CCH Tax Briefing

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FY 2013 Federal Budget Proposals

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Special Report

HIGHLIGHTS

- Increased Tax Rates For Higher Income Individuals
- Permanent American Opportunity Tax Credit
- New Manufacturing Communities Tax Credit
- Extended 100 Percent Bonus Depreciation
- More Targeted Business Tax Incentives
- Carried Interest Taxed As Ordinary Income
- Repeal Of Oil, Gas And Coal Tax Preferences
- Energy Incentives
- Increased Funding For IRS

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President Obama Proposes FY 2013 Budget With $1.5 Trillion In Revenue Raisers

President Obama proposed a fiscal year (FY) 2013 federal budget on February 13, 2012 containing approximately $1.5 trillion in revenue raisers. The budget reiterates the President's long-standing opposition to extending the Bush-era tax cuts for higher income individuals, proposes to extend or make permanent a number of temporary tax credits and deductions and introduces some new tax incentives. The President's proposals impact individuals, businesses, exempt organizations, multi-nationals, and taxpayers of all types. The FY 2013 budget and explanations by the Treasury Department also flesh out some of the President's tax proposals in his January 24, 2012 State of the Union address and his "Blueprint for an America Built to Last." Some proposals, such as the Buffett Rule and a proposed minimum tax on overseas profits, are left for further explanation later in this process.

IMPACT: *President Obama's FY 2013 budget did not include details about corporate tax reform. Treasury Secretary Timothy Geithner, in testimony before the House Ways and Means Committee on February 15, indicated that the administration intends to release a "framework" for corporate tax reform later in February. The size of the reduction in the corporate tax rate the President will propose is unclear. In the past, President Obama has said he would support reducing the corporate tax rate in exchange for the closing of unspecified tax loopholes. Geithner further explained that the administration would not also tackle individual tax reform in the immediate future. However, consensus is growing that no matter what the outcome of the November elections, comprehensive tax reform for both corporations and individuals is on the horizon and will bring significant changes to the Tax Code as early as 2013 or 2014.*

President Obama's FY 2013 budget frames the debate over the Bush-era tax cuts, which, under current law, are scheduled to expire after 2012. Among the expiring provisions are reduced individual income tax rates, lower capital gains and dividend tax rates, marriage penalty relief, the increased child tax credit, and more. While the president's proposals generally follow earlier recommendations, one change in this year's budget has attracted particular attention: the shift to taxing dividend income of higher-income taxpayers as ordinary income, rather than at the capital gain rate.

IMPACT: *Most likely, the lame duck Congress that returns to work after the November elections will take up the fate of the Bush-era tax cuts. The outcome of the November elections will also most likely determine whether many of the other items in President Obama's FY 2013 budget proposals will either fade into history or become strong contenders for tax legislation at the end of 2012 and into 2013.*

COMMENT: *President Obama's FY 2013 budget is proposed in an environment unlike others in the recent past. The Budget Control Act of 2011 reduces the federal deficit by at least $2.1 trillion over the FY 2012 – FY 2021 period. Absent*

Congressional amendment, an automatic spending reduction process is scheduled to begin in January 2013. The automatic reduction would be divided evenly between defense and non-defense spending.

INDIVIDUALS

President Obama's FY 2013 budget proposals for individuals are a familiar mix of old and new ideas.

Payroll Tax Cut. The Temporary Payroll Tax Cut Continuation Act of 2011 extended the employee-side payroll tax cut through the end of February 2012. President Obama's budget proposed to extend the employee-side payroll tax cut for all of calendar year 2012. Congress approved that extension on February 17, as part of the Middle Class Tax Relief and Job Creation Act of 2012. No proposal to extend this OASDI rate reduction for a third year, into 2013, has yet been made.

Income Tax Rates. As expected, the President would reinstate the 36 percent and 39.6 percent tax rate brackets for higher income taxpayers. When the tax rate brackets provided under Bush-era legislation and extended by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) expire after 2012, the President would extend the tax rate brackets of 10, 15, 25, and 28 percent, eliminate the 33 percent and 35 percent tax rate brackets, and reinstate the prior law tax rate brackets of 36 percent and 39.6 percent. The rate increases, the President explained, would apply to single individuals with incomes over $200,000 and to married taxpayers filing joint returns with incomes over $250,000 levels. These income levels are 2009 amounts, indexed to inflation in subsequent years.

IMPACT: *After 2012, additional Medicare taxes impacting higher income taxpayers are scheduled to take effect. The Patient Protection and Affordable Care Act imposes both a 3.8 percent Medicare tax on the lesser of an individual's net investment income for the tax year or modified AGI in excess of $200,000 ($250,000 in the case of joint filers) as well as an additional 0.9 percent increase in the Hospital Insurance (HI) portion of the FICA tax for individuals falling into that same income range.*

Personal Exemption Phaseout/Limitation on Itemized Deductions. The Bush-era tax cuts, as extended by the 2010 Tax Relief Act, gradually phased out and then removed –but only through 2012-- two long-standing cutbacks in the amount of personal exemptions and certain itemized deductions otherwise taken by higher-income taxpayers.

> **"President Obama's FY 2013 budget frames the debate over the Bush-era tax cuts, which, under current law, are scheduled to expire after 2012."**

Under these limitations, the deduction for personal exemptions of taxpayers and their dependents phased out for taxpayers with adjusted gross income in excess of certain thresholds. Additionally, the amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, theft and casualty losses, and wagering losses) were reduced by three percent of adjusted gross income in excess of certain threshold amounts but not by more than 80 percent. Starting in 2013, these limitations are scheduled to return to pre-2001 levels unless Congress acts.

The President has proposed to reinstate the personal exemption phaseout and the limitation on itemized deductions for single individuals with incomes over $200,000 and married taxpayers filing joint returns with incomes over $250,000, effective for tax years beginning after December 31, 2012.

COMMENT: *President Obama also has proposed to reduce the value to 28 percent of specified exclusions and deductions that would otherwise reduce taxable income in the 36 percent and 39.6 percent income tax rate brackets. A similar limitation would apply under the AMT.*

AMT. The President's budget envisions repeal of the AMT and its replacement with the so-called Buffett Rule (discussed below). Until (and if) repeal is accomplished, the President proposed to extend the AMT "patch." The patch provides increased exemption amounts.

IMPACT: *For 2011, the AMT exemption amounts were $48,450 for single individuals, $74,450 for married couples filing joint returns and surviving spouses, and $37,225 for married couples filing separate returns. Absent action by Congress, the AMT exemption amounts for 2012 are $33,750 for single individuals, $45,000 for married couples filing joint returns and surviving spouses, and $22,500 for married couples filing separate returns. Most everyone in Congress agrees that the AMT needs to be fixed, but a permanent solution has been avoided so far because of the significant offsetting revenues that would be needed. One possible scenario is for another one-year AMT "patch" to be enacted for 2012, followed by rolling a solution into an overall consideration of comprehensive tax reform for years after 2012.*

Buffett Rule. The President's FY 2013 budget does not include a specific Buffett Rule but keeps it alive as a future goal. President Obama has asked Congress to pass measures that ensure individuals making over $1 million a year pay a minimum effective tax rate of at least 30 percent.

