Let the Tax Debate Begin
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Just a couple of weeks ago, the smart money in financial circles was betting on a year of tax gridlock, punctuated by a bruising battle over the extension of the payroll tax cut.

Then, suddenly, everything turned around. Last Friday, a bipartisan House/Senate committee is expected to bless a new payroll tax cut extension that was negotiated without any of the bitter partisan posturing that everybody expected. The cut will reduce Social Security taxes from 6.2% of income to 4.2% for workers through December 31, and put up to $130 billion back into the pockets of lower- and middle-income workers.

The same bill extends unemployment benefits from 59 weeks to anywhere from 89 to 99 weeks, depending on the unemployment level in each state, and will require the recipients of unemployment insurance payments who have not finished high school to enroll in a GED program. States could also create voluntary training programs for those seeking jobless benefits.

In other provisions, doctors who treat Medicare patients would avoid seeing their payments cut. To partially offset the costs, federal workers would have to pay more into their pension plans, and $5 billion will be cut from the new health care law.

If you add the $100 billion that the measure will add to the deficit to the $1 trillion in government budget cuts that went into effect automatically, government expenditures will shrink by a net $900 billion this fiscal year.

Bigger picture, President Obama has released a new proposed budget which would, among other things, extend the Bush-era tax cuts for all but the top two brackets. The 33% and 35% marginal rates would go back to their pre-2001 levels of 36% and 39.6%. The budget proposal would also raise the long-term capital gains rate to 20% for single taxpayers with more than $200,000 a year in income, or married taxpayers filing jointly earning

$250,000 per year. For these same upper-income taxpayers, the tax rate on qualified dividends would revert to ordinary income rates--up to a maximum of 39.6%. For everyone else, dividends would still be taxed at a 15% or 0% rate, depending on the tax bracket.

The bill would create a permanent solution to the vexing Alternative Minimum Tax, essentially replacing its complex formulae with the so-called Buffett Rule, requiring any household earning more than $1 million a year to pay at least 30% of income in federal taxes.

Also: instead of allowing the current estate, gift and generation-skipping transfer tax rates to expire and default back to a $1 million exemption and 55% tax rate at the end of the year, the budget proposal would take the estate tax system back 2009 rates. That would give each spouse a $3.5 million estate tax and generation-skipping tax exemption to work under, a $1 million gift tax extension for each spouse, and a maximum 45% estate tax rate for amounts above these levels.

In all, the tax proposals are expected increase government receipts by an estimated $1.5 trillion over the next ten years.

The budget proposal virtually ensures that Congress will take up the extremely messy, highly-partisan issue of taxes during this election year, which may actually be good news for taxpayers. Without Congressional action, estate tax and income tax rates were due to revert back, as of January 1, 2013, to rates not seen in more than a decade.

If you have a lot of spare time, you can read the full text of the budget proposal here: http://www.whitehouse.gov/omb/budget/Overview, and if you're curious about historical tax rates every year going back to the very first income tax in 1913, you can find them here: http://www.taxfoundation.org/taxdata/show/151.html. What you'll find is that the only years when people earning over $1 million a year were able to pay less than a 30% federal tax rate were 1988-1989, 1925-1931, and 1913-1916.
Sources:

http://www.politico.com/news/stories/0212/72869.html