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BUDGET CONTROL ACT OF 2011

On August 2, President Obama quickly signed the Budget Control Act after passage by the Senate 74 to 26. The House had passed the Budget Control Act on August 1 by a vote of 269 to 161. The new law raises the debt limit to avoid a projected default and creates a bipartisan joint select committee on deficit reduction.

The first part of the act is projected to cut approximately $1 trillion in federal spending over 10 years. The second part of the act creates a 12 member bipartisan joint committee, which is charged with the goal of reducing the federal deficit by at least $1.5 trillion over 10 years. If the joint committee cannot agree on legislative language or Congress fails to take up the joint committee's proposal, automatic spending cuts would apply.

It is unclear what changes to the Tax Code may be addressed by the joint select committee on deficit reduction. The joint committee's mandate under the new law requires it to draft additional deficit reduction legislation in time to be voted on by Congress before year end. In recent months, tax proposals from both sides of the aisle have included bold, sweeping tax proposals, as well as more limited loop-hole-closing recommendations. All these proposals remain on the table for consideration by the joint committee as it begins work shortly.

The mere fact that sweeping tax reform is now being considered in connection with solving long-term deficit problems indicates a desire by many in Washington to seriously consider fundamental changes. Both sides see the economy growing through a fairer tax system. Add to that catalyst the reality that the Bush-era tax cuts are scheduled to automatically sunset after December 31, 2012 if Congress takes no action and a major round of tax legislation not seen since the 1986 Tax Reform Act becomes possible.

President Obama continues to take the official position that any long-term deficit reduction under the two-stage deal must include revenue increases as well as spending cuts. At the center of President Obama's plan is an extension of the Bush-era tax cuts for lower and middle income taxpayers after 2012, but not for some higher income taxpayers now in the top two rate brackets. Under the president's plan, taxes would increase for individuals with incomes above $200,000 and families with incomes above $250,000. The White House has also called for the elimination of certain oil and gas tax preferences, a permanent research tax credit and an extension of the 2011 payroll tax cut.

The future of federal estate tax was hardly discussed during the deficit negotiations. The 2010 Tax Relief Act provided higher exemption amounts (up to $5,000,000) and lower tax rates (35%), but its relief is temporary and is scheduled to expire after 2012. There will be much debate over the estate tax since sunset provisions will require the estate tax to revert to pre-2001 rates and exemptions if no Congressional action is taken. That would mean a rise in the maximum estate tax rate from its current 35 percent to 55 percent and a drop in the maximum estate tax exemption from $5 million to $1 million.

In early 2011, six members of the Senate began negotiations on a comprehensive deficit reduction plan. They include Senator Saxby Chambliss, R-Ga., Tom Coburn, R-Ok., Ken Conrad, D-N.D., Mike Crapo, R-Idaho, Dick Durbin, D-Ill., and Mark Warner, D- Va. They become known as the gang of six. On July 19, 2011 the senators released a plan to reduce the budget deficit by $3.7 trillion over 10 years with a combination of sending cuts and revenue hikes. Details of the plan were sparse and the Congressional Budget Office did not score it. It projects an estimated $1 trillion from revenue increases.

The bipartisan National Commission on Fiscal Responsibility issued it final report, "The Moment of Truth", in December 2010. The Commission developed a six-part plan designed to reduce the federal deficit by almost $4 trillion by 2020. The 18-member commission approved the report by a 11-7 vote. The commission's six-part plan calls for cuts in discretionary and mandatory federal spending, health care savings and reduced heal care spending, changes to Social Security and budget process reforms. Tax reform as envisioned by the Deficit Commission would achieve at least 20 percent of the $4 trillion reduction. The deficit commission plan aims to reduce, if not eliminate, $1.1 trillion in tax expenditures in the current Tax Code for individuals and businesses. Under current law, the largest tax expenditure is the tax-free treatment of contributions to health care plans at approximately $144 billion per year. Other substantial tax expenditures targeted for elimination include $79 billion for home mortgage interest, $57 billion for accelerated depreciation, $53 billion for capital gains, and $49 billion for the earned income credit. At the same time, the plan would reduce tax rates, depending on the amount of tax expenditures eliminated. There are over 150 tax expenditures the Deficit Commission would eliminate. The deficit Commission's plan would provide three ordinary income tax rates as low as 8, 14, and 23 percent. The plan would treat capital gains and dividends as ordinary income. The plan would eliminate AMT.

Other reforms proposed by the Deficit Commission are:

- Limiting the charitable deduction for individuals to amounts over two percent of adjusted gross income
- Repealing the state and local tax deduction for individuals
- Repealing all miscellaneous itemized deductions for individuals
- Capping the income tax exclusion for employer-provided health insurance; and
- Raising the federal gasoline tax by 15 cents per gallon.

The Deficit Commission would provide a single corporate tax rate of 26 percent. One thing seems certain; changes made under the banner of tax reform can have support from both parties. The Senate Finance Committee has not yet presented any comprehensive tax reform legislation. The House Ways and Means Committee has examined a value added tax (VAT), tax incentives to encourage foreign investment in the U.S. and corporate tax rates.