COMMENT: *President Obama first proposed the Buffett Rule in 2011 and repeated the proposal in his 2012 State of the Union address. Sen. Sheldon Whitehouse, D-RI, has introduced legislation*

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based on the President's proposals. Taxpayers earning over $2 million would be subject to a 30 percent minimum federal tax rate. The tax would be phased in for incomes between $1 million and $2 million, with those taxpayers paying a portion of the extra tax required to get them to a 30 percent effective tax rate.

Capital Gains/Dividends. Under the President's proposal, reduced tax rates on qualified capital gains and dividends enacted during the Bush-era and extended by the 2010 Tax Relief Act would expire after 2012 for higher income taxpayers. The President would increase the tax rate on qualified capital gains to 20 percent for single individuals with incomes over $200,000 and married taxpayers filing a joint return with incomes over $250,000, effective for tax years beginning after December 31, 2012. In a controversial move, however, the President proposes that the current reduced capital gain tax rates on dividends would expire at the end of 2012 for those taxpayers above the $200,000/$250,000 level and would be replaced by taxing them as ordinary income.

IMPACT: *Decoupling capital gains and dividends caught many administration observers by surprise. The tax rates on qualified capital gains and qualified dividends have been linked for nearly 10 years. A Treasury official told reporters that "long-term capital gains often have had a preferential rate for the entire history of the income tax from 1913 until now." Utility companies and other industries that traditionally rely on rewarding investors through regular dividends rather than dramatic share appreciation are obviously expressing concern over this proposal. A decoupling of capital gains and dividends would also resurrect certain universal techniques and issues inherent in corporate tax planning for taxable distributions.*

Child Tax Credit. The $1,000 child tax credit is scheduled to revert to $500 per qualifying child after 2012. The American Recovery and Reinvestment Act of 2009 (2009 Recovery Act) increased the refundable child tax credit by reducing the threshold dollar amount to $3,000. The 2010 Tax Relief Act extended the enhanced child tax credit through 2012. President Obama has proposed to permanently extend the $1,000 child tax credit with a $3,000 threshold for refundability.

Earned Income Tax Credit. The 2009 Recovery Act increased the credit percentage for families with three or more qualifying children to 45 percent and provided marriage penalty relief for purposes of the earned income tax credit (EITC). The 2010 Tax Relief Act extended the enhanced EITC through 2012. President Obama has proposed to extend permanently the enhanced EITC for tax years beginning after December 31, 2012.

IMPACT: *The phase-in rate of the EITC for taxpayers with three or more qualifying children would be maintained at 45 percent under the President's proposal.*

COMMENT: *The President also proposed to simplify the rules for claiming the EITC for workers without qualifying children.*

American Opportunity Tax Credit. Qualified taxpayers may claim the American Opportunity Tax Credit (AOTC) for certain expenses related to the first four years of post-secondary education subject to income phaseouts. The AOTC is scheduled to expire after 2012. President Obama has proposed to extend permanently the AOTC for tax years beginning after December 31, 2012.

IMPACT: *Under the President's proposal, the tuition and expense amounts ($2,000) and the income phaseouts, would be indexed for inflation.*

COMMENT: *The AOTC is essentially an enhanced Hope credit. The President has not proposed any changes to the Lifetime Learning credit.*

Child and Dependent Care Credit. The child and dependent care credit provides qualified taxpayers who are working or looking for work with a nonrefundable credit that partially offsets these expenses. The credit, currently set at 35 percent of $3,000 of expenses for one qualifying child ($6,000 for more than one), begins to phase down when a taxpayer's AGI level is over $15,000, up to an AGI level of $43,000 when it levels off at 20 percent. President Obama has proposed to increase from $15,000 to $75,000 the AGI level at which the credit begins to phase down for tax years beginning after December 31, 2012.

IMPACT: *Without action by Congress, the child and dependent care credit is scheduled to revert to lower, pre-EGTRRA levels after 2012: The maximum amount of qualifying expenses to which the credit may be applied will revert to $2,400 for individuals with one qualifying child or dependent and $4,800 for two or more (for a maximum credit of $720/$1,440 for taxpayers with AGIs of $10,000 or less, and $480/$960 for AGIs at or above $28,000).*

Home Mortgage Debt. Current law provides for the exclusion of the discharge of qualified principal residence indebtedness from income only through 2012. President Obama has proposed to extend the exclu-

Selected Revenue Raisers In President's FY 2013 Budget*	
Reinstate 36 and 39.6 percent rates	$441.5 Billion
Tax qualified dividends as ordinary income	$206.4 Billion
Repeal LIFO method of accounting	$73.7 Billion
Eliminate oil/gas/coal tax preferences	$56.4 Billion
Tax carried interest as ordinary income	$13.4 Billion

*Over 10 years

sion for the discharge of qualified principal residence indebtedness to amounts that are discharged before January 1, 2015 and to amounts that may be later discharged under an agreement entered into before that date.

COMMENT: *The President's budget also suggests that an extension beyond January 1, 2015 may be appropriate to correspond to the availability of additional homeowner relief as a result of government actions or other arrangements. Without an extension of the qualified principal residence exclusion, only those beleaguered homeowners who can take advantage of the insolvency exclusion will be able to avoid income tax on discharge of indebtedness income in either a mortgage workout or foreclosure situation.*

Student Loans. Certain federal student loan programs provide for loan forgiveness. Under current law, any debt forgiven under these programs is generally considered gross income to the taxpayer and is subject to income tax. President Obama has proposed to exclude from income qualified loan forgiveness under these federal programs. The proposal would apply to loans forgiven after December 31, 2012.

COMMENT: *The President's budget would provide similar loan forgiveness to certain scholarship amounts for participants in the Indian Health Service Health Professions Scholarship Program. Certain loan forgiveness programs under post-graduation commitments in connection with certain community or social services have been made exempt under prior recent legislation.*

Tax Extenders for Individuals. A number of popular but temporary tax incentives for individuals expired after 2011. President Obama would extend these so-called tax extenders through at least 2013. The extenders for individuals include (not an exhaustive list):

- State and local sales tax deduction
- Higher education tuition deduction
- Teachers' classroom expense deduction
- Transit benefits parity

COMMENT: *While many in Congress expressed the need to consider these tax extenders in negotiations over the payroll tax cut extension, the extenders ultimately were not included. Tax extenders in past years have been made retroactive in year-end legislation to the start of the year, so the precedent exists for a delay until after the November elections.*

ESTATE TAX

The federal estate tax underwent significant modification in the 2010 Tax Relief Act for decedents dying in 2010, 2011 and 2012. The estate tax provisions in the 2010 Tax Relief Act are scheduled to expire after 2012. In their place, President Obama has proposed to make permanent the federal estate tax at parameters in effect for calendar year 2009 (a top tax rate of 45 percent and an exemption amount of $3.5 million). The proposal would be effective for estates of decedents dying after December 31, 2012.

