

OBAMA'S MIDTERM TAX PROPOSALS

The President recommends what amounts to a second stimulus package.

Provided by: Tri Pillar Investments, LLC

Quote for the week: “ Life is 10% of what happens to me and 90% of how I react to it.” John Maxwell

Many Americans are frustrated with the pace of the economic recovery; many Democrats are worried that their party will lose its majority in the House and Senate. As elections loom, President Obama has offered a new platform of tax initiatives for Congress to consider and potentially approve.

Extending the Bush-era tax cuts (for the middle class). President Obama wants to extend the EGTRRA and JGTRRA cuts of the last decade – but not to what Treasury Secretary Timothy Geithner referred to as the “most fortunate 2% of Americans.” Taxpayers who earn more than \$250,000 would see those tax breaks disappear in 2011, while others would still benefit from them.¹

Why not extend the Bush-era tax breaks for the demographic that is probably the most economically influential? “We don’t think that’s responsible economic policy,” Geithner commented during an interview on the FOX Business Network. He felt that preserving the cuts for the highest-earning Americans would be analogous to “borrowing hundreds of billions of dollars from our children.”¹

Some contend that EGTRRA and JGTRRA have had broader impact. The Tax Foundation (a non-partisan Washington D.C. think tank which often criticizes tax policy) claims that the Bush-era tax cuts have saved the median U.S. family of four about \$2,200 per year.²

However, an August Gallup poll indicated that only 37% of Americans wanted to keep the 2001 and 2003 tax cuts in place for all taxpayers. A plurality (44%) wanted to end them for those earning above \$250,000, and 15% wanted them gone altogether. In partisan terms, 60% of the Democrats polled favored extending the cuts for all but the wealthiest Americans; 54% of Republicans polled wanted them retained for everyone.³

Offering tax breaks for capital spending and R&D. President Obama wants to allow businesses to write off 100% of their investment costs through 2011. He also wants to bring back the research tax credit for businesses – it would be expanded and made permanent.

What would a 100% expensing credit do for the business sector? On the right, Harvard economist Greg Mankiw calls it a “good idea” yet feels “the impact will be relatively modest.” In his view, this tax break amounts to “a zero-interest loan if [companies] invest in equipment. But with interest rates near zero anyway, the value of the loan is not that great.” On the left, UC Berkeley economist (and former Labor Secretary) Robert Reich thinks that “the economy needs two whopping corporate tax cuts right now as much as someone with a serious heart condition needs Botox. The reason businesses aren’t investing in new plant and equipment has nothing to do with the cost of capital. It’s because they don’t need the additional capacity.”⁴

Historically, the R&D tax credit has favored larger companies with long track records in research rather than smaller firms. Since 1981, Congress has allowed the R&D credit to sunset 13

times – it expired again at the end of last year. In the Obama proposal, the most popular R&D tax credit offered to businesses would rise to 17% from 14%. Many Silicon Valley firms and biomedical firms would love any break they can get – R&D credits in India, China and Brazil are all greater than in the U.S., and France's R&D tax credit is six times more generous than ours.⁵

Infrastructure projects to provide added stimulus. The President also wants to devote another \$50 billion to infrastructure spending on roads, railroads and airports. The money would be used to repair 150,000 miles of highways and 4,000 miles of railways, among other uses.⁶ Some transportation industry analysts see it as merely a drop in the bucket – but also possibly a step toward the creation of a national infrastructural fund.

What might the effect be? Moody's Analytics chief economist Mark Zandi thinks the proposed tax breaks would be “helpful but they're not going to jump start the economy, at least not in the next six to twelve months.” Interviewed by CNN, Zandi noted that “Investment spending has picked up very nicely, that's not the problem. The problem is a lack of hiring.”⁷

David Rosenberg, chief economist at investment bank Gluskin Sheff, is one voice more skeptical about the business tax breaks. He notes that “We already have business spending running at its fastest rate in three decades ... how ridiculous is it for the government to be targeting tax relief to the one part of the economy that needs it the least?”⁷

Standard & Poor's chief economist David Wyss feels that any new government stimulus is better than none, saying that “going cold turkey” in 2010 would severely damage growth.⁷ The debate on Capitol Hill over these tax initiatives will likely amplify as we head into fall.

Citations.

1 – foxbusiness.com/markets/2010/09/09/treasury-secretary-geithner-urges-approval-economic-tax-package/ [9/9/10]

2 – boston.com/business/personalfinance/managingyourmoney/archives/2010/09/expiring_bush_t.html [9/10/10]

3 – theatlantic.com/business/archive/2010/09/59-of-americans-want-to-mess-with-bush-tax-cuts/62779/ [9/10/10]

4 – economix.blogs.nytimes.com/2010/09/07/reactions-to-obamas-business-tax-write-off-proposals/ [9/10/10]

5 – mercurynews.com/politics-government/ci_15990903 [9/5/10]

6 – newsweek.com/blogs/the-gaggle/2010/09/08/does-obama-s-infrastructure-proposal-have-the-right-priorities.html [9/8/10]

7 – money.cnn.com/2010/09/07/news/economy/obama_proposal_react/ [9/7/10]