultimately deadlock and reach no agreement or the lawmakers will compromise and reach an agreement that could include spending cuts and revenue raisers. If the joint committee does not make any recommendations and submit legislative language or if Congress fails to act on the recommendations and legislative language, the *Budget Control Act* provides for automatic spending cuts.

Timeline

The *Budget Control Act* sets out a timeline for the joint committee to report to Congress.

- Not later than 14 days after enactment of the *Budget Control Act,* the Democratic and Republican leaders in the House and Senate shall appoint the members of the joint committee (three Democrats from the House, three Democrats from the Senate, three Republicans from the House and three Republicans from the Senate).
- Not later than 45 days after enactment of the *Budget Control Act,* the joint committee shall hold its first meeting.
- Not later than October 14, 2011, House and Senate committees may transmit to the joint committee their recommendations for deficit reduction.
- Not later than November 23, 2011, the joint committee shall vote on a detailed report that contains the findings, conclusions and recommendations of the committee and proposed legislative language to carry out those recommendations. The *Budget Control*

Act requires seven members of the joint committee to agree on its final recommendations and legislative language.
- Not later than December 23, 2011, Congress shall vote on the joint committee's recommendations and legislative language.

Taxes

Potentially, the joint committee has a host of tax measures to consider.

Late in 2010, Congress passed the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (2010 Tax Relief Act),* which extended reduced individual income tax and capital gains/dividends tax rates through the end of 2012. The 2010 Tax Relief Act also provided for temporary extensions of marriage penalty relief, temporary enhancements to the child tax credit and earned income credit, and temporary repeal of the limitation on itemized deductions and personal exemption phase out for higher income taxpayers. Additionally, the *2010 Tax Relief Act* provided for temporary estate tax reform and alternative minimum tax (AMT) relief.

Many popular but temporary tax incentives, known as extenders, are also set to expire after 2011. These extenders include, but are not limited to, the research tax credit, special depreciation rules for qualified leasehold, restaurant and retail improvement property, the Indian employment credit, and expensing of environmental cleanup costs. Additionally, current provisions for 100 percent first-year bonus depreciation and enhanced Code Sec. 179 small business expensing are also temporary.

The joint committee could also consider corporate and international tax reform. The U.S. corporate tax rate is the second highest in the industrialized world and the White House previously signaled its openness to reducing it in exchange for the closing of unspecified business tax loopholes. President Obama also has proposed some international tax reforms. Lawmakers from both parties have supported a temporary repatriation tax holiday for overseas profits of multinational companies.

Additional tax measures the joint committee could consider include (but not limited to):

- Change in the tax treatment of so-called carried interest;
- Repeal of the last-in/first-out (LIFO) method of accounting;
- Repeal of tax preferences for oil and gas production;
- Reform or elimination of the AMT; and
- Reform or repeal some of the tax provisions in the Patient Protection and Affordable Care Act (PPACA).

The joint committee may also build on previous tax reform proposals. In 2010, the President's National Commission on Fiscal Responsibility and Reform developed a six-part plan to reduce the federal deficit. The commission recommended reducing or eliminating many tax incentives for individuals in exchange for lower individual income tax rates. The commission also endorsed lowering the corporate tax rate to 26 percent. In July 2011, a bipartisan group of senators, known as the "gang of six," introduced a plan for deficit reduction. The senators' plan would, among other provisions, replace the current individual income tax rate schedule with three new tax brackets along with abolishing the AMT.

Tax planning

Uncertainty about federal tax legislation in the past few years has contributed to uncertainty in tax planning. This year is no exception.

During negotiations over the *Budget Control Act,* President Obama often repeated his opposition to extending the Bush-era tax cuts for higher income taxpayers after 2012. The White House generally defines higher income taxpayers as individuals with incomes over $200,000 and families with incomes over $250,000. After the *Budget Control Act* became law, several White House officials predicted that President Obama will veto any bill that extends the Bush-era tax cuts for higher income taxpayers after 2012. Many Washington observers see the President Obama's veto threat as intended to encourage the joint committee to compromise on extending the Bush-era tax cuts for lower and middle income taxpayers but allowing the Bush-era tax cuts to expire for higher income taxpayers.

If the joint committee cannot agree on recommendations and legislative language, Congress could take up some expiring tax measures in separate bills. Congress could, as in past years, extend the research tax credit and other extenders, AMT relief and additional expiring provisions, in stand-alone legislation or attached to other bills. Larger tax measures, such as the Bush-era tax cuts, may wait until after the 2012 presidential election.

HA&W will monitor the work of the joint committee as it develops proposals that impact the Tax Code. If you have any questions about the *Budget Control Act,* the joint committee and tax planning, please contact our office.