COMMENT: *President Obama also proposed to make permanent the provision allowing a surviving spouse to use the deceased spouse's unused estate tax exclusion (portability), which is scheduled to expire for decedents dying after December 31, 2012*

Under the President's proposal, the gift tax and the generation skipping transfer (GST) tax would return to the parameters in effect in 2009. The top rate would be 45 percent and the exclusion amount would be $1 million for gift taxes and $3.5 million for GST taxes.

GRATs. In a grantor retained annuity trust (GRAT), the grantor creates an irrevocable trust and retains the right to receive, for a specified term, an annuity based on a specified sum or fixed percentage of the value of the assets transferred to the trust. President Obama has proposed to require that GRATs have a minimum term of 10 years and a maximum term of the life expectancy of the annuitant plus 10 years. Additionally, the President's proposal would require that any remainder interest have a value greater than zero at the time the interest is created and would prohibit any decrease in the annuity during the term of the GRAT.

IMPACT: *According to the administration, a minimum term would not prevent "zeroing-out" the gift tax value of the remainder interest but a minimum term would increase the risk that the grantor fails to outlive the term of the GRAT and the resulting loss of any anticipated transfer tax benefit.*

More Proposals. Additionally, President Obama has proposed to:

- Require consistency in value for transfer and income tax purposes
- Modify rules on valuation discounts
- Limit the duration of GST tax exemption
- Coordinate certain income and transfer tax rules applicable to grantor trusts
- Extend the lien on estate tax deferrals under Code Sec. 6166

RETIREMENT MEASURES

In February 2012, Treasury and the IRS issued a guidance package intended to encourage employers to offer more flexibility to workers in retirement savings vehicles. The administration launched a similar initiative in 2009. President Obama's FY 2013 budget reflects these developments.

Saver's Credit. The retirement savings contribution credit – also known as the saver's credit – is available to lower and moderate income taxpayers and offsets a portion of the first $2,000 individuals contribute to IRAs, 401(k)s and other retirement savings vehicles. President Obama has proposed to make the saver's credit refundable and make other modifications to encourage individuals to contribute to retirement funds.

COMMENT: *For 2012, the AGI limit for the saver's credit is $57,500 for married couples filing joint returns; $43,125 for heads of households; and $28,750 for married taxpayers filing separately and single taxpayers.*

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RMD Rules. Required Minimum Distributions (RMDs) generally are minimum amounts that a retirement plan account owner must withdraw annually starting with the year that he or she reaches 70 ½ years of age or, if later, the year in which he or she retires. President Obama has proposed to exempt from the RMD rules individuals whose aggregate value of their IRA and tax-favored retirement plan accumulations does not exceed $75,000, effective for taxpayers attaining age 70 ½ on or after December 31, 2012.

IMPACT: *The RMD rules are intended to ensure that retirement savings are used for retirement instead of leaving the funds for the individual's heirs. However, individuals with what the administration characterizes as modest amounts of retirement savings are unlikely to abuse the RMD rules.*

COMMENT: *Under the President's proposal, the RMD requirements would phase in ratably for individuals with aggregate retirement benefits between $75,000 and $85,000. Additionally, amounts held in Roth IRAs would be taken into account in determining if an individual's aggregate retirement accumulation does not exceed $75,000 (even though Roth IRAs are exempt from the pre-death RMD rules and escape tax on distribution).*

Rollovers. Generally, a surviving non-spouse beneficiary under a tax-favored employer retirement plan may roll over assets to an IRA only by means of a direct rollover. A surviving non-spouse beneficiary under an IRA may move assets to a non-spousal inherited IRA only by means of a direct trustee-to-trustee transfer. President Obama has proposed to allow 60-day rollovers of such assets, effective for distributions made after December 31, 2012.

Automatic Enrollment. Under the President's budget, employers that do not offer a retirement plan to their employees would be required to automatically enroll them in Roth IRAs. Contributions would be made through payroll deductions of three percent of the employee's compensation.

IMPACT: *Very small employers (10 or fewer employees) would not be required to offer automatic enrollment.*

IMPACT: *Small employers (employers that have no more than 100 employees) would be eligible for a temporary nonrefundable tax credit for expenses related to the arrangement, up to $500 for the first year and $250 for the second year. Qualified employers would also be eligible for a nonrefundable credit of $25 per enrolled employee up to $250 for six years.*

"....the administration intends to release a 'framework' for corporate tax reform later in 2012."

Small Employer Plans. President Obama has proposed to enhance a nonrefundable credit to encourage employers to sponsor a qualified retirement plan, SEP or SIMPLE plan. The start-up costs credit would increase from $500 per year for three years to a maximum of $1,000 per year for three years and extended to four years in certain cases.

CHARITABLE PROVISIONS

Charitable Contributions from IRAs. IRA owners age 70 ½ and older could transfer funds from their IRA to an eligible charitable organization tax-free before 2012. The maximum amount that an IRA owner may transfer annually tax-free was $100,000 to an eligible organization. This special rule expired after 2011. President Obama has proposed to extend the rule at least through 2013.

Golf Courses. President Obama has proposed to disallow a tax deduction for any contribution of property that is, or is intended to be, used as a golf course.

BUSINESSES

President Obama's business tax proposals include several new incentives intended to encourage job creation. President Obama did not propose a specific reduction in the corporate tax rate but appeared to support a reduction in exchange for the closing of unspecified tax loopholes.

Manufacturing Communities Tax Credit. One centerpiece of the President's FY 2013 budget is the proposed Manufacturing Communities Tax Credit. The Manufacturing Communities Tax Credit is intended to support investments in communities that have experienced a major job loss, such as the closure of a military base or a mass layoff.

IMPACT: *The President has asked Congress to provide $2 billion in credits for qualified investments approved in 2012 through 2014.*

COMMENT: *According to the White House, the Manufacturing Communities Tax Credit would be structured using the mechanism of the New Markets Tax Credit (NMTC) or as an allocated investment credit similar to the Qualifying Advanced Energy Project Credit.*

Tax Credit for New Jobs/Wage Increases. A new, temporary 10 percent tax credit for new jobs and wage increases would be available to qualified employers. The credit would be equal to 10 percent of the increase in the employer's 2012 eligible wages over the prior year (2011). The maximum amount of the increase in eligible wages would be $5 million per employer with a maximum credit of $500,000. The proposal would be effective for wages paid during the one-year period beginning on January 1, 2012.

Tax Incentives for "Insourcing" Jobs. President Obama has proposed to create a new general business credit against income tax equal to 20 percent of the eligible expenses paid or incurred in connection with insourcing a U.S. trade or business. Additionally, the President would disallow deductions for expenses

paid or incurred in connection with outsourcing a U.S. trade or business.

