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*Congress is in recess this week following the July 4<sup>th</sup> holiday (July 2—July 11). Prior to leaving Washington, lawmakers addressed—with limited success—many critical issues, including extensions of 2009 expiring tax provisions, extensions of emergency unemployment insurance, and financial regulatory reform. Without agreement on many of these high priority issues, there will be significant pressure on the Congress during the brief July work period to advance their agenda before again adjourning for the six-week August recess.*

*Looking ahead to the July work period, it is evident that the current environment will provide several challenges that could impede legislative activity. The current environment is one principally defined by election year politics and an increasingly worrisome fiscal outlook; the difficulties posed by this environment could create a scenario where several legislative priorities—such as middle-class tax cuts—may be delayed, while others—such as a reinstatement of the estate tax—may be left unaddressed altogether. Beyond the July work period, the revenue pressures will only mount, posing challenges for the life insurance industry and the tax treatment of its products. This bulletin provides a synopsis of recent developments surrounding tax and regulatory issues and provides an outlook for the remainder of the abbreviated Congressional calendar on issues of interest to AALU members and their clients.*

## **Summary of Recent Developments**

In what was a sobering end to the June work period, Senators paid their final respects to the late Senator Robert Byrd (D-WV)—the longest serving member in the history of the United States Congress—before adjourning on July 1. Prior to their adjournment, the Senate was at an impasse as Senate Democrats were unable pass a six-month extension of unemployment insurance benefits (S.A. 4425 to H.R. 4213), unable to complete consideration of a small business tax incentives and lending relief bill (S.A. 4402 to H.R. 5297, the “Small Business Jobs Act of 2010”; see our bulletin 10-68), and unable to corral sixty votes in support of the House-Senate conference report for H.R. 4173, the “Dodd-Frank Wall Street Reform and Consumer Protection Act.” This creates an extremely challenging landscape for Democratic leaders in the Senate, who had hoped to resolve these issues prior to the July 4 recess to clear floor time for other priorities before leaving for the remainder of the summer next month. These items range from immediate priorities such as re-considering the broad package of 2009 ‘tax extenders’ (H.R. 4213), addressing emergency supplemental spending for the Afghan war, and confirming Solicitor General Elena Kagan’s nomination to the Supreme Court, to the other important goals of bringing to the floor the House-passed campaign finance bill H.R. 5175 (the “DISCLOSE Act”), introducing energy and immigration legislation, and determining the best path forward for consideration of expiring 2001 (EGTRRA) and 2003 (JGTRRA) tax cuts, including estate and gift taxes, and the Alternative Minimum Tax (AMT).

Largely as a result of these delays, Congressional Democratic leaders have speculated that a decision on extending elements of the expiring 2001 and 2003 tax cuts—which ultimately may or may not include AMT relief and a reinstatement of the estate tax to 2009 levels—could be withheld until after the November elections and possibly even after the bipartisan “debt commission” (the National Commission on Fiscal Responsibility and Reform) has released its fiscal policy prescriptions for significantly reducing the deficit, due on Dec. 1.

The continuing Senate gridlock has only compounded the frustrations felt in the lower chamber. After passing more than 300 bills in the 111<sup>th</sup> Congress which have not been enacted by the Senate, House leaders are signaling their frustrations. In late June, House Majority Leader Steny Hoyer (D-MD) announced that the House would be adjourning for August recess at the end of July, a week earlier than was originally intended. This decision was partially based on the sentiment that the first week in August would be more beneficial for members if spent on the campaign trail, rather than remaining in Washington to consider legislation that House leaders are not confident will be enacted by the Senate.

In the June work period, House lawmakers did, however, acquiesce to the Senate on the enactment of the so-called ‘doc fix’ (H.R. 3962)—the six-month extension of delays to scheduled cuts in Medicare reimbursements for physicians, which was partially offset by single and multi-employer pension funding relief provisions (see our bulletin 10-64). After Senate passage of the measure on June 18, House Speaker Nancy Pelosi (D-CA) had initially opposed House consideration of the legislation on the grounds that the short-term extension was insufficient and that the excision of the ‘doc fix’ from the larger ‘tax extenders’ legislation threatened the ultimate passage of that bill. After the Senate again failed to end the debate on a pared-down version of the ‘tax extenders’ bill (S.A. 4386 to H.R. 4213) following eight weeks of floor consideration, House lawmakers begrudgingly moved to adopt the short-term ‘doc fix’.

