

TRENDMACRO LIVE!

## On Extending the Tax Cuts: The Home Stretch

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The *Wall Street Journal* is reporting this morning that **House/Senate negotiators** have agreed on a **\$70 billion tax reconciliation bill**, including three important **pro-growth** provisions: a **two-year extension of the 2003 tax cuts on dividends and capital gains**, **one-year extension of the Alternative Minimum Tax "patch,"** and **lifting the income cap on Roth IRA conversions**. Sources in both houses of **Congress** confirm to us that this report is accurate, that a vote could come this week, and that **leadership** has lined up **sufficient votes** for passage under **filibuster-proof** reconciliation rules.

Last week the sticking point had been **Senate Finance Committee chair Chuck Grassley's** demand that a **second tax bill**, including as yet undetermined additional provisions -- including, potentially, a second year of extension of the AMT "patch" -- be moved at the same time (see ["On Tax Bill Progress"](#) May 3, 2006). Leadership has persuaded Grassley to drop this demand.

**BOTTOM LINE:** We continue to believe -- now more than ever -- that the 2003 tax cuts on dividends and capital gains and the AMT "patch" will be extended. We believe that this is substantially, although not entirely, discounted in the **stock market** -- indeed, it goes some distance to explain why stocks have done so well in the face of **higher interest rates**, **rising inflation expectations**, and **high energy prices** (see ["Extending Visibility"](#) February 17, 2006). Looking ahead, extending the 2003 tax cuts is a **necessary condition** -- though **not sufficient** -- for expecting the **Republican majority** to be returned in the **November elections**. With the extensions in place, the **GOP** will have an important **legislative victory** under its belt, and have redeemed an important pledge to its **base**. Thus the stock market can head into November with somewhat higher hopes that the **pro-growth consensus** -- the bulwark against **protectionism** and future automatic tax increases as tax cuts of the past sunset away -- will survive another election (see ["High Noon"](#) April 25, 2006). **TM**