IMPACT: *The President's budget describes insourcing as reducing or eliminating a trade or business (or line of business) currently conducted outside the U.S. and starting up, expanding or otherwise moving the same trade or business within the U.S., to the extent that this action results in an increase in U.S. jobs.*

Outsourcing. The President's budget would disallow deductions, for expenses paid or incurred in connection with outsourcing a U.S. trade or business. More details are expected to be released by the administration.

Code Sec. 199 "Manufacturing" Deduction. The Code Sec. 199 domestic production activities deduction generally allows taxpayers to receive a deduction based on qualified production activities income resulting from domestic production. The deduction is nine percent for tax years beginning after 2009. Qualifying domestic production includes the manufacture of tangible personal property; the production of computer software, sound recordings and certain films; the production of electricity, natural gas, or water; and construction, engineering, and architectural services. The President would eliminate the Code Sec. 199 deduction for oil, gas and coal (as he has proposed in the past) and expand the deduction to cover advanced technology manufacturing activities.

Bonus Depreciation. The 2010 Tax Relief Act provided for 100 percent bonus depreciation through the end of 2011. President Obama has proposed to extend 100 percent bonus depreciation through the end of 2012 (2013 for certain long-lived property and transportation property).

COMMENT: *Extending 100 percent bonus depreciation into 2012 has been popular on both sides of the aisle in Congress. The sticking point remains how to pay for it, since it requires a $45 billion revenue offset during the 2012-2013 period.*

Code Sec. 45R Credit. Code Sec. 45R provides a tax credit to qualified small employers (including small tax-exempt employers) to help offset the cost of health insurance premiums for their employees. An eligible small employer is an employer that has no more than 25 full-time employees and the average annual compensation of these employees is not greater than $50,000. President Obama has proposed to simplify the Code Sec. 45R credit and expand its reach to include employers with up to 50 full-time equivalent employees, effective for tax years beginning after December 31, 2011.

COMMENT: *The maximum Code Sec. 45R credit is 35 percent (25 percent for tax-exempt employers) for 2010 through 2013. The maximum credit is scheduled to increase to 50 percent (35 percent for tax-exempt employers) for 2014 and later years; however, the credit is only available for tax years beginning after 2013 for health insurance purchased through an Affordable Insurance Exchange and only for a maximum coverage period of two additional consecutive tax years.*

Research Tax Credit. The research tax credit rewards taxpayers that make qualified research expenditures with a 20 percent tax credit (14 percent in the case of the alternative simplified credit). The 2010 Tax Act extended the research tax credit through 2011. President Obama has proposed to permanently extend the research tax credit after 2011. Additionally, the rate of the alternative simplified credit would increase from 14 to 17 percent after 2011 under the President's proposal.

IMPACT: *Businesses have long argued that they need certainty over the longevity of the research tax credit in order to commit significant resources to research and development. The President's revenue estimate for making this credit permanent – almost $110 billion over 10 years—clearly showcases the reason it will be an uphill battle.*

Eliminate Capital Gains Taxes on Small Business Stock. The 2009 Recovery Act increased the 50 percent exclusion from tax for capital gains realized on the sale of certain qualified small business stock held for more than five years to 75 percent. The 2010 Small Business Jobs Act increased the exclusion to 100 percent for stock. The 100 percent exclusion expired after 2011. The President has proposed to make permanent the 100 percent exclusion for qualified small business stock acquired after December 31, 2011.

IMPACT: *Additionally, the AMT preference item for gain excluded under the small business stock provision would be repealed for all excluded small business stock gain and the time for a taxpayer to reinvest the proceeds of sales of small business stock under Code Sec. 1045 would be increased to six months for qualified small business stock the taxpayer has held for longer than three years.*

COMMENT: *The President's budget also indicates that additional but unspecified information reporting requirements would be imposed.*

Start-Up Expenses. The 2010 Small Business Jobs Act temporarily increased –for tax years beginning in 2010 only-- the limit on expensed qualified start-up expenses from $5,000 to $10,000, where that amount was reduced, but not below zero, by the amount by which start-up expenses with respect to an active trade or business exceeded $60,000 (up from a $50,000 cap). President Obama has proposed to make the $10,000/$60,000 levels permanent, for tax years ending on or after the date of enactment of this proposal.

New Markets Tax Credit. The New Markets Tax Credit (NMTC) is available for qualified investments in community development entities. The NMTC credit expired after 2011. President Obama has proposed to extend the NMTC for 2012 and 2013.

COMMENT: *President Obama's budget would appropriate $10 billion for two rounds of NMTC allocations: $5 billion for 2012 and $5 billion for 2013. Additionally, the President's proposal*

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would allow NMTC amounts resulting from qualified equity investments made after December 31, 2011 to offset AMT liability.

Growth Zones. President Obama has proposed to designate 20 growth zones in which an employment tax credit would be provided to employ zone residents and qualified property placed in service in the zone would be eligible for 100 percent bonus depreciation. Fourteen growth zones would be in urban areas and six would be in rural areas.

COMMENT: *Additionally, President Obama has proposed to restructure the New York City Liberty Zone.*

Repeal LIFO and LCM. The first-in, first out (FIFO) method assumes that sales are made from the items that have been longest in the inventory. The LIFO method assumes that the most recently purchased items are the ones sold. President Obama has proposed to repeal the last-in, first-out (LIFO) method of accounting. Additionally, the President would repeal the lower-of-cost-or-market (LCM) inventory accounting method.

IMPACT: *Combined, these two changes are estimated to bring over $85 billion over the next ten years.*

FUTA. The Federal Unemployment Tax Act (FUTA), authorizes the IRS to collect a federal employer tax used to fund state workforce agencies. The FUTA taxable wage base is the first $7,000 paid in wages to each employee during a calendar year. President Obama has proposed to increase the FUTA taxable wage base to $15,000 in 2015 and index the wage base to wage growth in subsequent years.

FUTA Surtax. The 0.20 percent FUTA surtax expired mid-year 2011. President Obama has proposed to reinstate and make permanent the FUTA surtax effective for wages paid with respect to employment on or after January 1, 2013.

COMMENT: *Under current law, the FUTA tax rate is 6.2 percent for the first half of 2011 and 6.0 percent for the second half of 2011. Employers that pay their state unemployment taxes on time and in full are eligible for a tax credit of 5.4 percent. However, the credit is reduced (credit reduction states) where the state has unpaid federal loans. President Obama also proposed to provide short-term relief to employers by suspending interest on state unemployment insurance debt and suspending the FUTA credit reduction for 2012 and 2013.*

Worker Classification. The President's FY 2013 budget calls on Congress to allow the IRS to issue general guidance on worker classification. Additionally, the IRS would be able to require prospective reclassification of workers whose reclassification has been prohibited under current law. The proposal would be effective on enactment but prospective reclassification would be delayed.

