Washington Update

FTA Revenue Estimating and Tax Research Conference
Minneapolis, Minnesota
September 24, 2001

Purpose

• Review legislation affecting state tax authority
• Review major elements of recent federal tax bill and issues for states
• Overview fiscal conditions and implications for states
ITFA/E-commerce Legislation

- Cox bills - Straight extension/permanent moratorium; repeal grandfather
- Dorgan et al. - S. 512 - Extend ITFA, set simplification standards, procedure for fast track approval of collection authority
- Wyden/Leahy - S. 288 - Extend IFTA, require BAT nexus standards, simplification standards, no fast-track

Legislation [Cont.]

- BAT Nexus Bills - Gregg/Kohl (S. 664) and Goodlatte/Boucher (HR 2526)
  - Establish “substantial physical presence” standard (G/K also sales tax)
  - Establish carve-outs that are not “substantial physical presence”
- Conyers (HR 1697) 4-R protection for broadband providers
State of Play

• House - Leadership committed to ITFA extension; interested in BAT nexus; uncertainty regarding strength of conviction among membership
• Senate - Good support for Dorgan bill with ultimate congressional review before authorization; mixed bag on BAT

Outlook

• Congress working on seriously shortened and focused agenda
• ITFA is not on agenda
• Concern that ‘rapacious’ states will attack Internet with new taxes
• Issues may indeed ‘go quietly into that good night’ for this year
• BAT and sales tax likely to arise again; sales tax timing is ours
• Alternative scenario is straight, short-term (18-24 months) extension
States need to …

- Sharpen understanding of BAT issue among delegation
- Develop understanding/projection of the impact on state
- Strengthen positive approach on dialogue, etc. to resolve issues

Major Pieces

- Marginal rate reductions
  - New 10 percent bracket
  - Drop others over time
  - Repeal “Pease” and “PEP”
- Marriage penalty relief
  - Standard deduction increase
  - Increase width of 15 percent
  - Begin in 2005
Major Pieces [Cont.]

• Tax benefits relating to children
  – Increase child credit
  – Adoption assistance
  – Dependent care credit
• Education incentives
  – Expand Education IRAs
  – Above the line deduction for four years
  – Other stuff

Major Pieces [Cont.]

• Retirement and pension provisions
  – Increase elective deferrals
  – IRA tax credit
  – Increase IRA contributions
• Phase-out of the estate tax
  – Increase unified exemption
  – Phase down rates
  – Step up basis limited
  – Repeal estate (not gift) tax in 2010
  – Phase-out state death tax credit
State Death Tax Credit

- Credit calculation remains the same
- Amount allowed is reduced by 25% in 2002; 50% in 2003, 75% in 2004 and 100% in 2005
- Effect is to reduce state revenues in pick-up tax states; shift revenue to federal government
- Some movement to not conform to change -- leave at amount computed

Distribution of Cuts

- Rate Cuts
- Child Prefs
- Education
- Marriage Penalty
- Retirement
- Estate
Issues for States

- Quite Modest
- Estate tax
  - $50 to $75 billion over 10 years
- Base reductions
  - Higher education deduction
  - IRA expansions
  - Elective deferral expansions
  - Education IRAs

Federal Issues - Pre-downturn

- Total sunset in 2010
- Intermittent sunsets
  - Education deduction
  - IRA credit
- AMT Relief
  - Number triples; $300 billion
- Other relief ‘requirements’
- Current surplus minus tax cut minus additional spending minus interest cost equals non-trust fund deficit
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Post-Downturn/Pre-attack

- Softening economy reduces receipts by $40 billion in 2002
- Absolutely NO non-Social Security money for
  - More spending
  - Education and defense
  - Tax cuts
- Political spotlight on Social Security surplus and the proverbial “lockbox”
- Terrible predicament for both sides

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Post-Attack Outlook

- Near-term economic deterioration
- International threat to nation
- Lockbox pressure is off
  - Respond to terrorist threat
  - Meet critical national needs
  - Economic stimulus seems important
- Huge constraints removed
  - Will choices be made
  - What choices will be made
Congressional Agenda

- Want to be home within one month
- Seriously curbed/focused agenda
  - Response to attacks -- Fiscal and legislative
  - Finish FY 2002 appropriations bills
  - Airline industry assistance
  - Education bill
  - Economic stimulus

Stimulus Package

- Spending component
- Tax component
  - Capital gains
  - Rates/rebates
  - Accelerated depreciation
  - Energy provisions
  - Corporate reductions
- Not a lock-cinch
  - Disagreement on need
  - Disagreement on tools
Issues for States

- Some potential “good news”
  - Bad things may not happen
  - ITFA-related bills could be left untouched
- Stimulus package has some risk
  - Efforts aimed at promoting investment could affect state tax bases
  - Unintended “bad things” could happen if state issues sacrificed to “national need”

Conclusion

- Tax bill was a HUGE deal
- Impact on states is relatively modest, but terribly ill-timed
- Real issues are at federal level
  - Removed fiscal flexibility
  - Exacerbated by economic downturn and attack
  - Long-term economic outlook and unmet needs could occasion debate on wisdom of out-years
  - Debate on role and size of government
- Contentious period forthcoming