

Tax Legislative Update

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

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President pitches new job creation tax proposals; Senate protects tax priorities from new pay-go requirement

President Obama used this week's State of the Union address to unveil an updated tax agenda and on Jan. 28 unveiled the details behind a new job creation tax credit.

The president's speech highlighted a renewed focus on economic recovery and job creation. Most significantly, President Obama has proposed extending bonus depreciation, excluding capital gains on qualified small business stock and a creating a new jobs tax credit for small businesses. The president also called for several taxpayer relief proposals unveiled last week, including a proposed increase in the child care tax credit and changes to the rules for tax-preferred retirement accounts.

While job creation and economic recovery will be the immediate focus, the president renewed his commitment to several longer-term tax priorities. He urged Democrats not to give up on health care reform and made a new pitch for legislation to cap carbon emissions. His push for financial industry reform included his recently proposed tax on financial institutions. He also reiterated longstanding priorities to:

- reform international tax rules;
- extend the 2001 and 2003 tax cuts for "middle-class" taxpayers and reverse them for taxpayers with incomes over \$200,000 (single filers) and \$250,000 (joint filers);
- change the taxation of carried interest; and
- curb tax incentives for the oil and gas industry.

The president did not mention efforts to reform the estate tax or extend expired tax provisions like the research credit. However, this should not be taken as an indication that the administration is abandoning that effort. The administration's budget proposal is expected on Feb 1 and should include more details on the White House's tax positions.

Meanwhile, Congress is in the process of codifying its tax priorities. The Senate voted 60 to 40 on Jan. 28 to pass a debt limit increase that includes statutory "pay-as-you-go" budget rules. The rules require tax cuts to be offset, but exempt a number of top tax items that represent top Democratic priorities.

Contact information

Mel Schwarz
Partner
National Tax Office
T 202.521.1564
E Mel.Schwarz@gt.com

Dustin Stamper
Manager
National Tax Office
T 202.861.4144
E Dustin.Stamper@gt.com

www.GrantThornton.com/tax

Job creation incentives

Jobs tax credit

The administration's endorsement of a jobs tax credit should provide significant momentum to the effort. A job creation package including this proposal and other tax incentives is expected to be considered by Congress in the near future.

The president has proposed a pair of job creation tax credits worth \$33 billion, primarily directed at small businesses, with the total benefit capped at \$500,000 per employer. One credit would provide \$5,000 for each net new job created in 2010. The other would offer a credit equal to 6.2 percent of aggregate wage increases in excess of inflation, effectively offsetting the employer's portion of social security taxes on such increases.

The administration said it would add anti-abuse rules. Start-ups would be eligible for only half the \$5,000 credit, and employers that reduce payrolls would not be eligible for either credit. The credits would be limited to 25 percent of the increase in the base Social Security payroll. Other rules would prevent companies from replacing full-time employees with part-time employees or renaming or merging to claim the credit. The credits would be administered by reducing an employer's unemployment insurance wage base.

The House passed a job creation bill last year that does not include a tax credit for jobs, but Senate Democrats are currently working on a bill that would include such a credit. There are several different Senate proposals for the credit:

Senate job creation tax proposals	
Sponsor	Proposal
Sens. Chuck Schumer, D-N.Y., and Orrin G. Hatch, R-Utah.	Private sector employers would not pay their share of Social Security taxes (6.2%) for the remainder of 2010 for workers hired that were unemployed for at least 60 days. Employers would also receive an additional \$1,000 credit on their 2011 tax return for any worker hired in 2010 that remains on their payroll for a continuous 52 weeks.
Sen. Russell Feingold, D-Wis.	Employers would receive a tax credit equal to 15% of increases in quarterly payroll subject to Social Security taxes in 2010 and 10% in 2011.
Sen. Bob Casey, D-Pa.	Employers with less than 100 employees would receive a one-year tax credit equal to 20% of year-over-year payroll growth while employers with over 100 employees would receive a credit of 15%.

Bonus depreciation

The president said in his speech that he wanted to "provide a tax incentive for all large businesses and all small businesses to invest in new plants and equipment," indicating that the administration supports an extension of bonus depreciation rules for property placed in service in 2010. Bonus depreciation — originally put in place for 2008, and then extended for 2009 — allows half of the cost of eligible property to be recovered in the year it is placed in service, while the remaining half is depreciated using the normal rules.

Qualified small business stock

The president reiterated his support for eliminating “all capital gains taxes on small business investment.” Previous versions of this proposal would have fully excluded gain from the sale of newly issued qualified small business (QSB) stock. In the stimulus bill enacted in February 2009, Congress and the president increased the 50 percent exclusion of gain from QSB stock to 75 percent for stock issued between Feb. 17, 2009, and the end of 2010. Presumably, this proposal would increase the exclusion amount to 100 percent for qualified small business stock issued in the future.

Taxpayer relief proposals

Child care credit

The administration has proposed increasing the child care credit rate from 20 percent to 35 percent for families with less than \$85,000 of income. According to the administration, the proposal would result in a larger credit for nearly all taxpayers with income under \$115,000. The maximum credit would be \$3,000 for one child and \$6,000 for two.

