TrendMacrolytics

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On Tax Bill Progress

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Press reports circulated late yesterday that **House/Senate negotiators** have finally agreed on a **$70 billion tax reconciliation bill,** including a **two-year extension of the 2003 tax cuts on dividends and capital gains** and a **one-year extension of the Alternative Minimum Tax "patch."** This is all to the good. It confirms indications we've been getting from sources this week that a resolution is near at hand, and reinforces our continuing belief that this **growth-critical tax legislation** will be enacted. However, we caution against reading too much into these particular reports. Leaks to the press of progress in these negotiations are probably calculated to create a **demand effect** that will put pressure on the negotiators, and to provide a more favorable backdrop for a speech today by **the President** on the economy and taxes.

Sadly, last week's sticking points (see "On Another Tax Bill Breakdown" April 27, 2006) appear to be remain unresolved. While the contents of the **filibuster-proof** reconciliation bill seem to be settled, the exact contents of a companion bill -- encompassing all the provisions that couldn't be fit into reconciliation bill's $70 billion cap -- remain in dispute. And, reportedly, **Senate Finance Committee chair Chuck Grassley** is insisting that the companion bill be moved simultaneously with the reconciliation bill, while **House Ways and Means chair Bill Thomas** wants the reconciliation bill to move first, and on its own merits. The risk in Grassley's position is that the companion bill is not filibuster-proof in the Senate. So if the two bills are tied together, the reconciliation bill would effectively lose its filibuster-proof status.

And apparently Chuck Grassley continues to be unhelpful in the negotiating process (see "Tax Cut Rashomon" April 11, 2006). According to a ***Washington Post*** report, he missed a meeting at the **White House** to discuss the bills yesterday, making the lame excuse that he had "prior commitments with constituents."

BOTTOM LINE: We continue to believe that the 2003 tax cuts on dividends and capital gains and the AMT "patch" will be extended. And yesterday's reports confirm our earlier hopes that **pro-growth provisions** not included in earlier separate House and Senate versions of the bill will be included too -- **elimination on the income cap for Roth IRA conversions**, and a **higher cap on small business expensing**. But there is still considerable uncertainty. There's some **upside in stocks** to be captured if the tax bill passes, and that's where our bets are placed as negotiations move closer to the finish line. But the **downside** if it *doesn't* pass is significant, even though less likely. If the 2003 tax cuts aren't extended now, they never will be. Legislative failure would lead to the loss of the **Republican majority** in the House, and a series of automatic tax increases as the tax cuts of earlier years **sunset** out (see "High Noon" April 25, 2006). TM

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