IMPACT: *The President's proposal would allow the IRS to waive penalties for service recipients with only a small number of misclassified workers and that consistently filed information returns reporting all payments to misclassified workers along with agreeing to prospective reclassification of the workers.*

COMMENT: *The IRS launched a Voluntary Classification Settlement Program (VCSP) in 2011. The VCSP is open to taxpayers treating their workers as independent contractors or other nonemployees and that want to prospectively treat the workers as employees.*

Corporate Jets. Generally, the depreciation recovery period for aircraft not used in commercial or contract carrying of passengers or freight – including corporate jets – is five years. The recovery period for aircraft used in commercial or contract carrying of passengers or freight is generally seven years. President Obama has proposed to make the recovery period for corporate jets seven years effective for property placed in service after December 31, 2012 (12 years under the alternative depreciation system).

COMMENT: *This provision represents plugging the "corporate jet loophole" that has been referred to in several recent press releases from the Administration. The recovery period for aircraft used in crop-dusting, fire-fighting and other non-passenger activities would remain at five years (six years under the alternative depreciation system).*

Boot-in-Gain. When a taxpayer receives stock and boot in a corporate reorganization, the taxpayer's recognized gain under Code Sec. 356(a)(1) cannot exceed the value of the boot. Under Code Sec. 356(a)(2), if such an exchange has the effect of the distribution of a dividend, the shareholder must treat the gain recognized on the exchange as a dividend to the extent of the distributee's ratable share of the corporation's undistributed earnings and profits. President Obama has proposed to repeal the boot-within-gain limitation in the case of any reorganization if the exchange has the effect of the distribution of a dividend, as determined under Code Sec. 356(a)(2), effective for tax years beginning after December 31, 2012.

Effective Dates Of Selected Budget Proposals	
Reinstate 36 and 39.6 percent rates	after 12/31/2012
Eliminate oil/gas/coal tax preferences	after 12/31/2012
Extended bonus depreciation	through 2012
Permanent small business stock exclusion	after 12/31/2011
New jobs/wage increase credit	wages paid in 2012
International reforms	after 12/31/2012
New Manufacturing Communities Tax Credit	starting in 2012

Carried Interest. President Obama's FY budget would designate a carried interest in an investment partnership as a services partnership interest (SPI). A partner's share of income from an SPI that is not attributable to invested capital would be taxed as ordinary income. This treatment would apply regardless of the character of the income at the partnership level. Additionally, self-employment tax would attach to such income. Special rules would apply to the sale of an SPI.

IMPACT: *The carried interest proposal was also included in the president's FY 2012 budget. Last year's budget proposal anticipated $14.8 billion in revenues over 10 years; this year's lowers the revenue estimate to $13.4 billion. Due to a growing public awareness of carried interest as a "loophole," it has been mentioned as one possible revenue raiser that might be used to offset the cost of tax extenders legislation.*

Punitive Damages. Under current law, a deduction may be allowed for compensatory or punitive damages paid or incurred as ordinary and necessary expenses in carrying on any trade or business. President Obama has proposed to eliminate the business expense deduction for punitive damages paid or incurred after December 31, 2013.

Partnerships. President Obama has proposed to expand the definition of built-in loss for purposes of partnership loss transfers and extend partnership basis limitation rules to nondeductible expenditures.

Business Tax Extenders. A long list of business tax extenders expired after 2011. President Obama has proposed to extend some of the expired extenders, which in addition to the research credit already discussed, include (not an exhaustive list):

- Brownfields remediation
- Special expensing rules for television and film productions
- Indian employment credit
- 15-year recovery period for qualified leasehold improvements/restaurant property/retail improvement property
- Enhanced deduction for corporate donations of computers for educational purposes
- Special rules for shareholders to adjust their basis in the stock of S corporations making charitable contributions

COMMENT: *The Work Opportunity Tax Credit (WOTC) expired after 2011 but The VOW to Hire Heroes Act of 2011 made changes to the credit available for 2012. The Heroes Act added two new categories to the existing qualified veteran targeted group and made the WOTC available to certain tax-exempt employers as a credit against the employer's share of social security tax. The Heroes Act allows employers to claim the WOTC for veterans certified as qualified veterans and who begin work before January 1, 2013.*

INTERNATIONAL TAXATION

In recent years, President Obama's budgets have carried a number of international tax reforms. The President's FY 2013 budget likewise includes international provisions.

COMMENT: *During his 2012 State of the Union address, President Obama proposed a minimum tax on overseas profits. Administration officials have indicated that further information about the proposed minimum tax on overseas profits will be released later in February.*

Interest Expense Deduction. President Obama's budget would defer the deduction of interest expense allocable to foreign-source income (of a subsidiary) that exceeds the proportional amount of income of the subsidiary that is currently subject to U.S. taxes. The interest would be deductible in a subsequent year. The proposal would better match the timing of income and deductions.

IMPACT: *Under current law, a U.S. person can deduct foreign interest expenses even if they exceed the taxpayer's foreign source income. The administration is concerned that this tax benefit may cause U.S. businesses to shift investments and jobs overseas.*

Foreign Tax Credit. The foreign tax credit is designed to mitigate double taxation of U.S. taxpayers' foreign-source income. President Obama has proposed requiring a U.S. taxpayer to determine its deemed paid foreign tax credit under Code Sec. 902 by aggregating taxes and earnings and profits of all of its foreign subsidiaries. The tax credit to be claimed would be limited to the proportionate amount of consolidated earnings that are repatriated to the U.S. and currently subject to U.S. taxes.

IMPACT: *Excess foreign taxes would be deferred and would be creditable in a subsequent year.*

Transfers of Intangibles. If a U.S. corporation transfers an intangible asset to a related controlled foreign corporation (CFC), "excess" income from the intangible would be treated as Subpart F income and would be currently taxable, if the income is subject to a low foreign effective tax rate. An effective tax rate of 10 percent or less would trigger the provision.

A second proposal would clarify the definition of intangible property transferred from a U.S. person to a related foreign person in certain nonrecognition transactions. The proposal would include workforce in place, goodwill, and going concern value and would permit the IRS to value transfers of multiple intangibles on an aggregate basis.

IMPACT: *According to the administration, there is evidence that income shifting through transfers of intangibles to low-taxed affiliates has significantly eroded the U.S. tax base. The first proposal is designed to reduce the incentive for taxpayers to engage in these transactions. The second proposal would also address tax avoidance through the transfer pricing rules.*

Reinsurance Premiums. The proposal would deny an insurance company a deduc-

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tion for premiums paid to affiliated foreign companies for reinsurance of property, if the foreign insurer is not subject to U.S. taxes on the premiums received. The foreign corporation receiving the premiums could elect to treat the premiums as income taxable in the U.S.

IMPACT: *Reinsurance with untaxed foreign affiliates can save substantial taxes compared to transactions with entities taxed in the U.S., creating an inappropriate incentive for foreign-owned domestic insurance companies to reinsure U.S. risks with foreign affiliates.*

Earnings Stripping. President Obama would revise Code Sec. 163(j), which limits the deductibility of certain interest paid by a corporation to related persons subject to low U.S. taxes on that interest. The proposal would tighten the limitation on the deductibility of interest paid by an expatriated entity (a U.S. parent company that is replaced with a foreign parent) to related persons.