In all likelihood, the legislative difficulties experienced in recent weeks will continue throughout the remainder of the year and are principally derived from the conflicts between the need to address our fiscal dilemma and the quandary posed by our slow economic recovery and desire among some Democratic policymakers and the Administration for continued fiscal stimulus measures.

## **Fiscal Concerns Deepen**

In late June, the Congressional Budget Office (CBO) released a comprehensive analysis of our long-term budget outlook. In assessing the impact of growing debt and deficits, the CBO poignantly stated that “growing debt would [also] reduce lawmakers’ ability to respond to economic downturns and other challenges.” While CBO’s assessment is made with the long-run in mind, this has clearly become true for this Congress. The focus on our rising national debt and budget deficits has gradually increased throughout the year and is now infiltrating the legislative process at nearly every turn. For example, Congress will not pass a FY 2011 budget resolution this year—the first time since the enactment of the Congressional Budget Act of 1974 that the House will not pass a budget resolution. Instead, the House narrowly passed a “budget enforcement resolution” on July 1, which sets limits on discretionary spending for FY 2011, but does not project long-term budget figures nor does it prescribe which fiscal policies should be implemented to reach short-term spending goals, as a traditional budget resolution would. The Senate Budget Committee did pass a more traditional five-year budget resolution, but it is doubtful that the full Senate will consider this plan.

The lack of political will to pass a Congressional budget resolution may be the most direct example of the depth of the concerns over our fiscal challenges, but these concerns have also been expressed over nearly every piece of legislation that has come before the Congress in recent weeks—highlighted by the 2009 ‘tax extenders’ package in the Senate, which in its most recent form would add roughly \$33B to the budget deficit, as well as a temporary extension of unemployment insurance benefits, which carries a similar cost of approximately \$34B. The latter was attempted to be moved in June—unsuccessfully—by Senate Democrats as un-offset emergency spending<sup>1</sup>.

Lawmakers are aiming to balance the threat of prolonged economic turmoil with the threats—social, economic, and political—that are associated with ballooning debt and deficits. CBO analysis underscores this challenging conflict by highlighting our ‘fiscal gap’. The fiscal gap measures federal shortfalls between spending and revenue and determines the magnitude of immediate fiscal policy actions needed to close the gap<sup>2</sup> (measured as a share of GDP). The CBO projects that if the federal government were to aim to close the fiscal gap in twenty-five years beginning in 2011, the combined tax hikes and spending cuts needed to do so would amount to 4.8% of GDP. If those fiscal policy decisions were delayed until 2020, their size would grow to 7.9% of GDP. In short, CBO indicates that the longer the federal government waits to correct the course of our unsustainable debt and deficits, the more dramatic those corrections will need to be. Yet, during a period of economic recovery and consistently high unemployment (9.5% in June) there has also been a strong drive for the enactment of short-term deficit spending to help stimulate economic activity and improve the condition of the labor markets.

## **Outlook**

The current gridlock in Washington has left a series of tax and regulatory issues on the table for the July work period and beyond. Below is a list of outstanding legislative matters of particular interest to AALU members, accompanied with an analysis of their status and outlook for the months ahead.

