



What Leftovers Are on Congress' Plate for 2009?

Congress has a lot of unfinished business from 2008, including repeal of the AMT, resolve expiring tax provisions, reform or repeal of the estate tax, dealing with the economic substance doctrine, among others.

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During 2008, Congress passed several pieces of legislation designed to respond to the economic crisis. As the year ended, congressional attention turned again to economic stimulus. Leaders in Congress, as well as President-Elect Obama, have indicated that economic stimulus legislation will be a focus in early 2009. While a new economic stimulus package might help recovery in the short term, it will more likely add to the rising federal deficit. In the long run, the federal deficit may put us at risk of losing confidence in the dollar and government debt.

Carefully enacting fiscal and economic policies to bring about stability into the markets will be necessary in the coming years.

Some proposals for legislation target employment-related issues (*e.g.* suspension of tax on unemployment benefits). Other proposals include the extension of bonus depreciation, suspension of rules requiring withdrawals from individual retirement accounts and the waiver of penalties associated with early withdrawals from individual retirement accounts. Still other proposals include the reduction of taxes on low- and moderate-income individuals and the raising the taxes on high income individuals, the reduction of the corporate tax rate from 35 percent to 30.5 percent and elimination of the AMT (Alternative Minimum Tax).

The following matters left over from 2008 are bound to be debated by Congress in 2009 and the subject of legislation.

Extend the AMT Patch

The basic mechanics of the AMT calculation have caused more individuals to be subject to AMT. By 2010, an estimated 25.6 percent of the population will owe AMT. The original purpose of the AMT was to ensure that individuals with substantial income could not use tax benefits and omissions to reduce his or her income below a certain threshold. However, there are several reasons why Congress may be concerned with the increased applicability to individuals. One reason is that taxpayers subject to AMT will pay a higher tax liability than they otherwise would and thus, may view AMT as an increase in taxes. In addition, the time spent in tax preparation for taxpayers at or near AMT status increases as well.

Economists argue, however, that broad-based tax systems with lower rates — characteristic of AMT — are less damaging to economic efficiency than systems with higher rates that apply to bases with special benefits. Arguably, the benefits of economic and social growth are balanced with fairness and efficiency. But with more individuals subject to AMT, pressure grows to readjust or index it. It becomes more complicated because the AMT's revenue effect is significant. According to the Congressional Budget

Office, indexing AMT for inflation would reduce federal revenues by \$569 billion over 10 years, an amount equal to 1.6 percent of federal revenues expected over the period. Most recently, the Tax Extenders and Alternative Minimum Tax Relief Act increased the AMT exemption to \$46,200 (singles) and \$69,950 (couples), for the tax year 2008. Also extended by the Act was the allowance of nonrefundable individual income tax credits to offset AMT liability.

Resolve Expiring Tax Provisions

The tax cut provisions of EGTRRA (Economic Growth and Tax Relief Reconciliation Act), other than those made permanent or extended by subsequent legislation, expire at the end of 2010 and will not apply to years beginning after 2010. Thus, upon the sunset of EGTRRA, the Code will revert back to its status before the enactment of EGTRRA. The scheduled expiration of EGTRRA was debated by the Congress throughout 2008 on the basis of its impact upon the federal budget deficit, long term economic growth and tax fairness. During the presidential campaigns, proposals were suggested to allow the expiration of the reduction of the highest marginal tax rate and to extend the reduction of others. To some, this modification represents a compromise between the need to raise revenue while improving fairness.

Reform the Estate Tax

The current estate tax will expire at the end of 2009 and then, in 2011, revert to much higher taxation under pre-2001 rules. Congress and the president will have to work out a compromise to enact permanent estate tax law in 2009. Some suggest that the compromise would retain the estate tax but increase the exemption amount and/or lower rates.

Balance the Budget

In 1990, Congress enacted a PAYGO or pay-as-you-go system as part of the Budget Enforcement Act of 1990. PAYGO required all increases in direct spending or revenue decreases to be offset by other spending decreases or revenue increases. It was thought that this would control deficit spending.

In the initial PAYGO regimen, any increases in the deficit were to be offset by an across the board "sequestration" of programs — an automatic cut in nonexempt mandatory spending programs. These rules were in effect from FY1991 – FY2002 and were seen as having assisted Congress in maintaining budget discipline. Effectively, however PAYGO was terminated in late 2002. In 2002, the deficit was \$157.8 billion, increasing to \$377.6 billion in 2003 and \$412.7 billion in 2004.

The PAYGO system was reestablished as a standing rule of the House of Representatives on January 4, 2007. The

Senate modified its rule in 2007 to make it comparable to the House rule. However, each chamber waived their PAYGO rules to pass legislation dealing with the economic crisis.

Some of the proposals in Congress entail significant revenue loss. It will be interesting to see whether Congress will revise PAYGO to accommodate revenue losses while still promoting fiscal discipline.

Reduce the Tax Gap and Tax Shelters

Due to concerns about the federal budget deficit and congressional interest in some revenue-reducing measures, leaders from both parties have expressed interest in closing the "tax gap." The tax gap includes both deliberate (and illegal) tax evasion or avoidance and nonpayment that occur for more innocent reasons, such as taxpayer error.

The Office of Tax Policy at the Treasury has developed a comprehensive strategy for reducing the tax gap, by better targeting enforcement efforts while minimizing additional burdens on those taxpayers who already pay what they owe. In the FY 2008 and 2009 Budgets, President Bush proposed legislation characterized as assisting in the implementation of the Treasury's comprehensive strategy to reduce the tax gap. Expanding information reporting and expanding penalties were key to these proposals and account for the greatest percentage of projected increased compliance. As of the end of 2008, 19 bills relevant to the tax gap have been introduced in Congress. Consequently, during the next session Congress will be addressing tax gap legislation.

Tax shelters, whether legal with unintended results or illegal, contribute to the tax gap. Congress has shown considerable interest in tax shelters and has enacted legislation to restrict their use. Congress has also considered legislation to codify the economic substance doctrine as a way to restrict the use of transactions without economic substance which produce tax deductions and similar benefits. With the pressure of federal budget deficits and the increasing tax gap, Congress will likely consider adopting economic substance legislation as a way to provide increased revenue.

Conclusion

With the increased cost of providing economic stimulus and the further reduction of revenues by repealing the AMT or extending the tax cuts scheduled to expire, Congress will be faced with modifying the PAYGO regimen, closing the tax gap and enacting legislation to restrict the use of transactions without economic substance.

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