THE WASHINGTON SHELL GAME of TAX REFORM

By Troy Anderson

In the recent release of his proposed budget, President Obama called for an overhaul of the nation's 74,000-page tax code.

Speaking at the White House, Obama claimed that his $3.8 trillion budget—a gargantuan spending plan that *Forbes* magazine called the "highest government spending in world history"—would cut tax rates and simplify the byzantine tax system while generating additional revenue to help reduce government borrowing.

Obama's Proposal

Today's tax code, Obama said, has become overly complex and inequitable. His 2013–14 budget offers detailed proposals to "broaden the tax base, close tax loopholes and establish a Buffet Rule that will prevent millionaires from taking advantage of special provisions to pay taxes at lower rates than many middle-income families do."

"My budget will reduce our deficits not with aimless, reckless spending cuts that hurt students and seniors and middle-class families, but through the balanced approach that the American people prefer, and the investments that a growing economy demands," Obama said.

"And we'll enact commonsense tax reform that includes closing wasteful tax loopholes for the wealthy and well-connected—loopholes like the ones that can allow a billionaire to pay a lower tax rate than his or her secretary."

In reality, though, the budget would raise taxes by $1.1 trillion over the next decade through increased levies on the wealthy and corporations. The proposed budget also includes an increase in the federal tax on cigarettes, from $1.01 a pack to $1.95, raising $78 billion to pay for preschool programs. The plan includes $580 billion in tax increases to help reduce government borrowing and $400 billion in additional tax increases to pay for more spending.

Skepticism About Tax Reform

Although Obama hopes his tax-reform proposal will gain momentum, business and tax experts told *NBIZ Magazine* that they are skeptical. They say an overhaul of the tax code will face many obstacles, although they concede that congressional interest is growing to take some action.

"I've heard about (tax reform) for 35 years, ever since I've been a tax professional, and it is unlikely it will happen," says Stewart A. Feldman, a founding partner of the Houston-based The Feldman Law Firm, a tax and corporate law firm for closely held businesses. "The tax system is a very complicated system. Not only have people made investment decisions based on it, but there are also many vested interests. You can tweak at the edges of it, but doing something that goes to the heart of the system is very doubtful. There is no consensus as to what the new system would be, let alone the adverse effects it would have on all the people who have based their economic lives on the current tax system. I think this is more of an intellectual discussion than a substantive exercise."

However, Katie Vlietstra, director of government relations for The National Association for the Self-Employed, the nation's leading resource for America's 22 million self-employed and micro-businesses, is more upbeat. She hopes Obama's proposed tax reforms will help energize a movement in Congress to enact comprehensive tax reform. Vlietstra says she could not agree more with the president's proposal to make the tax code simpler and fairer.

"But the sad reality is, our tax code is unfair for the millions of small businesses that want to grow and expand their small businesses, and even more deterring for those who want to open their own small businesses," Vlietstra says. "While job creation and closing loopholes are important, just as essential is creating the environment for new and existing small businesses to thrive without a paper trail of unnecessary and complex requirements."

Unlikely to Get Approval

Business and economic experts told *NBIZ Magazine* that Obama's proposed budget is unlikely to get approval in a Congress where GOP lawmakers—who hope to take control of Congress and the White House in the next two elections—are vigorously opposed to any additional tax increases.

"I don't think this budget will have any impact on the economy because [it] won't get adopted by Congress," says Curtis Dubay, a senior tax policy analyst at The Heritage Foundation in Washington, D.C. "If it was approved, I think that would be a big mistake, because it would have an undoubtedly large, negative impact on growth and job creation.

"President Obama's budget is dead in the water—all the policies, but especially the tax policies. But what could move forward is corporate tax reform. He's in favor of corporate tax reform, and Congress may pick it up from there."

Passed in January, the **TAXPAYER RELIEF ACT OF 2012** extends certain tax cuts—temporarily averting the "fiscal cliff"—while increasing taxes on high-income taxpayers. The tax is expected to generate $620 billion in revenues over the next decade.

Impact on Texas

In terms of the impact on Texas, Alan Viard, a resident scholar at the American Enterprise Institute in Washington, D.C., says the president's budget contains proposals to abolish a number of oil, gas, and coal tax breaks.

"Under the current system, big oil companies don't get some of those tax breaks, or only get them in very restricted forms," Viard says. "While small oil companies get a full range of tax breaks, the president is proposing to abolish them. This would hit more severely on small oil drillers because they are getting these tax breaks today."

While uncertainty surrounds tax reform and Obama's budget seems unlikely to garner congressional approval as proposed, experts say two other tax hikes—the Taxpayer Relief Act of 2012 and the Patient Protection and Affordable Care Act—are already having significant impacts on businesses in Texas and throughout the nation.

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The largest tax increase contained in the act involves the expiration of the payroll tax cut. The payroll tax cut reduced the Social Security portion of the payroll tax from 6.2 percent to 4.2 percent for workers in 2011 and 2012. Its expiration will raise revenues by more than $1.6 trillion over the next decade, primarily from middle-class families, according to an issue brief, "Fiscal Cliff Deal: Tax Increases Spoils Permanent Victory for Most Taxpayers," written by Dubay.