***Financial Regulatory Reform.*** The ‘Dodd-Frank Wall Street Reform and Consumer Protection Act’ was passed by the House on June 30<sup>th</sup> by a vote of 237-192, although a vote in the Senate has been delayed until after the July 4 recess. A small group of Republican Senators—led by Sen. Scott Brown (R-MA)—opposed the measure on the grounds that \$19B in fees assessed to large banks and hedge and

<sup>1</sup> The Statutory Pay-as-You-Go Act of 2010 (P.L. 111-139) exempts discretionary spending provisions that the Congress designates as an ‘emergency requirement’

<sup>2</sup> ‘Closing the fiscal gap’ refers only to ensuring a ‘sustainable’ spending level; that is to say closing the fiscal gap means adopting fiscal policy decisions that will produce the same debt-to-GDP ratio at the end of the term as was experienced at the beginning of the term.

private equity funds were too onerous. The financial reform conference committee, led by House Financial Services Committee Chairman Barney Frank (D-MA) and Senate Banking Committee Chairman Chris Dodd (D-CT), reconvened to re-craft this portion of the legislation in an effort to persuade Sen. Brown and other holdouts to approve the bill. At the moment, Senate Democrats appear to be in good position to pass the ‘Dodd-Frank Act’ when the Senate reconvenes. Sen. Maria Cantwell (D-WA), who voted against the bill in May, has agreed to switch her vote; Sen. Susan Collins (R-ME), who initially voiced concerns over the conference report, has also agreed to support the legislation. As a result, Senate Democrats are two votes shy of the sixty votes needed to pass the bill and send it to President Obama for his signature. These ‘aye’ votes could be cast by a combination of the yet to be appointed replacement for Sen. Byrd and one or more of the bill’s previous Republican supporters—Sen. Brown, Sen. Charles Grassley (R-IA), or Sen. Olympia Snowe (R-ME).

It should be noted that the ‘Dodd-Frank Act’ includes a six-month Securities and Exchange Commission (SEC) study of the effectiveness of existing broker and adviser regulations and standards of care, to be followed by an SEC rulemaking whereby the Commission has been given the authority to impose a ‘best interest’ standard on brokers and registered representatives, including life insurance agents who sell variable insurance products. However, the Commission shall consider the findings and conclusions of its study when commencing any rulemaking<sup>3</sup>. AALU has strongly advocated for the adoption of an SEC study prior to any rulemaking and will be integrally involved with SEC officials as the study is conducted. There are a number of additional provisions in the larger regulatory reform bill that AALU will be monitoring as well, including the establishment of an Office of National Insurance within the Treasury Department, along with a number of studies that will emerge from the bill examining different components of the insurance marketplace.

**2009 ‘Tax Extenders’.** It is uncertain whether the Senate will again take up their amendment to H.R. 4213—the package of 2009 ‘tax extenders’. The Senate must first move to consider the aforementioned extension of unemployment insurance benefits through November. The House passed a six-month extension of these benefits on July 1, but the Senate could move to pass its own version of the extension rather than considering the House-passed version. Senate Democratic leaders would like to move towards consideration of the remaining tax extenders in the near future, but with critical elements of the package, such as the ‘doc fix’, the unemployment insurance extension, and the home buyer’s tax credit extension excised and considered independently, the appetite and ability to offset the cost of the remaining tax extenders remains unclear.

**2001 (EGTRRA) & 2003 (JGTRRA) Tax Cuts.** As was previously mentioned, it is increasingly plausible that the expiring 2001 & 2003 tax cuts will not be considered in Congress until November at the earliest, and in addition to uncertainty around timing, we do not yet know exactly how lawmakers plan to address these expiring tax cuts. Many Congressional leaders would prefer to consider the findings of the ‘debt commission’ before substantively addressing this issue. President Obama’s FY 2011 budget proposed extending income tax cuts for families earning \$250,000 or less annually and for individuals earning \$200,000 or less annually, while allowing income tax cuts to expire as scheduled for wealthier taxpayers (thereby increasing the marginal rates of 33% and 35% to 36% and 39.6%, respectively). Further, the President proposes to reinstate and permanently extend the estate and gift taxes at their 2009 parameters (\$3.5 million exclusion; 45% estate tax rate).

