

Our Tax Future – The View from Washington Viva Hammer



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The Fiscal Cliff Deal

- **Payroll Tax**
 - Expiration of payroll tax holiday that reduced workers' share of social security taxes by 2%; the holiday applied to the first \$110,000 of income, so the change in available cash flow could be as much as \$2,200
 - Combined employer and employee rate would have to increase from 15.30% of earned income to over 19% to make the program solvent as a form of mandatory insurance
- **Capital Gains**
 - Capital gains rates were restored at high income levels from 15% to 20%
- **Estate and Gift Tax**
 - Before the Bush tax cuts, the lifetime exclusion (adjusted to today's dollars) was the equivalent of \$2.5 million for a married couple using both of their exclusions; today, it is \$10 million – adjusted for inflation
 - The marginal rate applicable beyond \$10m was reduced from 55 to 40%

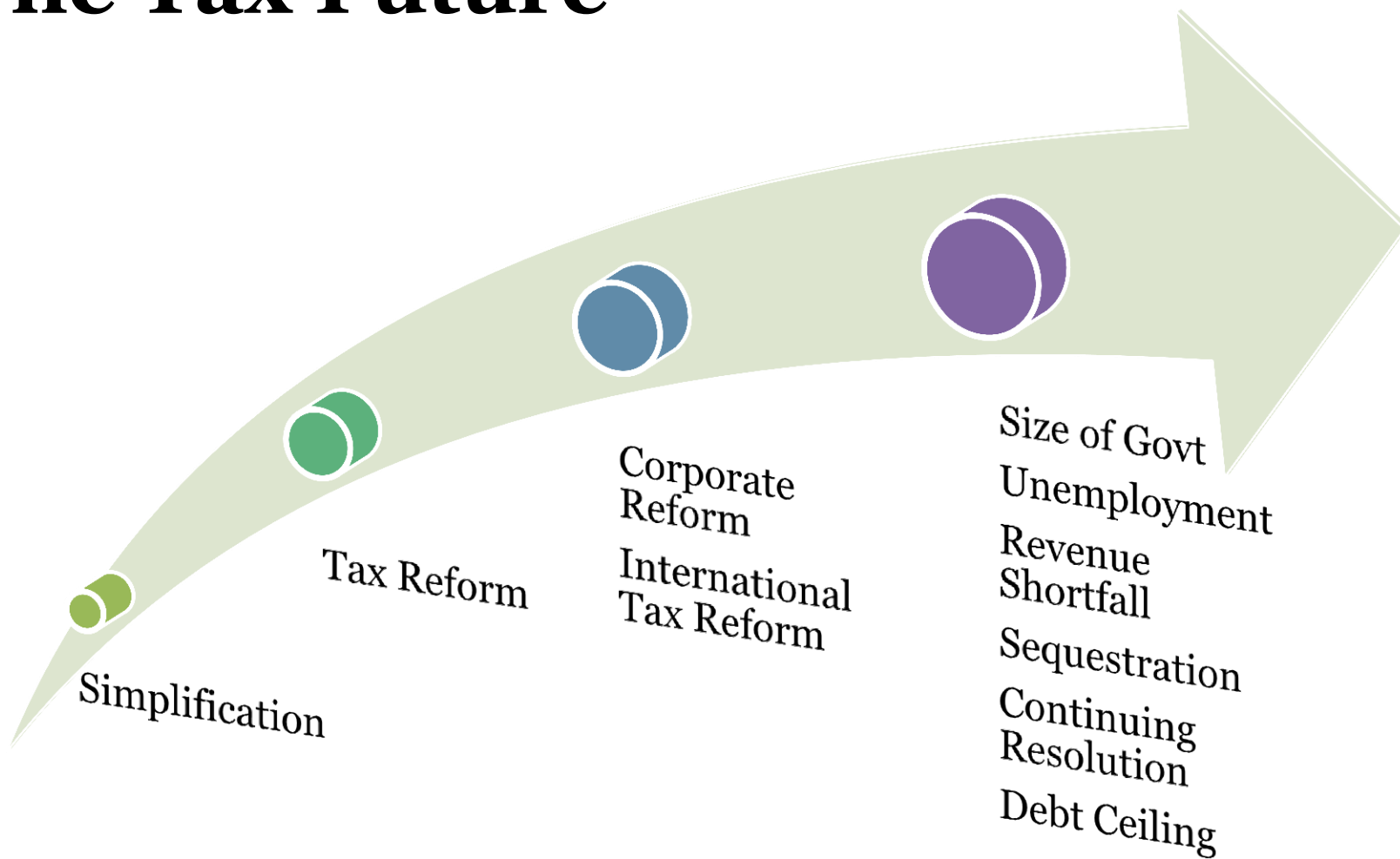


The Fiscal Cliff Deal – Income Tax

- Phase-out of Bush tax cuts as AGI increases from \$300,000 to \$575,000
- Income tax cuts first enacted by Bush were set to expire at the end of 2012; the Fiscal Cliff law retained those rates for the first \$450,000 of taxable income for a married couple /\$400,000 for singles
- For amounts of taxable income over \$450,000/\$400,000, tax rates were *increased* by 4.6% back to 2000 level
- Through a cut-back on itemized deductions and personal exemptions, an effective tax rate increase of slightly over 1% was imposed on the AGI of married couples over \$300,000
- To summarize – for married couples with AGI between \$300,000 and approximately \$575,000 – the benefits of the Bush tax cuts are gradually phased out through a combination of explicit rate increases (on taxable income above \$450,000/400,000) and rate increases in the form of a phase-out of personal exemption and a limitation on itemized deductions – proportional to the amount of AGI over \$300,000
- At approx \$575,000 of AGI, the benefits of the Bush tax cuts have been eliminated – and incremental income is subject to a tax on taxable income of 39.6% -plus an effective tax on AGI of 1.2% for a total marginal rate of 40.8%