The act allowed the top marginal income-tax rate to rise from 35 percent to 39.6 percent for families with taxable income over $450,000 and single filers with taxable income over $400,000.

As part of the measure, individuals with incomes exceeding $250,000 or married couples making more than $300,000 will see a phase-out of personal exemptions and certain itemized deductions. The deal allowed tax rates on capital gains and dividends to increase from 15 percent to 20 percent for families with taxable incomes over $450,000 and singles with taxable incomes over $400,000.

Affordable Care Act

The Affordable Care Act, or Obamacare, raises taxes even more. It levies a 3.8 percent surtax on capital gains and dividends for family incomes over $250,000 and single persons' incomes over $200,000, starting this year. It also applies to interest income and some passive business income, Viard says.

The "fiscal cliff" deal allowed the death tax rate to rise from 35 percent to 40 percent but kept the exemption amount above $5 million ($10 million for married couples) and indexed it for inflation.

"I think taxpayers are just really beginning [to be] at the very early stages of seeing what the effects are going to be," Feldman says. "I don't think it's really going to come home to roost until there is a withholding tax paid on the investment income or excess earnings."

Meanwhile, experts say Obamacare will raise taxes by $1 trillion over the next decade. The law goes into effect on January 1, 2014. Under Obamacare, all U.S. citizens are required to have health insurance, either through their employer or by purchasing it directly from the government. People who don't have it by 2016 face a penalty amounting to either 2.5 percent of a person's taxable income or approximately $2,000 per family, depending on their income.

Open enrollment begins October 1, and businesses with 50 or more "full-time" employees (those working more than 30 hours per week) must offer health benefits to staffers by January 1, 2014 or pay a $2,000 per-worker penalty.

"Three years after the Affordable Care Act passed, it's proved to be neither affordable nor caring," Senator Ted Cruz (R-TX) wrote in a recent opinion article posted on his website. "Insurance premiums are skyrocketing. Seniors are losing healthcare choices. Millions of Americans are being pushed into a struggling and ineffective Medicare system. Americans are grappling with scores of new taxes. Employers are slashing jobs and hours to avoid complying with Obamacare requirements.

"This isn't what was promised. Americans were told if Obamacare was made law, they would be able to keep their health plans, taxes wouldn't go up, premiums would go down, and more jobs would be created. But the law isn't living up to its label. And it's hurting working families, young people, poor minorities and seniors the most."

John Lumley, the Houston Area Manager of SOI, a professional employer organization, says Obamacare will have several impacts on businesses. First, Lumley says, businesses with less than 50 full-time employees will experience a reduction in the number of health plans available to their employees because the act eliminates the high-deductible plans that allowed some employers to offer health insurance with relatively low monthly premiums.

"Some of those plans that have $7,000 or $10,000 deductibles are going to go away," Lumley says. "The other thing for small businesses that have a benefits program in place is that they will probably see an increase in premiums. Depending on who you talk to, they could see anywhere from a 10 percent to a 100 percent increase in their premiums. Nobody is sure right now exactly what is going to happen. We're kind of in a wait-and-see mode."

Meanwhile, businesses with 50 or more full-time employees will have to decide whether to offer the insurance or pay the $2,000 per employee penalty.

In Texas, Lumley says he doesn't expect many companies to resort to laying off employees to get below the 50 full-time employee threshold. "I don't see the Texas economy being hit that hard," Lumley says. "The economy is so strong in Texas that I don't think it will have that much of an impact. Other places in the nation where there are more stringent regulations, like California, will take a hit, but the Texas economy is pretty strong and should be able to weather this."

THE AFFORDABLE CARE ACT, OR OBAMACARE, raises taxes even more. It levies a 3.8 percent surtax on capital gains and dividends for family incomes over $250,000 and single persons' incomes over $200,000, starting this year.

But Ben Keel, Jr., president of Financial and Insurance Consultants in Katy, Texas, says Obamacare is a "train wreck waiting to happen." "It's something that is going to be very detrimental to American businesses, and it's already being detrimental to American businesses," Keel says.

Craig Splawn, president of the Houston Association of Health Underwriters, says the act doesn't address the main factors driving up healthcare costs. "It's designed to fail," Splawn says. "There is a high possibility we'll have more uninsured people than we currently do, which will just implode the whole system."

Keel says the system is set up to generate so many crises that "the government will have to come in and say, 'We are taking over.'When the government takes over, we'll have socialized medicine, which has just about bankrupted every country that ever developed socialized medicine," Keel notes.

Dubay says Obamacare is going to be "[as] painful as the fiscal cliff tax increase." "It's going to lessen investment throughout the economy, which means businesses will hire fewer workers and pay their existing workers less," Dubay says.

As businesses prepare for Obamacare and a spate of new taxes, Vlietstra says there is a growing momentum in Washington, D.C. to explore tax reform.

The Heated Discussion: Tax Reform

"There are some great conversations in both houses about full, comprehensive tax reform, which I think is an avenue that both Republicans and Democrats need to explore and really walk down the path to look at changing our entire tax code," Vlietstra says. "If we had true, comprehensive reform of our tax code, we would see a more prosperous country and government."