American Opportunity credit

The administration supports making the American Opportunity tax credit permanent. This credit was enacted in the 2009 stimulus bill to replace the Hope credit for 2009 and 2010. It increases the maximum credit from \$1,800 to \$2,500, makes it 40 percent refundable and increases the income phase-out thresholds.

Retirement accounts

The administration has several proposals for retirement tax incentives:

- **Automatic IRAs:** Require employers who do not offer a retirement plan to enroll their employees in a direct-deposit individual retirement account unless the employee opts out.
- **Saver’s Credit:** Expand the Saver’s Credit to match 50 percent of the first \$1,000 of contributions by families earning up to \$65,000 and providing a partial credit to families earning up to \$85,000.
- **401(k) regulations:** Amend 401(k) regulations to tighten rules on investment advice, transparency and fee disclosures.

Long-term priorities

Health care

The president urged Democrats not to give up on health care reform despite the recent victory of a Republican in a special election to fill the seat of Democrat Ted Kennedy. But Obama also acknowledged that the effort may need to backtrack, and said he was ready to listen to new proposals from either party.

Climate change

The president reiterated support for climate change legislation — an issue that was placed on the back burner last year as Democrats focused on health care. The House has passed sweeping climate change legislation (H.R. 2998) that would cap carbon emissions, increase

the earned income tax credit (EITC) and offer the potential for import tariffs. The White House proposal is similar, but would auction off, not give away, a higher proportion of new carbon emission allowances. The Senate has not made significant progress on a bill.

Financial institutions tax

The president confirmed his strong support of a new proposal to impose \$90 billion in taxes on the liabilities of financial institutions with over \$50 billion in assets. Financial institutions covered by the tax would include insured depository institutions, bank holding companies, thrift holding companies, insurance companies, companies that own insured depository institutions and securities broker-dealers. The tax would be equal to 0.15 percent of liabilities, which would be defined as assets minus Tier 1 capital, FDIC deposits and any insurance policy reserves.

Tax reform

The president did not mention the estate tax or expired tax provisions known as “extenders.” He did confirm longstanding positions on international tax reform, carried interest tax changes, oil and gas industry tax incentives, and the 2001 and 2003 tax cuts. His positions on these issues were detailed in last year’s budget proposal and are expected to be addressed again in the budget proposal due out on Feb 1.

Congressional tax priorities

Pay-as-you-go budget rules

The Senate voted 60 to 40 on Jan. 28 to increase the federal debt limit after adding an amendment that would create statutory pay-as-you-go budget rules. The House still needs to take up and pass the Senate debt limit legislation, but House democrats have pushed for pay-go rules all year.

Pay-go rules require tax cuts to be offset by other tax increases or spending cuts. The rules could make it much harder to pass tax cuts in the future, including extensions of some of the 2001 and 2003 tax cuts. They also increase the need for revenue offsets such as changes to the taxation of carried interest and international reform proposals.

The Senate amendment exempts several tax items from the pay-go rules. The exemptions make it much easier to pass certain tax items and also provide an excellent summary of Democratic future tax priorities:

Tax items exempted from pay-go rules	
Estate tax	<ul style="list-style-type: none"> • Extension of 2009 exemption and rate through 2011, adjusted for inflation
AMT	<ul style="list-style-type: none"> • AMT patch for 2010 and 2011 to hold the number of taxpayers affected by the AMT to 2008 levels
Rate cuts	<ul style="list-style-type: none"> • Permanent extension of the 10%, 25% and 28% brackets • Permanent extension of the 33% bracket only for taxpayers with income under \$200,000 (single) or \$250,000 (joint) • NO PROTECTION to prevent reversion of 33% bracket to 36% and 35% bracket to 39.6% for taxpayers with income over 200,000 (single) or \$250,000 (joint)

Family incentives	<ul style="list-style-type: none"> • Permanent extension of current child tax credit (including recent enhancements) • Permanent extension of current marriage penalty relief (including recent amendments) • Permanent extension of adoption tax credit • Permanent extension of dependent care credit • Permanent extension of employer-provided child care credit
Education incentives	<ul style="list-style-type: none"> • Permanent extension of student loan interest deduction • Permanent extension of exclusion for certain amounts received under National Health Service Corps Scholarship program and F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program
Capital gains and dividends	<ul style="list-style-type: none"> • Permanent extension of the 15% capital gains and dividend rates (and zero bracket) for taxpayers with income under \$200,000 (single) or \$250,000 (joint) • NO PROTECTION to prevent reversion to 20% capital gains rate and ordinary income rates for dividends for taxpayers with income over \$200,000 (single) or \$250,000 (joint)
PEP and Pease	<ul style="list-style-type: none"> • Permanent elimination of the personal exemption phase-out (PEP) and limits on itemized deductions (Pease) for taxpayers with income under \$200,000 (single) or \$250,000 (joint)
Small business expensing	<ul style="list-style-type: none"> • Permanent extension of current Section 179 limits and phase-out threshold (including recent increases)

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