- ALSO, there's an increase in the Medicare tax for high-earning employed and self-employed, and a corresponding 3.8% Net Investment Income Tax; those both apply as incomes exceed approx \$250,000



The Tax Future



Simplification

- Fiscal Cliff Law made things MUCH more complex
- Which is the constituency for simplification?
- Easier to add on than start all over again
- Simplification unlikely



Tax Reform

- Revenues from expected tax expenditures plus borrowing don't cover even a minimalist government
- Easy revenues were collected in the Fiscal Cliff Law – could have gotten more but chose not to; those items are not on the table any more (e.g., Estate Tax)
- Sequestration and Continuing Resolution
- Spending cuts
- Taxes and spending cuts – White House vs. Congress



Routes to Reform

- Fiscal Cliff deal done out of regular order – Senate Finance Committee and Ways & Means Committee did not lead
- Where were the policy thinkers? Was there any policy?
- No policy – Fiscal Cliff Law is expedient, quick, got very high vote in both House and Senate
- In the future, are we going to have tough decisions based on policy or ad hoc laws based on expedience?
- Unlikely Tax Committee heads will give up power in future



Corporate Reform

- Corporate issues weren't addressed in Fiscal Cliff deal
- If corporate are addressed in future, the big question is whether it's going to be
 - Revenue neutral reform – business community will NEVER unite around a plan that just shifts revenue around
 - Revenue raising reform – GOP will oppose
 - Revenue losing reform – Democrats will oppose
 - Unlikely there will be a big corporate rate drop soon
 - But there might be indirect paths to an effective lower corp rate:
 - Incentives for doing manufacturing in the US
 - R&D credit might be broadened
 - Incentives to keep jobs in US
 - Incentives for greener energy , manufacturing
- Business reform is not only about corporate reform –S Corps, passthru; will there be a level playing field?
- **Territoriality.** Early budgets indicated the Administration was opposed to it. Many cited studies that territoriality creates huge number of jobs overseas. Highly contentious issue.



Our Tax Future





Tax Reform

*If people thought tax reform were real,
everyone would want to be part of it.*

You're not going to hear anyone say they're
opposed to tax reform.

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