IMPACT: *The 50 percent income-limitation threshold would be reduced to 25 percent, and the carryforward for disallowed interest would be limited to 10 years.*

Dual Capacity Taxpayers. A dual-capacity taxpayer is one that pays a foreign income tax and that also pays a foreign levy that is not a tax because it is paid for a specific economic benefit provided by the foreign country. The President's budget would further limit the portion of a payment that is treated as a creditable foreign income tax.

IMPACT: *Current law recognizes the distinction between a creditable tax and a payment for an economic benefit, but fails to properly limit the foreign tax when a single payment is made. This especially affects oil and gas companies.*

Partnership Interest. The proposal would require that gain or loss from the sale of a partnership interest is effectively connected income (ECI), taxable in the U.S., to the extent attributable to unrealized gain or loss from ECI property. The purchaser of the interest would be required to withhold 10 percent of the amount realized on the sale, unless the transferor was not foreign.

IMPACT: *Capital gains of a nonresident alien generally are not subject to U.S. taxes unless the income is treated as effectively connected with a U.S. trade or business. The provision would ensure that the unrealized gain was taxable as ECI and would not escape U.S. taxation.*

Leveraged Distributions. The dividend rules permit the earnings and profits of one foreign corporation to be repatriated to its U.S. owner, without being characterized as a dividend, by having the corporation fund a distribution from a second, related foreign corporation that does not have earnings and profits. The President would prevent the distribution to the U.S. owner from being treated as a nontaxable return of capital, by disregarding the shareholder's basis in the distributing corporation's stock.

COMMENT: *Funding transactions would include capital contributions, loans, and distributions.*

Certain Asset Acquisitions. Code Sec. 338 permits a corporation to elect to treat a qualified stock purchase as an asset acquisition, but Code Sec. 901(m) denies a foreign tax credit for certain foreign taxes paid after a covered asset acquisition (CAA), including a Code Sec. 338 election. Code Sec. 338(h)(16) prevents a seller from increasing allowable foreign tax credits by making a 338 election. The proposal would extend Code Sec. 338(h)(16) to any CAA described in Code Sec. 901(m).

COMMENT: *A 2010 law enacted the President's proposals to tighten the foreign tax credit, effective in 2011. This would expand one of those proposals, effective in 2013.*

Foreign Tax Pool. Certain transactions other than dividend distributions (such as a stock redemption) reduce or eliminate a corporation's earnings and profits. This results in taxpayers claiming a foreign tax credit under Code Sec. 902 for foreign taxes paid on earnings that will no longer fund a dividend distribution to the U.S. The President's proposal would reduce the amount of foreign taxes paid.

IMPACT: *The reduction of foreign taxes would equal the amount of foreign taxes associated with the eliminated earnings and profits.*

ENERGY

President Obama mentioned energy frequently during his 2012 State of the Union address and his FY 2013 budget reflects this focus. President Obama has proposed to create new energy incentives, to repeal others and to extend some expired incentives.

Repeal Oil/Gas and Coal Preferences. The President has proposed to repeal a number of credits and deductions available to oil, gas and coal producers for tax years beginning after December 31, 2012. The incentives targeted for repeal include:

- Enhanced oil recovery credit
- Credit for oil and gas produced from marginal wells
- Expensing of intangible drilling costs
- Deduction for tertiary injectants
- Exception to passive loss limitation for working interests in oil and natural gas properties
- Percentage depletion for oil and natural gas wells
- Expensing of exploration and development costs
- Percentage depletion for hard mineral fossil fuels
- Capital gains treatment for royalties

Additionally, the President has proposed to increase the amortization period from two to seven years for geological and geophysical expenditures incurred by independent producers in oil and gas exploration in the U.S. for amounts paid or incurred after December 31, 2012.

Production Tax Credit. Wind facilities placed in service in 2012 and other renewable energy facilities placed in service before 2014

may qualify for a production tax credit. Additionally, an investment tax credit for energy property may be available. President Obama has proposed to extend the production tax credit for wind facilities and the investment tax credit for wind facility property to facilities and property placed in service in 2013.

Grants in Lieu of Tax Credits. The "Section 1603 program" provided cash grants for specified energy property in lieu of tax credits. The Section 1603 program expired after 2011. President Obama has proposed to extend the Section 1603 program for 2012. For property placed in service after 2012, grants would be replaced with a refundable tax credit.

> **IMPACT:** *The Code Sec. 1603 program, enacted as part of the 2009 Recovery Act, has been touted for helping to finance renewable energy projects at a time when there was little tax equity for investments.*

Alternative Fuel Commercial Vehicles. Current law provides a tax credit for fuel-cell vehicles purchased before 2015. President Obama has proposed to allow a tax credit for medium- and heavy-duty commercial alternative fuel vehicles.

Advanced Technology Vehicles. Under current law, taxpayers may qualify for a tax credit when they place plug-in electric vehicles into service. President Obama has proposed to expand the plug-in electric vehicle credit to other vehicles that operate primarily on an alternative to petroleum and that meet other requirements. The expanded credit would be allowed for vehicles produced after the date of enactment and before January 1, 2020, subject to certain limitations.

> **COMMENT:** *The enhanced credit would be allowed to the person who sells or finances the vehicle, rather than the person placing the vehicle in service, but only if the credit is disclosed to the purchaser.*

Advanced Energy Manufacturing Projects. The 2009 Recovery Act capped tax credits for investment in qualified property used in a qualifying advanced energy manufacturing project at $2.3 billion. President Obama has proposed to authorize an additional $5 billion of credits for investments in eligible property used in a qualifying advanced energy manufacturing project.

Energy-Efficient Commercial Building. Under current law, taxpayers may be eligible to deduct expenses for energy-efficient commercial building property placed in service on or before December 31, 2013. President Obama has proposed to replace the deduction with a credit for property placed in service during calendar year 2013.

Oil Spill Liability Trust Fund. The Oil Spill Liability Trust Fund pays for, among other things, the costs of cleaning up oil spills. The Oil Spill Trust Fund tax is currently eight cents per barrel, but is scheduled to increase to nine cents per barrel after 2016. President Obama has proposed to increase the Oil Spill Trust Fund tax to nine cents per barrel beginning in 2013, and to 10 cents per barrel beginning in 2017.

Superfund. Before 1996, Superfund excise taxes and a corporate environmental income tax helped pay for the cleanup of polluted sites. President Obama has proposed to reinstate the Superfund excise taxes and the corporate environmental income tax for 10 years, from 2013 through 2022.

FINANCIAL AND INSURANCE INDUSTRIES

President Obama has proposed a number of tax-related proposals affecting the financial and insurance industries.

Financial Crisis Responsibility Fee. The President would impose a fee on covered liabilities of U.S. bank holding companies, thrift holding companies, certain broker-dealers and insured depository institutions with assets in excess of $50 billion. The rate of the fee would be 17 basis points, discounted by 50 percent for more stable sources of funding, such as long-term liabilities.

