THE SMALL BUSINESS LEGISLATIVE COUNCIL REPORT

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On February 2, 2015, President Obama released his proposed federal budget for fiscal year 2016 (which will commence on October 1, 2015). Every year the President is obligated by statute to submit his budget proposal to Congress by the first Monday in February (though there are no penalties for missing this deadline). While Congress is under no formal obligation to consider the President's budget, the President's budget will inevitably have a significant impact on the upcoming budget and tax reform debates. This year, the impact of the President's budget proposal may also carry into the debates leading up to the 2016 presidential elections.

President Obama's 2016 budget spans 2,000 pages and calls for approximately $4 trillion in spending. Most of the key provisions in the proposal come as no surprise as the White House previewed the vast majority of them during or surrounding the State of the Union.

Some of the most significant new expenditures in the President's budget include:

- Funding targeted at expanding the availability of early child care, including tripling the child care tax credit for certain families with children under 5, increasing funding for Head Start and funding expanded access to preschool for low and middle income families.

- Funding targeted at increasing the affordability of higher education, including providing free community college, expanding Pell Grants, managing student loan debt and modifying existing education related tax credits.

- Establishing a second earner tax credit for families in which both spouses work.

- Investing $478 billion in a six year surface transportation reauthorization proposal. This provision in particular would be funded by changing the manner in which companies are required to pay taxes on overseas earnings.

- Establishing or increasing funding for various international efforts including, the fight against ISIL, the response to Russian aggression, protecting the nation against foreign cyber threats and combating the international spread of infectious diseases.

- Increased funding for research and development.

Additionally, what is sure to be of interest to small businesses, the President's budget includes:

- Funding to encourage states to establish paid family leave programs (i.e. encouraging more states to enact laws like California, New Jersey and Rhode Island which require private employers to provide paid sick leave).

- Funding to "expand retirement savings options" which would include requiring that certain part time employees be offered the opportunity to participate in an employer sponsored retirement plan and providing funding to allow states to implement State-based automatic enrollment IRAs or 401(k)s for employees who are not offered plans by their employer. How much these proposals would cost small businesses if enacted would depend on the details which are not yet released. For instance, if small businesses are required to make 3% contributions (the so-called "top-heavy" contributions) to the part time employees who would become eligible under this proposal to participate in the plan, it will cost small businesses who sponsor retirement plans extra dollars. Similarly, many are opposed to the expansion of states into IRA plans and believe that all IRAs should be established in the private sector rather than through the government.

The Budget would also close a number of "inefficient, unintended, and unfair tax loopholes in the individual tax code." For example, it would end a loophole that lets some "high-paid professionals avoid Medicare and Social Security payroll taxes," costing almost $10 billion a year by the end of the decade. It seems likely that this is some variation on Chairman Camp's Sub-S proposal where 70% of the net income is automatically subject to payroll taxes.

In addition to the funds raised as a result of changes to the taxation of foreign corporate earnings (which, as noted above, the President would use to fund infrastructure investments), other key ways that the President would propose to pay for these new expenditures include:

- Eliminating the step-up in basis at death. With certain exceptions, this proposal would generally require that property given as a gift or transferred at an individual's death would be subject to capital gains taxes on the appreciation that occurred during the original owner's life. As we discussed at length in our last alert, this proposal could have a significant negative impact on small business owners, as well as many Americans who own appreciated assets. Some are now calling this proposal the new capital gains tax. As you may recall from the last Alert, the proposal calls for an exemption for "family owned and operated businesses" so that the tax on the capital gains would not be collected until the business was sold. For small businesses that are not family owned and operated, the proposal would allow the capital gains tax to be collected over 15 years. This will not provide much solace to a small business owner's family subject to a potentially large new tax with only $100,000 of gain sheltered under this new proposal.

- Increasing the top capital gains rates to 28% for "high-income earners".

- Imposing new fees on large financial firms.

Beyond the new expenditures and revenue raisers, the President's budget would also scale back a number of the cuts imposed by the sequester and purport to reduce the deficit by $1.8 trillion (primarily through health savings, tax reform and immigration reform).

As a whole, the President and the White House have framed the 2016 budget proposal as focusing on **"**Middle Class Economics" and showing "what we can do if we invest in America's future and commit to an economy that rewards hard work, generates rising incomes, and allows everyone to share in the prosperity of a growing America." Key Administration officials, including various Secretaries, will be carrying this message to the Hill in the coming weeks.

Even before the text of the budget itself was released, the Republicans had already begun to respond to the President's proposals. In a Meet the Press interview yesterday, Ways and Means Committee Chairman Paul Ryan (R-WI) stated that "[w]hat I think the president is trying to do here is to, again, exploit envy economics. This top-down redistribution doesn't work."

Chairman Ryan and his Republican colleagues on the Ways and Means Committee met at a three day retreat at the end of last week, with the goal of identifying and discussing the House Republican's approach to tax reform. As a result of these meetings, Chairman Ryan and his Republican committee members have indicated that they will focus on pursuing comprehensive tax reform (as opposed to simply corporate or other piecemeal tax reform).

It is clear from Chairman Ryan's comments on the President's budget that the Republicans on the Ways and Means Committee are likely to have very different ideas for tax reform than those which were offered as part of the President's budget. This comes as no surprise. The President's budget appeals to a number of Democratic priorities, including expenditures for education and working families, while taking aim at provisions, such as the step up in basis and capital gains rates, that the White House has framed as increasing taxes on the very wealthy (though as we discussed in our prior alert these provisions could also negatively impact middle class tax payers).

While most of the President's proposals do not have legs (particularly with the Republican controlled house and Senate), they are sure to be a source of debate in the coming weeks and months as both parties formalize and negotiate their visions for tax reform and spending.

UPCOMING EVENTS

February 9, 2015 – The SBLC will hold its Annual Meeting, which is open to members and guests, at the Willard Hotel in Washington, D.C. on February 9, 2015, at 11:00 a.m. Lunch will be included. We are so pleased to have **Preston Rutledge**, Republican Tax and Benefits Counsel for the Senate Finance Committee, as our keynote speaker. Mr. Rutledge has an in-depth understanding of the key tax issues facing our country today and because of his experience and his long-standing relationship with Senator Orrin Hatch will be able to give us his unique insights on what may or may not happen with tax legislation this year, including tax reform. **For more information or to reserve a seat, contact Erin McEvoy at emcevoy@paleyrothman.com or (301) 652-8302. Come join us for a great meeting at the Willard next Monday.**

March 19, 2015 – The SBLC will be hosting a webinar on tax reform at 2:00 p.m. on Thursday, March 19, 2015. This will be the first in a series of webinars in 2015 focused on important legislative and business issues.