

An added difficulty: Congress will need to find additional revenue raisers to pay for the extenders bill. Foreign tax provisions proposed as revenue raisers for H.R. 4213 were used last week to fund increased education and Medicaid spending.

THE INCOME TAX?

Everyone wants to know what will happen with the income tax.

Although the popular press has focused chiefly on the potential for higher marginal income tax rates, even more is at stake. The Bush-era tax legislation, set to expire this December 31, gave us not only lower marginal rates but also marriage penalty relief, an expanded child tax credit and education incentives. Upper-income taxpayers, in particular, were benefited by a repeal of the limitation on itemized deductions (i.e. repeal of the so-called “Pease provisions”) as well as repeal of the personal exemption phaseout (“PEP”). Extending these ancillary provisions is expensive—\$322.7 billion over 10 years to extend marriage penalty relief, for example; \$261.3 billion to extend the expanded child tax credit; and \$131.7 billion to repeal Pease.

All this means that Congress will have many complex choices to make—and it will be working within a very tight time frame. There are only four weeks between the time its two houses reconvene (September 13 and 14, respectively) and the time they recess (October 8) to prepare for the November elections. Although Congress is scheduled to reconvene for a final session beginning on November 15, it is not at all clear that major tax legislation would be passed by lame-duck legislators. Not a pretty picture, unless you like the prospect of “kicking the ball” to 2011.

Within these parameters, there are myriad alternatives, including:

- Extending all Bush personal income tax cuts permanently, at an estimated cost of **\$2.7103 trillion** over 10 years
- Extending all Bush personal income tax cuts permanently, except those affecting upper-income taxpayers, at an estimated cost of **\$2.0307 trillion** over 10 years

Note: the Obama 2011 Budget Proposal would modify this basic approach by giving upper-income taxpayers a top 20 percent rate for both long-term capital gains and qualified dividends; there is considerable support for keeping the same tax rate for both types of investment income

- Extending all Bush personal income tax cuts for a temporary two year period
- Extending all Bush personal income tax cuts, except those affecting upper-income taxpayers, for a temporary two-year period
- Allowing pre-2001 income tax law to return (the “default” alternative)

Commentators, to the right and to the left, argue the merits of each alternative. A few, like Alan Greenspan, believe that, given the \$1.74 trillion budget deficit, any extension of the Bush tax cuts would be a mistake. In my personal view, given the limitations of static scoring and the uncertainties of global economies, “getting it right” is no easy task.

ALTERNATIVE MINIMUM TAX (“AMT”) PATCH?

The U.S. Treasury estimates the 10 year cost of a permanent alternative minimum tax (“AMT”) patch—i.e. an increase in the AMT exemption amount that would permanently prevent more taxpayers from becoming subject to AMT—at \$671.7 billion over 10 years. Some Congressional leaders have said they would consider a permanent AMT solution in the context of larger income tax legislation; significantly, a permanent patch is what is included in President Obama’s 2011 budget proposal. Given the projected cost, I would look for a permanent answer to the AMT conundrum in the context of comprehensive, as-yet-to-be-determined income tax reform.

TRANSFER TAX?

There is nothing new on the likely outcome of the 2010/2011 transfer tax debacle. President Obama’s position continues to be a \$3.5 million exemption, with a 45% top rate. Prospects for the bi-partisan “Responsible Estate Tax Act” (S. 3533, H.R. 5764), with its “billionaire’s surtax,” are as yet unclear.

AND THAT’S NOT ALL, FOLKS. . .

Don’t be surprised if there’s not immediate action on the income and transfer tax front when Congress reconvenes. House leadership has indicated it will look to the Senate to take the lead. Meanwhile, in the Senate, a small business bill (H.R. 5297) may be the first priority, with a \$30 billion small business lending pool, bonus depreciation, enhanced expensing for equipment and certain real estate--and expanded start-up cost write-offs. Also on the Senate agenda are an energy bill and Department of Defense appropriations, both likely to be sharply contested.

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