> **IMPACT:** *The fee would be effective beginning January 1, 2014 and is intended to recoup the costs of the Troubled Asset Relief Program (TARP) and to discourage excessive risk-taking by major financial firms.*

Sale of Corporate Stock. A corporation does not recognize gain on the issuance or forward sale of its own stock, but does recognize interest income on a current sale of its stock for a deferred payment. The President's proposal would require the corporation to treat a portion of the payment from a forward sale of stock as a payment of interest, includible in income.

Dealers. Dealers of certain property (commodities, commodities derivatives, securities, and options) treat 60 percent of the income from day-to-day dealer activities as capital gains. President Obama would require these dealers to treat the income as ordinary, not capital. The proposal would apply to individuals and partnerships.

> **IMPACT:** *Dealers of other types of property treat income from their day-to-day dealer activities as ordinary income. There is no reason for different treatment, according to the administration.*

Definition of "Control." If a corporation purchases a debt instrument convertible into its stock or into stock of a controlled or controlling corporation, the tax code limits the deduction for any premium paid to repurchase the instrument. The President's budget would expand the definition of "control" to encompass indirect relationships (a parent and a second-tier subsidiary) as well as direct relationships (a parent and its first-tier subsidiary). The proposal would be effective on the date of enactment.

Life Insurance. President Obama has proposed requiring a purchaser of a policy with a death benefit of at least

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$500,000 to report the purchase. The insurance company would have to report the payment of any policy benefits to the buyer. The proposal would also modify transfer-for-value rules to ensure that buyers are properly taxed when they collect on the policies.

IMPACT: *Recent years have seen a significant increase in transactions where individuals sell their previously-issued life insurance contracts to investors. The administration is concerned that investors are not reporting payments they receive, and may be inappropriately escaping taxes on the profit when the insured person dies.*

Proration Rules. Under current law, a life insurance company must prorate its investment income between the company's share and the share allocated to policyholders. The proration is used to limit the company's funding of (deductible) reserves with tax-advantaged income, such as dividends and tax-exempt interest. President Obama has proposed a simpler regime, a flat proration percentage of 15 percent that is applied to non-life insurance companies regarding the dividends-received deduction, tax-exempt interest, and certain policy cash values.

COLI. President Obama would expand the pro rata interest expense disallowance regime that applies to corporate-owned life insurance (COLI). The current disallowance regime is designed to prevent the deduction of interest expense that is allocable to a life-insurance policy's inside buildup that is not taxed. The proposal would eliminate an exception to the regime for contracts that cover the lives of officers, directors, and employees. The proposal would not repeal the exception for 20-percent owners.

IMPACT: *Retaining the exception for 20-percent owners would benefit small businesses and other taxpayers that depend heavily on the services of a 20-percent owner.*

INFORMATION REPORTING

In 2011, Congress repealed two recently enacted information reporting measures: expanded business information reporting under the Patient Protection and Affordable Care Act (PPACA) and rental property expense reporting. The administration supported repeal of these provisions. In his FY 2013 budget, President Obama has proposed new information reporting requirements.

Life Insurance. Under the President's proposal, life insurance companies would be require to report to the IRS, each variable insurance contract which is at least 10 percent invested in a private separate account, effective for tax years beginning after December 31, 2012. Ownership would be determined quarterly.

Contractors. Contractors receiving payments of $600 or more in a calendar year from a particular business would be required to provide to the business the contractor's certified taxpayer identification number (TIN), effective for payments made to contractors after December 31, 2012. Reporting would be accomplished on Form W-9. If the TIN is not provided, the business would be required to withhold a flat-rate percentage of gross payments.

BONDS

A number of provisions in the President's FY 2013 budget address tax-exempt bonds

Build America Bonds. The Build America Bond program, which expired after 2010, provided a tax credit of 35 percent to the bondholder, unless the issuer elected to receive a direct payment instead. President Obama has proposed to make permanent the Build America Bond program but at a reduced subsidy.

COMMENT: *The President also proposed to expand eligible uses for Build America Bonds to include, for example, financing for nonprofit hospitals and short-term governmental working capital.*

Indian Tribal Governments. President Obama has proposed several changes to tax-exempt bonds issued by Indian tribal governments. These include adopting the comparable state or local government standard of eligibility for issuing tax-exempt governmental bonds on a permanent basis; adopting a comparable private activity bond standard; generally requiring projects be located on Indian reservations; and generally prohibiting the use of bond proceeds to finance gaming projects.

State and Local Governmental Bonds. President Obama has proposed to allow current refundings of state and local governmental bonds, subject to a size limit and a maturity limit.

More Proposals. Additional proposals in the President's budget affecting tax-exempt bonds would:

- Simplify arbitrage investment restrictions
- Simplify single-family housing mortgage bond targeting requirements
- Streamline private business limits on governmental bonds

IRS BUDGET

The IRS' budget was cut by $305 million for FY 2012. President Obama has proposed to increase the IRS' FY 2013 budget by $944.5 million (an eight percent increase from FY 2012 levels). More than $400 million would be devoted to new enforcement activities, which the IRS projected would raise $1.48 billion in revenue annually at full performance, once newly hired employees are fully trained and develop broader experience by FY 2015.

COMMENT: *President Obama also proposed a multi-year program integrity cap adjustment for IRS tax enforcement to fund $350 million in new*

revenue-producing initiatives above current levels of enforcement and compliance activities.

ELECTRONIC FILING

Current rules require certain taxpayers, such as large corporations, to file returns electronically. Specified tax return preparers are also subject to an e-file mandate.

Schedule M-3. President Obama has proposed to require all corporations and partnerships that file Schedule M-3 (Net Income (Loss) Reconciliation for Corporations with Total Assets of $10 Million or More) to file their tax returns electronically.

COMMENT: *The President would authorize the IRS to require electronic filing by certain other large taxpayers, such as large tax-exempt organizations, not required to file Schedule M-3.*

250-Return Threshold. Generally, large corporations that file at least 250 returns during a calendar year must file their income tax returns electronically. Similar rules apply to large tax-exempt organizations. President Obama has proposed to reduce the 250-return threshold to an unspecified number in the case of information returns.

IMPACT: *The President's proposal would allow taxpayers to request a waiver if the threshold is lowered. A waiver could be granted, for example, to a taxpayer who cannot meet the requirement because of technology constraints.*

Failure to Comply with E-file Requirements. President Obama has proposed an assessable penalty for failure to comply with e-filing requirements. The penalty would be $25,000 for a corporation and $5,000 for a tax-exempt organization.

Form 5500. The President's budget would allow the IRS to require additional information to be included in electronically-filed Form 5500 Annual Reports, effective for tax years beginning after December 31, 2012.