Even a short-term extension of middle-class tax cuts would be very costly. While cost estimates have varied, CBO projects the two-year cost of extending provisions related to EGTRRA and JGTRRA to

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<sup>3</sup> The Commission ‘shall’ consider the findings, conclusions, and recommendations of the study. With respect any SEC rulemaking that would impose a ‘best interest’ standard on brokers and registered representatives, the receipt of commission and the sale of a proprietary or limited range of products would not, in and of themselves, be considered as violations of such a standard. Further, no continuing duty of loyalty would be required under such a standard.

be \$275 billion. This figure does not include indexing the AMT for inflation at 2009 levels, which would cost \$98 billion over two years<sup>4</sup>. These cost estimates will drive the debate, and House Democratic leaders have already suggested lowering the income threshold for the extension of these provisions, perhaps to families earning \$150,000 annually rather than \$250,000. Legislators' ultimate decision will likely be short-term in nature and will be a precursor to a much more significant tax debate, which is poised to play out in the 112<sup>th</sup> Congress. A complete analysis of expiring 2001 and 2003 tax provisions will be detailed in forthcoming *Washington Report* bulletin.

**Estate Tax.** The estate tax is included in the context of the EGTRRA and JGTRRA expiring provisions, but deserves additional analysis. If current estate tax laws were allowed to expire, the exemption and tax rate in 2011 would be \$1 million and 55%, respectively. The one-year cost estimates of reinstating the estate tax at 2009 parameters as opposed to allowing pre-2001 law to return in 2011 range between \$13 and \$16 billion<sup>5</sup>. Given the resistance to any tax legislation where costs are not fully offset, and considering the lack of palatable offsets available, there is a legitimate possibility of returning to pre-2001 estate tax law in 2011. It should be noted that legislators in the Senate have indirectly indicated their desire to use estate planning provisions to offset the cost of legislation which provides estate tax relief. A provision that would require a ten-year minimum term for GRATs has been included as a 'pay-for' in the House-passed small business tax incentives bill, H.R. 5486 (engrossed as H.R. 5297 and introduced in the Senate) and later as part of a supplemental appropriations bill passed by the House on July 1 (H.R. 4899; see our bulletin 10-68); yet, the Senate has not included the measure in any amended legislation. This provides Senators with the possibility of retaining this provision, which is estimated to raise \$5.3 billion over ten years (see our bulletins 10-60 and 10-68), for use with estate tax legislation, if moved.

The estate tax was one of several tax items that received short-term exemptions for two years from the Statutory Pay-as-You-Go Act of 2010<sup>6</sup>, but as has been demonstrated with the debate over extending unemployment insurance benefits, this has not been a successful deterrent for opponents who wish to see tax or spending measures fully offset so as to avoid adding to the federal budget deficit.

An additional hurdle for estate tax reinstatement at 2009 levels is a clear legislative vehicle. It has been widely assumed that the estate tax would be included as part of a larger piece of tax legislation which also addresses the 2001 and 2003 cuts as well as AMT relief. Yet, as the strategy around addressing these tax provisions has become clouded, this assumption is much less certain. In fact, prior to recess, House tax-writers on the Ways & Means Committee began crafting a one-year extension of expiring tax cuts that included middle-class income tax relief and AMT relief, but did not address the estate tax. It is possible that House leaders will move to adopt a package such as this prior to the November elections with the understanding that the Senate will be unable or unwilling to address this legislation in a similar timeframe. Such a move would provide House Democrats with something on which to campaign, while delaying substantive consideration until after the midterm elections.

AALU will monitor the progress of the progress of issues discussed in this bulletin as well as other noteworthy legislative initiatives and issue additional *Washington Report* bulletins as needed.

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<sup>4</sup> Data derived from CBO and JCT analysis of the President's FY 2011 Budget, as prepared for the Senate Committee on Appropriations, March 5, 2010.

<sup>5</sup> Tax Policy Center data indicates estate tax liability under existing law to be \$34.4 billion in 2011, while implementing 2009 estate tax parameters for 2011 would yield \$18.1 billion in tax liability.

<sup>6</sup> The Statutory Pay-as-You-Go Act of 2010 (P.L. 111-139) exempts a reinstatement of the estate tax at 2009 levels (\$3.5 million; 45% tax rate), through 2011.

source material or (2) email Anthony Raglani at [raglani@aalu.org](mailto:raglani@aalu.org) and include a reference to this *Washington Report*.

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