ON THE HORNS OF A DILEMMA

Last week, the House passed by a 225-200 margin, a bill to “freeze” permanently the estate tax exemption and top estate tax margin rate at 2009 levels. H.R. 4154 sets the top rate at 45 percent and the individual exemption at $3.5 million. Unfortunately, it does not do one thing we would like, and that is to index the exemption for inflation. If this version were enacted into law, the freeze would take effect at the end of this year and there would not be a one-year repeal.

As I expected, the House leadership used a parliamentary maneuver to “deem” the attachment of a previously-passed statutory pay-go requirement bill to the estate tax upon passage. To refresh your memory, earlier this year, during the budget debate, the fiscally conservative House Blue Dogs arrived at an agreement with the House leadership under the terms of which they would let the budget resolution move forward provided the House leadership brought a statutory pay go bill to the floor. In addition, the leadership was able to convince the Blue Dogs, that if the statutory pay go bill was enacted, four items would be exempt from the requirements. The permanent estate tax freeze was one of the four.

The House passed the pay go bill, H.R. 2920, in July. The Senate has shown little interest in the bill. The main “objector” has been Senate Budget Committee Chairman Kent Conrad (D-ND) and his main objection has been an objection to the exemption of the four items. He has additional concerns about the pay go process. The statutory version requires “sequestration” as the enforcement mechanism. Under sequestration, the Office of Management keeps track of all the mandatory spending and tax actions taken, and if at the end of the year, it is not in balance or has a “positive” balance, across the board cuts are supposed to be implemented by agencies. (Congress and the President always managed to avoid a sequestration with some procedural moves.)

This brings us to the dilemma. There is plenty of sympathy in the Senate for at least adding the inflation indexing to the estate tax relief. There may even be enough votes to increase the exemption to $5 million and perhaps lower the top rate to 35 percent. The Senate is probably going to delete the statutory pay-go provisions too.

Well, do we tell the Senate, “As much as we would like indexing for inflation, and yes, you may even have the votes for increasing the exemption, just pass the House version, and let’s call it a day?” Or do we push for the improvements and then hope we can convince the House to accept the revisions? It is a tough call. It depends on your assessment of whether the House is willing to blink if the Senate tinkers with the terms. There is a significant block of members in the House majority who do not see estate tax relief as a priority. They would not lose any sleep if it was repealed for a year and came back in its old form thereafter.

I think Congress will find a way around the statutory pay-go impasse (the House will probably blink). However, on the substance of the estate tax relief, I am not so sure. I can see the estate tax relief being attached to some “must-do” legislation. That might give the Senate the wiggle room to serve up its own version of estate tax relief. See the “closing out the year” story for the risks associated with this scenario.
EXTENDERS

A couple of weeks ago, I reported that the House was preparing a bill to extend a variety of credits and deductions that are set to expire. They are expected to be extended for one year. The House is expected to vote on the bill this week. They still have not released the text yet, but an extension of the R&D credit, an extension of the temporary accelerated depreciation schedule for retail structural improvements, some energy-related items, a number of deductions and credits taken by individuals such as the deduction for state and local sales taxes, some related to specific charitable contributions, some very narrow business deductions and credits, and some related to disaster relief will be included.

My understanding is there could somewhere between 30 and 40 expiring provisions that get a one year reprieve.

As I have written before, there are over a hundred tax relief provisions that expire at the end of this year or at the end of 2010. If Congress passes this extension, all 100 plus will be fighting for revenue oxygen at the end of next year.

Will the Senate approve the package when the House is done with it? I expect them to do so. The problem is going to be the revenue offset. The House is expected to use a provision requiring “carried interest” (this is how private equity and hedge funds are able to treat income as capital gains) to be treated as ordinary income and the Senate does not like that option.

CLOSING OUT THE YEAR

Congress has not finished funding the entire government for the fiscal year that began on October 1st.

While some appropriations bills have been enacted, parts of the government have been operating on a continuing resolution that expires on December 18th. Remember my article above about the estate tax relief dilemma? Attaching the relief to the next funding bill might be an option for moving the estate tax relief. For that matter, do not be surprised to find the extender bill attached to it too.

At this point, the choices for the funding decision include another short term continuing resolution that expires early next year, a continuing resolution that extends funding through the end of the fiscal year, or some magical omnibus funding bill that covers all of the unfinished appropriations bills.

The House is better positioned to play a game of legislative chicken. The Senate is struggling with health care reform. The House could pass some version of a continuing resolution or an omnibus funding bill on December 18th, throw in whatever else it wants and go home.

While on the subject of going home, the timing of the health care debate in the Senate is not being driven by the clock or the charade of floor amendments. Senate Majority Leader Harry Reid (D-NV) will file a cloture motion to end the debate when he knows he has the 60 votes, not when the Senate is finished with amendments.

There is talk of the Senate being in session on Christmas Day.