

designed to get taxpayers through a particularly difficult period – such as the expiring extender dealing with mortgage forgiveness. Enacted at the end of 2007 in response to turmoil in the housing market, this provision was designed to help borrowers who were underwater with their home mortgages: previously, if a lender foreclosed on a home and sold it for less than the outstanding indebtedness, the forgiveness of the unpaid balance generated taxable income for the borrower, as did a renegotiated mortgage that reduced the outstanding indebtedness. Under this temporary provision, that forgiveness is not considered income – a welcome result for taxpayers in this unhappy situation.

Yet what about temporary provisions that promote favored tax policies but that don't respond to a particular situation? If they're such a good idea, why not make them permanent? This gets to a basic reality: permanent provisions are more costly than temporary ones. That is because the Joint Committee on Taxation must use a current law "baseline" when it estimates the revenue impact of tax legislation. Such a baseline assumes that a temporary measure, such as the mortgage forgiveness mentioned above, generates only a short-term revenue loss, and will expire as scheduled – even if that is unlikely to occur. This means that such measures can paint a rosier fiscal picture than is perhaps justified, and can therefore be a more "cost-effective" way to continue desired tax benefits (and policies), regardless of how inefficient and counter-productive the resulting uncertainty may be.

These current expiring extenders seem likely to languish – at least for a bit, especially considering that the House has already recessed for the year. Although Congress has often renewed expiring provisions retroactively, such a move early next year could take some of the steam out of tax reform (assuming it has a chance). In addition, despite how inherently worthy these expiring provisions may be, Congress is under less pressure to pass extenders legislation because of the American Taxpayer Relief Act of 2012 (ATRA) (Pub. L. 112-240). That is, in addition to making most of the 2001 and 2003 tax cuts permanent, ATRA, which was enacted on January 2, 2013, made the "granddaddy" of extenders permanent, by permanently indexing the AMT exemption for inflation, thereby permanently sparing over 25+ million taxpayers from the AMT, as opposed to the "mere" 4+ million currently affected by it (recall that the earliest incarnation of the AMT in the late 1960's was in response to 155 taxpayers who paid no income tax through use of permissible credits and deductions).

Tax reform – and extenders – are thus moving targets. Even though Rep. Camp and Sen. Baucus, along with others in Congress, say they would like to address tax reform in 2014, that is a tall order: not only will members of Congress soon be pre-occupied with the November mid-term elections, there is also that small matter of the philosophical divide between Republicans and Democrats – Republicans want tax reform to be revenue-neutral, while Democrats want higher taxes on the top 1% to 2% of taxpayers. Finally, the latest fly in the ointment is that Sen. Baucus, who is not running for re-election in 2014, reportedly will be nominated as the next ambassador to China – meaning that he will not complete his final term in office, assuming he is confirmed. Does this take additional momentum away from the prospect of tax reform in 2014? Arguably yes, although Sen. Ron Wyden (D-OR), who could be Sen. Baucus's successor as Chairman of the Senate Finance Committee, is also interested in tax reform and has previously put forth bipartisan tax reform proposals. It will be interesting to see what develops.

End of the year recap

With the end of 2013 upon us, we wanted to highlight a few of the tax and political developments that stood out to us this year, and that have long-term implications:

ATRA. As mentioned above, the American Taxpayer Relief Act (ATRA) made the AMT "patch" and most of the 2001 and 2003 tax cuts permanent. It also raised taxes on the top 1% to 2% of taxpayers, in part, by bringing back the top income tax rate of 39.6% and, for those at that rate, the 20% rate on qualified dividends and most long-term capital gains. In addition, ATRA reinstated the personal exemption phase-out and what is generally a 3% limitation on itemized deductions, such as for mortgage interest, state and local