TAX ADMINISTRATION

Audit and Adjustment Procedures. President Obama has proposed to create a new mandatory Required Large Partnership (RLP) regime for any partnership that has 1,000 or more partners at any time during the tax year. RLPs would be subject to the streamlined procedures that apply to elected large partnerships (ELPs), rather than the more complex and inefficient audit and adjustment procedures that currently apply to most large partnerships. The proposal would apply to a partnership's tax year ending on or after the date that is two years from the enactment date.

"The IRS' FY 2012 budget was cut by $305 million compared to FY 2011. President Obama has proposed to increase the IRS' funding for FY 2013."

Offers-in-Compromise. Current law requires taxpayers to make certain nonrefundable payments with any initial offer-in-compromise. President Obama has proposed eliminating the requirements that an initial offer-in-compromise include a nonrefundable payment of a portion of the taxpayer's offer.

COMMENT: *The National Taxpayer Advocate (NTA) and some tax professional groups have recommended that the nonrefundable partial payment requirement be eliminated. The NTA has said that the requirement may discourage taxpayers from seeking an offer-in-compromise.*

National Directory of New Hires (NDNH). The proposed budget would enable the IRS to use the data from the NDNH for general tax administration purposes. These include data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources.

Willful Failure to File. President Obama has proposed to upgrade, beginning on December 31, 2012, the willful failure to file a tax return from a misdemeanor to a felony. The proposal would make it a felony to willfully fail to file for three years within any five consecutive years, if the aggregated tax liability is $50,000 or more.

Compliance with Indian Tribal Government Taxes. President Obama has proposed that Indian Tribal Governments (ITGs) that impose income or wages taxes or excise taxes on alcohol, tobacco, or fuel, would be treated as states for purposes of information sharing. As a measure of protection, the ITG would be required to safeguard this information according to prescribed protocols.

State Tax Adjustments and Statutes of Limitation. The general, three-year statute of limitations for assessment of federal tax liability may prevent the IRS from making an assessment resulting from adjustments to state or local tax liabilities. President Obama has proposed a one-year extension of the statute of limitations from the date on which the taxpayer first files an amended tax return with the IRS reflecting adjustments to the state and local tax return; or a two-year extension from the date the IRS first receives information from the state or local agency under an information sharing agreement between the IRS and state and local agency.

Investigative Disclosure Statute. President Obama has proposed a clarification of existing taxpayer privacy law concerning "necessary" disclosures made in the course of an audit or investigation. The proposal would clarify that Treasury and IRS employees are not prohibited from identifying themselves, their organizational affiliation, and the nature and subject of their investigation when contacting third parties as part of a civil or criminal tax investigation.

Barcodes on Paper Returns. The proposed budged includes a requirement that all tax-

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payers who prepare their returns electronically, but print and file their returns on paper, print their returns with a 2-D barcode. The 2-D barcode on the paper return would enable the IRS to scan the return and convert it into an electronic format. The proposal would be effective for returns filed after December 31, 2012.

Credit and Debit Card Processing Fees. Generally, if the IRS accepts credit or debit card payments directly from taxpayers, the IRS is prohibited from absorbing credit and debit card processing fees. President Obama has proposed to allow the IRS to accept credit and debit card payments directly from taxpayers and absorb the processing fees for delinquent tax payments.

Math Error Authority. President Obama has proposed to expand the IRS' authority to correct certain mathematical or clerical errors. The IRS would have math error authority where a taxpayer claimed a deduction or credit in excess of a lifetime limit, and when the taxpayer claimed the earned income tax credit (EITC) during a period in which the taxpayer was previously prohibited by the IRS from claiming the EITC because, in a prior year, the taxpayer's EITC claim was due to fraud or reckless or intentional disregard of the rules and regulations.

Disclosure to Prison Officials. Under prior law, the IRS was authorized to disclose to the head of the Federal Bureau of Prisons and any state agency charged with the administration of prisons any return information with respect to incarcerated individuals whom the Secretary of the Treasury determined may have filed or facilitated the filing of a false return. This authorization expired after December 31, 2012. President Obama has proposed to make permanent this authorization.

COMMENT: *The U.S.-Korea Trade Agreement, signed into law by President Obama in October 2011, requires federal and state prisons to provide the IRS with certain information about inmates.*

Employee Leasing. The President's budget would impose joint and several liability on employee leasing companies, as well as their clients, for federal employment taxes, effective for employment tax returns required to be filed for wages paid after December 31, 2012.

Offset of Federal Refunds. President Obama has proposed to permit offset of federal refunds to collect state income tax, regardless of where the delinquent taxpayer resides.

IMPACT: *Under current law, refund offset is allowed only if the delinquent taxpayer resides in the state seeking the offset.*

Levy. Under the President's budget, the Treasury Department would be authorized to levy up to 100 percent of a payment to a Medicare provider to collect unpaid taxes.

Information Sharing. The President's budget would authorize the IRS to share return information of sole proprietors with receipts greater than $250,000 and of all partnerships with the Bureau of Economic Analysis (BEA).

TIGTA. The Treasury Inspector General for Tax Administration (TIGTA) reviews many IRS activities for compliance with the law. President Obama has proposed to eliminate and revise certain review requirements.

MISCELLANEOUS PROVISIONS

Inflation Adjustments. Many provisions in the Tax Code may be adjusted annually for inflation. Between 2008 and 2009, the annual index values used for two of the indexing methods declined for the relevant period. The President has proposed to modify the inflation adjustment provisions to prevent tax parameters from declining from the previous year's levels if the underlying price index falls.

LIHTC. Several provisions in the President's budget target the low income housing tax credit (LIHTC). These include allowing LIHTC-supported projects to elect a criterion employing a restriction on average income, permitting a real estate investment trust (REIT) that receive LIHTCs to designate as tax exempt some of the dividends it distributes, providing additional incentives for investment in preservation projects, and requiring LIHTC-supported housing to provide protections to victims of domestic violence.

REITs. A real estate investment trust (REIT) may claim a deduction for dividends paid. However, a deduction is unavailable for a preferential dividend. President Obama has proposed to repeal the preferential dividend rule for publicly offered REITs.

ESOPs. President Obama has proposed to clarify the current rule that allows a taxpayer to elect to defer the recognition of long-term capital gain on the sale of employer securities to an employee stock ownership plan (ESOP), by providing an express exception to the recapture rules for a nontaxable transfer of property to a spouse.

Non-Qualified Preferred Stock Designation. President Obama has proposed to repeal the non-qualified preferred stock (NQPS) provision and other cross-referencing provisions of the Tax Code that treat NQPS as boot.

Excise Taxes on Spirits, Wine and Beer. Any distilled spirits, wines and beer taxpayer that reasonably expects to be liable for not more than $50,000 per year in alcohol excise taxes, and that was not liable for more than $50,000 in alcohol excise taxes in the preceding calendar year, would be able to file and pay the taxes quarterly rather than semi-monthly, effective 90 days after date of enactment of the change.

Private Foundations. President Obama has proposed replacing the two rates of tax on private foundations that are exempt from federal income tax with a single tax rate of 1.35 percent.