charles SCHWAB

The Obama Budget Proposal: 5 Takeaways for Investors

April 15, 2013

Michael Townsend
Vice President, Legislative and Regulatory Affairs, Charles Schwab & Co., Inc.

Key Points

- President Obama's budget proposal, unveiled last week, comes on the heels of vastly different budgets approved in March by the Democratic-controlled Senate and the Republican-controlled House.
- Notable items for investors include proposals to instate the so-called "Buffett Rule," cap the value of itemized deductions, make changes to the estate tax, cap retirement savings, and require all cost-basis calculations to use the average cost basis method.
- It's important to remember that the proposal is really just a statement of the administration's position. It's not a legislative proposal and won't be considered on its own by Congress. Instead, it lays the groundwork for another run at a "grand bargain" this summer when Congress must increase the debt ceiling.

Last week, President Obama unveiled his budget proposal for fiscal year 2014, which calls for $1.8 trillion in deficit reduction over the next decade through a combination of spending cuts and tax increases. Let's examine the proposal and how it might affect the ongoing debate about deficit reduction.

First, it's important to be clear about what the proposal is and is not. This is a broad framework document, an outline of the administration's priorities and positions. It is not a legislative proposal. It will not receive an up or down vote in Congress.

In some ways, the president's budget seeks a middle ground between the Republican budget approved by the House and the Democratic budget approved by the Senate. His proposal has fewer tax increases and more spending cuts (including some cuts to entitlements) than his previous proposals, which is a significant concession to Republicans and has angered members of his own party. Still, the Republican reaction has been tepid at best.

It's the president's latest attempt to get to a "grand bargain"—a major agreement on a long-term deficit reduction package.

Key items for investors

Several of the president's proposals are noteworthy for investors:

- **The "Buffett Rule" is back**. The proposal named after financier Warren Buffett seeks to ensure taxpayers with more than $1 million in income pay a minimum of 30% in taxes.
- **Cap on itemized deductions**. The president has re-introduced an idea from last fall's campaign—capping at 28% the value of itemized deductions for higher-income filers.
- **Estate tax changes**. The fiscal cliff agreement in January made the estate tax permanent at a top rate of 40% and an exemption amount of $5 million. The president's budget proposal calls for setting the top rate at 45% and lowering the exemption amount to $3.5 million, starting in 2018.
- **Cap on retirement savings**. This proposal has already stoked a fair amount of controversy in Washington. It suggests capping at $3.4 million the amount that any individual can accumulate in tax-preferred retirement accounts. The cap would apply to the combined value of all accounts, including IRAs, 401(k)s and other plans, and assets in a defined benefit plan. Many people have already raised questions about the mechanics of this proposal, and have voiced concern about whether the government should be determining how much tax-advantaged retirement savings is "enough."
- **Cost-basis changes**. This proposal would require the average cost basis method for all cost-basis calculations.

eliminating investors' ability to designate which shares of stock they are selling.

We think the chances of any of these happening are pretty low. But they represent the White House's policy, and they are likely to be proposed in the context of deficit-reduction negotiations in the coming months.

Democrats' and Republicans' budget proposals

Republicans and Democrats have been stuck for several years in a bitter dispute about how to reduce the deficit. The result has been a series of short-term, last-minute agreements (continuing resolutions) that keep things moving but have not addressed the big issues. The different parties' budgets are an attempt to tackle those big issues, and they could hardly be more different:

- The Senate-approved (Democratic) budget calls for $975 billion in spending cuts and an equal amount in tax increases over the next decade.
- The House-passed (Republican) budget aims for $4.6 trillion in spending cuts and no tax increases over the next 10 years.

Normally, the two chambers would meet in a conference to hammer out a compromise after they'd each put forth their proposals, but no conference has yet been organized.

What happens next?

The debt ceiling will need to be raised sometime in July or else the US will risk defaulting on its obligations to international creditors. In advance of this, we think you'll see a renewal of the process that happened back in the summer of 2011, when the president and Congressional leaders—most notably House Speaker John Boehner (R-OH)—tried to use a deadline to raise the debt ceiling as an occasion to reach a "grand bargain" on long-term deficit reduction. Look for the president to point to the compromises in his recently proposed budget in order to put pressure on Republicans to compromise as well.

Consensus is still a long shot, but…

While recent history gives us little reason to be optimistic, the icy relations between the two parties seem to have thawed somewhat in recent weeks. Republican leaders have been relatively low-key in their criticisms of the president's budget proposal, perhaps indicating an openness to negotiations.

With the mid-term elections still 18 months away, the next few months may represent the best chance yet to achieve a long-term deficit reduction deal. But consensus remains very difficult to achieve.

Next Steps

Talk to us. Call **800-435-4000** or visit a branch near you.