

OCTOBER 31, 2005

NEWS: ANALYSIS & COMMENTARY

An Ugly Split Over Business Taxes

A Bush tax-reform commission could create big winners and bitter losers

President George W. Bush hopes to use tax reform to rally his base, revive his second term, and bury the idea that he's a lame duck. But if the White House follows the map drawn by Bush's tax-overhaul commission, the President could alienate everyone from corporate chieftains to real estate agents and suburban bankers.

The panel -- set to report on Nov. 1 -- will propose huge potential changes in the corporate income tax as well as the tax treatment of mortgage interest, health care, and retirement savings. That will cleave the business community down the middle, dividing CEOs into happy winners and bitter losers. "We're looking at corporate cannibalism," says a GOP business lobbyist. "This could get real ugly."

In theory, business likes lower tax rates and a simpler code -- key goals for the reform panel chaired by former Senators Connie Mack (R-Fla.) and John B. Breaux (D-La.). And high-paid executives will be glad to see the hated Alternative Minimum Tax disappear from their personal 1040 forms. But in practice every industry thrives on specific tax breaks, and corporate lobbyists get paid to defend those sacred cows, not principles of tax theory. Layer on the vast uncertainties of a tax transition, which could wipe out trillions in tax benefits that companies have stored on their books, and business may choose to just say no to any Bush tax plan.

Here are some of the flashpoints:

-- Either of the panel's two options -- a streamlined income tax or a consumption tax designed to promote savings -- would hit housing hard. Today homeowners use the mortgage-interest deduction to offset 35% of their interest for mortgages up to \$1 million. The proposal would let them offset only 15%, and only for mortgages up to \$312,000. Mortgage bankers, real estate agents, and builders of upper-bracket homes are rallying to defend the deduction.

-- Measures to boost savings via larger, streamlined tax-free accounts threaten the life insurance biz, which sells whole-life and annuity policies as tax-favored savings vehicles. Bigger individual retirement accounts and 401(k)s would

undercut those policies' steep fees. Insurers plan to fight back by arguing that their products promote badly needed long-term savings. "Not all savings are created equal," says an industry spokesman.

-- The panel's consumption-tax option would grant heavy industry its cherished goal -- the ability to write off all capital equipment in the year that it's purchased. But even that benefit comes with a big trade-off: Businesses wouldn't be allowed to deduct interest expenses. So big borrowers might be net losers -- particularly those in the service and technology industries that run more on brainpower than on heavy equipment and thus don't gain from immediate expensing.

-- In the transition to a new system, companies could lose some of the fortune in unused tax depreciation they're carrying -- a step that could force a major hit to earnings. Manufacturers, retailers, and service companies, whose books reflect years of carefully crafted tax planning, will fight to defend their breaks against a radically new tax regime.

The details of the commission's two plans could change before Nov. 1, and the Treasury Dept. is likely to sit on the proposals for months. Early next year the White House will decide which ideas to adopt, if any, for a tax overhaul plan Bush can embrace. Administration insiders are being extremely tight-lipped about their intentions. For now, says R. Bruce Josten, executive vice-president at the U.S. Chamber of Commerce, "this is a float-the-trial-balloon game."

It sure has gotten business' attention. Some of the industries with the most to lose were key supporters of Bush's big first-term tax victories. But those were tax cuts that gave everyone something. Tax reform, by contrast, will be a zero-sum game. Should Bush decide to play that game, he could find many of his usual business allies staring him down from the other side of the field.

By Howard Gleckman in Washington

Copyright 2005, by The McGraw-Hill Companies Inc. All rights reserved.