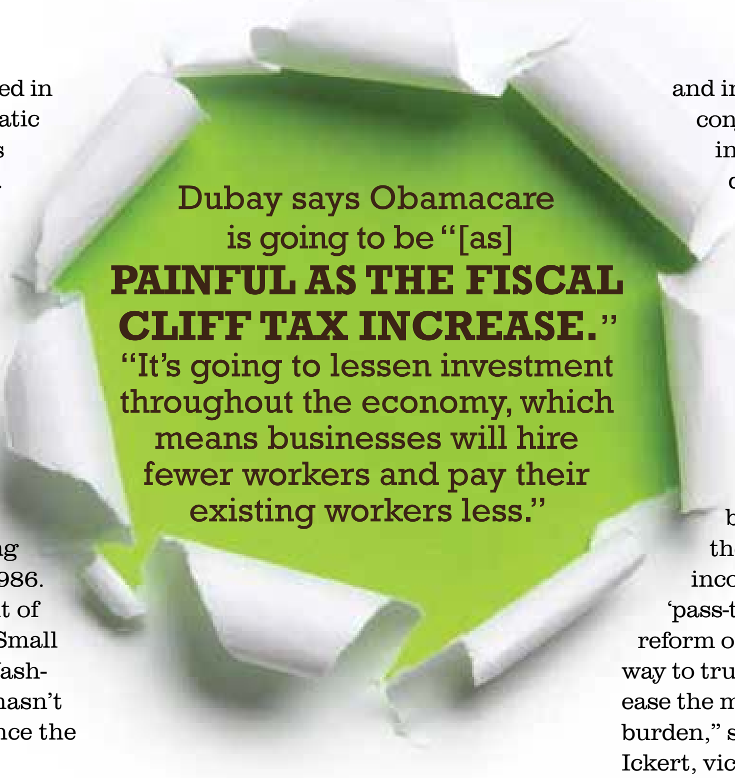
One of the efforts gaining the most traction is TaxReform.org, a website dedicated to obtaining input from the American public on tax reform. House Ways and Means Committee Chairman Dave Camp (R-MI) and Senate Finance Committee Chairman Max Baucus (D-MT) teamed up to launch the website. In the last two years, Camp and Baucus have held more than 50 hearings and heard from hundreds of experts on how to fix the tax code "to make it simpler and fairer and to help spark a more prosperous economy."

"The tax code is littered with special-interest provisions that Washington has put in over the last 27 years," Camp said in a prepared statement. "It is time to go line by line through the tax code and clean it up. There is no reason Americans should have to spend over 6 billion hours and over $160 billion every year just trying to comply with the tax code.

"Chairman Baucus and I believe in a tax code that is more effective and efficient. A simpler, fairer tax code will help families, and it will strengthen our economy. But Washington doesn't have all the answers. That is why we are joining together in a non-partisan way to invite you to weigh in on this debate."

The initiative is based on the efforts of former Ways and Means Chairman Dan Rostenkowski (D-IL), to engage the public in the last successful overhaul of the U.S. tax code, which occurred in 1985. He delivered the Democratic response to President Reagan's national address on tax reform. He used his speech, which drew immediate praise, as an opportunity to launch the Write Rosty campaign, calling on Americans to send his Capitol Hill office letters of support for a tax-reform plan that would make the system simpler and fairer. As a result, he received more than 75,000 letters from the public in support of tax reform, helping lead to the Tax Reform Act of 1986.

Todd McCracken, president of the 65,000-member National Small Business Administration in Washington, D.C., says tax reform hasn't gotten this much attention since the Write Rosty campaign.



"On the House side, Chairman Camp has put together a series of working groups," McCracken says. "We participated in some of their outreach sessions. He's been working with Chairman Baucus in the Senate. They are both really upbeat about their chance of doing something. Whether it will be as sweeping as small businesses may want remains to be seen, but I think they will make some headway in simplification."

A recent survey by the NSBA found that complexity and inconsistency within the tax code continues to be a major problem for small businesses, and that one in four small businesses report spending 120 hours or more per year doing federal taxes.

The overwhelming majority of small-business owners support broad reform of the federal tax code—corporate and individual tax reform, in conjunction with a reduction in business and individual deductions. Reducing the deficit is another key issue for small businesses, and the number-one method that 82 percent of small businesses support is tax reform—creating economic growth and generating more federal tax revenues.

"Given that the overwhelming majority of small businesses pay taxes on their business at the personal income level, or are so-called 'pass-through' entities, a broad reform of our tax system is the best way to truly help small business and ease the massive and growing tax burden," says NSBA Chair David Ickert, vice president of finance at Air Tractor, Inc. in Olney, Texas. N

An award-winning journalist at the Los Angeles Daily News, *the* Press-Enterprise *and other newspapers for 20 years, Troy Anderson writes for Reuters, Newsmax,* Christianity Today, Bankrate Insurance *and many other magazines and online publications. He lives in southern California. For more information, visit www.troyandersonwriter.com.*