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Bush Administration Releases Proposed Budget, Tax Plan

On February 2, 2004, President Bush sent Congress a $2.4 trillion budget for fiscal year 2005 that he said reflected his national priorities - tax cuts, homeland security and generating long-term economic growth. The budget, if passed, would result in record deficits for the federal government. The budget plan includes a 10% increase in homeland security spending, a 7% increase in defense spending and a 0.5% increase in other domestic spending programs. The budget projections assume that there will be a 13% increase in taxes and fees over fiscal year 2004. The election year budget does not include any projections for the war in Iraq, although the administration may need to request as much as $50 billion for the war.

Below is a summary of some of the provisions included in the proposed budget:

- **Extend certain 2001 and 2003 tax cuts through 2010** - The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), which is effective until December 31, 2010, phased in tax cuts through 2010. The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) accelerated some of the EGTRRA tax cuts for 2003 and 2004, including changes in the child tax credit, the marriage penalty and the 10% income tax bracket for individuals. The budget proposal would extend certain provisions of JGTRRA through 2010, rather than returning to the original EGTRRA provisions in 2005.

- **Make certain 2001 and 2003 tax cuts permanent** - Additional tax cuts made in 2001 and 2003 are scheduled to "sunset", or expire, unless they are extended by further legislation. The President's budget proposal seeks to extend tax cuts in the dividend tax rate, the capital gains tax rate, expensing for small businesses, as well as repeal of the estate and generation-skipping transfer taxes. Since these tax cuts are the most expensive part of the President's budget, this proposal will likely result in a contentious debate in Congress.

- **Savings/Retirement Accounts** - The President's plan reintroduces the proposed creation of three new savings vehicles - Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs) and Employer Retirement Savings Accounts (ERSAs). LSAs and RSAs, which could be used for a variety of reasons, would allow for annual contributions to a personal savings account of up to $5,000 (down from $7,500 in last year's budget proposal). Distributions from LSAs can be made at any time for purposes such as health care, emergencies or education, while distributions from RSAs cannot be made prior to age 58.. These accounts would allow people to consolidate all types of existing individual retirement accounts (IRAs) into a single format, similar to the provisions of Roth IRAs.

  ERSAs would consolidate 401(k) plans, 403(b) plans, governmental 457(b) plans, SARSEPs and SIMPLE IRAs into a single retirement account that could be sponsored by any employer. ERSAs would generally follow the existing rules for 401(k) plans but the "top heavy" rules would be eliminated and the nondiscrimination test would be simplified. The maximum total annual contribution to ERSAs would be the lesser of 100% of compensation or $41,000.

The budget also includes the proposal of a new savings initiative for low-income individuals called Individual Development Accounts (IDAs). IDAs have income limitations and would provide full matching contributions for up to $500 per year. Sponsoring financial institutions would receive a tax credit for their matching contributions to IDAs.

▪ **Charitable Giving Incentives** - The proposed budget also includes several familiar charitable giving incentives that have been included in the CARE Act. Separate versions of the CARE Act passed the House and Senate in 2003 but they were unable to reconcile the differences between the two versions. The budget has a provision that would extend the income tax charitable deduction to taxpayers who do not itemize their deductions (up to a $250 deduction for single taxpayers and $500 for married couples). Another familiar proposal is tax-free withdrawals from IRAs for charitable contributions. Taxpayers could exclude from gross income distributions made after age 65 from a traditional or Roth IRA directly to a charity. However, unlike the CARE Act, the budget proposal would not allow the income exclusion for gifts from IRAs to a split-interest entity such as a charitable remainder trust, a charitable gift annuity or a pooled income fund. The charitable giving incentives carry a price tag of approximately $18.5 billion over the next ten years.

Republicans in Congress generally support the tax cuts and the defense spending in the president's budget. Although some Democrats in Congress have called for a rollback of the 2001 and 2003 tax cuts, since it is an election year it is unlikely that they will make such a proposal. However, it may be difficult to get many of the budget proposals passed, particularly in the Senate, due to the looming federal budget deficit.

The budget does not include a fix for a tax glitch created by the Alternative Minimum Tax (AMT). Although the AMT was originally targeted at high-income taxpayers, it has not been indexed for inflation and has been affecting a greater number of middle class taxpayers in recent years. Estimates for fixing the AMT problem have run as high as $500 billion. Also missing from the proposed budget was funding for certain projects favored by President Bush such as missile defense, an expanded space program, and the partial privatization of Social Security.

Senate Finance Committee Approves COLI Provision

The Senate Finance Committee has approved the COLI proposal that had been recently circulated by Committee Chairman Senator Grassley's staff. (For a full description of the Chairman's proposal, see the February 2, 2004 edition of *Central Intelligence*). The COLI proposal was an alternative to amendments proposed by Senator Jeff Bingaman (D-NM) and is supported by the life insurance industry as a more reasonable proposal that would address some of the recent concerns over COLI but also preserve its benefits. Under the Chairman's proposal, a death benefit paid under a COLI contract would not be taxable if the insured was an employee within 12 months of death, benefits were payable to the employee's family, beneficiary, trust or estate, benefits were used to purchase an equity interest in the employer (such as a buy-sell arrangement) or the insured employee was a key person of the company.

The modified COLI proposal has been incorporated into the National Employee Savings and Trust Equity Guarantee Act of 2003 (known as NESTEG). The Committee also extended the effective date of the nonqualified deferred compensation provisions in the legislation to December 31, 2004 (from the date of enactment in the original proposal).

The Senate Finance Committee approved the provisions included in the Chairman's proposal on providing notice to employees of life insurance in advance of policy issuance and notification to the IRS regarding employee consents to life insurance. The committee defeated an amendment that would have required employers to notify the IRS of a breakdown of the size of the COLI policies held by the employer. Senator Bingaman introduced, but then withdrew, an amendment that would have prohibited an employer from retaliating against an employee for refusing to give consent to COLI coverage. Other committee members questioned the need for the proposed anti-retaliation provision.