

# Tax Legislative Update

Breaking news from Capitol Hill  
from Grant Thornton's Washington National Tax Office

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## Republicans and Democrats exchange 'supercommittee' tax proposals

Republican and Democratic members of a congressional "supercommittee" on deficit reduction have swapped new debt proposals that would each set up a framework for sweeping tax changes. Both plans propose hundreds of billions of dollars in new revenue and a plan for tax reform. Although the proposals bring the two sides closer to a potential agreement, significant differences remain, and a successful compromise cannot be assumed.

The competing offers were exchanged by members of the Joint Select Committee on Deficit Reduction (referred to as the "supercommittee"), which is tasked with crafting a plan to shave \$1.2 trillion of debt. The group has a Nov. 23 deadline to agree on a plan and must submit official legislative language by Dec. 2, 2011.

Before the new plans were unveiled, the supercommittee had reached a stalemate over revenue. Democrats had refused to consider entitlement cuts unless new tax revenue could be included, while Republicans refused to consider any tax increases. The new Republican proposal from Sen. Pat Toomey, R-Penn., put significant tax revenue increases on the table for the first time. The Toomey plan proposes to raise \$340 billion compared to an extension of current tax cuts, largely through tax reform.

Sen. Dick Durbin, D-Ill., immediately hailed the proposal as a breakthrough, and Senate Democrats quickly responded with a counteroffer that reduces their earlier revenue demands. However, the two sides remain far apart. The Democratic proposal would raise \$1 trillion using the same baseline as Republicans and envisions a "down payment" of \$350 billion in revenue raisers.

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Comparison of revenue proposals in supercommittee debt plans		
	Democratic plan	Toomey plan
<b>Revenue baseline</b>	Current policy	Current policy
<b>Revenue target</b>	\$1 trillion over baseline	\$340 billion over baseline
<b>Immediate tax provisions</b>	\$350 billion "down payment" with unspecified revenue raisers	\$40 billion in revenue for switching to "chained" CPI for inflation adjustments

<b>Tax reform principles</b>	<ul style="list-style-type: none"> <li>• Raise \$650 billion overall</li> <li>• Top individual rate “no higher” than 35%</li> <li>• Corporate tax reform to “enhance competitiveness”</li> <li>• Distribution as progressive as current law</li> </ul>	<ul style="list-style-type: none"> <li>• Raise \$250 billion on individual side</li> <li>• Raise \$50 billion on corporate side</li> <li>• Lower individual rates across the board with a top rate of 28%</li> </ul>
<b>Triggers if tax reform not enacted</b>	\$650 billion raised by limiting itemized deductions and levying new surtax on tax liability before credits	None provided

### **Democratic proposal**

The new Democratic plan proposes to raise \$1 trillion against a current policy baseline, meaning it would bring in \$1 trillion more revenue than if lawmakers simply extended the 2001 and 2003 tax cuts and all other expiring tax provisions such as the research credit and alternative minimum tax relief. Democrats propose to raise this revenue in two pieces:

- A \$350 billion “down payment” with the enactment of revenue raisers
- Instructions to the tax writing committees to develop a tax reform package that raises \$650 billion measured against the current policy baseline

If Congress does not enact tax reform satisfying the plan’s instructions by 2013, a “trigger” would raise \$650 billion through the enactment of a limit on itemized deductions for high income taxpayers and a “deficit reduction charge” levied on income tax liability before the application of credits. The Democratic plan would provide instructions for tax reform, and the plan outline includes the following three principles:

- Enact corporate tax reform to “enhance competitiveness” (presumably repealing tax expenditures in exchange for a rate cut)
- Create an individual rate no higher than 35 percent
- Maintain a distribution of the tax burden at least as progressive as under current law

The \$350 billion down payment on deficit reduction appears to suggest the immediate enactment of revenue-raising provisions within the deficit agreement itself. This represents a major shift from earlier proposals, which largely focused on setting up the framework for future legislation to raise revenue through tax reform. If Republicans ultimately accept some kind of down payment, revenue-raising provisions could be headed for enactment as quickly as within the next eight weeks (though the effective dates could be delayed). Democrats did not offer specific revenue-raising provisions, but they would likely look to use a menu of previously proposed revenue raisers, such as:

- repealing the last-in, first-out (LIFO) method of accounting;
- repealing the lower-of-cost-or-market (LCM) method of accounting;
- changing the taxation of carried interest in an investment services partnership;
- eliminating the mortgage interest deduction on a second home;
- repealing incentives for the oil, gas and coal industries;
- deferring interest expense deductions until the related foreign source income is repatriated;

- determining the foreign tax credit on a pooling basis;
- taxing excess returns associated with offshore transfers of intangibles;
- limiting shifting of income through intangible property transfers;
- limiting earnings stripping by expatriated entities;
- reinstating superfund taxes; and
- making the federal unemployment surtax permanent.

### **Republican proposal**

Republicans have offered to increase revenues by \$340 billion compared to a current policy baseline. Like Democrats, they propose to do the bulk of this in the context of tax reform. The only revenue increase to be included in supercommittee legislation itself would be a proposal to change how the government makes inflation adjustments for things like Social Security benefits and tax provisions. The proposal would replace the traditional inflation measure of consumer price index (CPI) with a so-called “chained CPI,” in which behavioral responses to price changes are taken into consideration. The Republican plan estimates that this would raise \$40 billion over 10 years through smaller annual adjustments in the tax brackets and other tax benefits.

Republicans propose to raise \$250 billion from the individual side of the tax code and \$50 billion from the corporate side through a tax reform exercise that would lower rates and repeal tax expenditures. Individual rates would be cut across all tax brackets with a top rate of 28 percent. The plan does not specify which tax expenditures would be cut, but the vast majority would likely need to be removed to cover both the rate cut and a \$300 billion revenue increase.

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