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White House Budget Proposes Numerous Tax Changes as Congressional Tax-Writing Committees Focus on Reform

On April 10, 2013, the White House released its proposed budget for fiscal year 2014. The budget contains significant tax proposals related to renewable energy, research and job creation, as well as numerous changes affecting corporate, partnership and international tax. It also contains numerous individual tax proposals, many of which are focused on increasing revenues raised from high-income earners. Many of the proposals are the same as or very similar to proposals made in previous White House budgets. But there are important differences from last year's budget. Perhaps most significantly, the Administration has strengthened its rhetoric in favor of broader tax reform, just as the leaders of the congressional tax-writing committees have signaled a more concerted effort to pursue reform.

In this context, it is noteworthy that the Administration has continued to refrain from providing significant detail of how it might pursue tax reform. In some areas, however, the Administration's budget reflects several detailed proposals. For example, the Administration has: (1) fleshed out the operation of the Buffet Rule, which would generally require households earning over $2 million per year to pay tax at a rate of at least 30 percent; (2) proposed a mark-to-market regime for derivatives contracts that would treat all gains and losses on such contracts as ordinary income/deductions; and (3) proposed subjecting debt purchased on the secondary market with a market discount to the original issue discount (OID) regime.

General Observations

The Administration's proposals enter a tax reform debate in Washington that is more lively than at any time in recent history. President Obama is beginning his second term and has claimed a mandate of sorts on taxes, but has expended significant political capital in several recent tax policy debates, with several more looming in the near future. The Administration and Congress recently reached one compromise that raised significant revenues (to avoid the fiscal cliff) but failed to reach agreement on another (the sequester). More fiscal deadlines are approaching over the next few months, and the parties remain far apart on revenue and spending issues. Moreover, as recent months have shown, the President will face opposition to any perceived increase in taxes, having already raised individual rates. This environment will affect the President's efforts to push the specific policies outlined in the FY2014 budget.

In addition to specific proposals discussed below, the FY2014 budget supports the more general principles of deficit reduction and revenue-neutral business tax reform. The President's vision of business tax reform would lower the overall corporate rate while eliminating various business tax incentives and loopholes (the budget focuses particularly on tax benefits for fossil fuels). This support for a lower corporate rate may generate calls, particularly from Republicans in the House, for a reduction in the top individual rate as well, because the vast majority of businesses operate as flow-through entities.

As these general principles suggest, President Obama may be willing to defer to Congress on the specifics of tax reform, perhaps in recognition of the fact that two key legislative actors appear genuinely interested in reform. Sen. Max Baucus (D-MT), Chairman of the Senate Finance Committee, and Rep. Dave Camp (R-MI), chairman of the House Ways and Means Committee, recently published an op-ed in the *Wall Street Journal* indicating a strong willingness to seek bipartisan compromise in pursuit of an overhaul of the Internal Revenue Code (the Code).[1] The op-ed highlighted the extensive efforts within the legislative branch over the last year to determine what policies are reasonable and politically feasible. Rep. Camp, meanwhile, has published his own proposals to reform international, financial products and small business taxation over the last two years, some of which, as discussed below, the Administration has adopted in modified form in this budget.[2] And more recently, Sen. Baucus (together with ranking member Sen. Orrin Hatch (R-UT)), has published a series of tax reform option papers as the Senate Finance Committee begins its work on developing a proposal to reform the Code. This convergence among the major actors suggests tax reform is becoming more likely. Potentially adding to the likelihood, Sen. Baucus has announced his intention to retire from the Senate at the end of his current term, and Sen. Camp is approaching the end of his term as chairman of the Ways and Means Committee. With their influence set to decline, both members appear to have the motivation and the opportunity to forge a deal.

Still, while the President's budget contains signs of compromise with Republicans (support for a shift to the chained consumer price index is another example), the gulf between the President's spending and revenue targets and those of Republicans (as articulated in the House Republicans' budget resolution) remains wide, giving rise to the same concern the country has faced for the past several years: whether the parties can resolve their fiscal differences in the absence of a national crisis. Until there is a breakthrough on this fundamental question, the shape and timing of reform will remain unclear. The debate over the fiscal cliff this summer will be revealing: If the parties can reach agreement on the overall revenue question, it will provide a real boost to prospects for meaningful reform. But regardless of the outcome of that debate, the President's budget and the proposals of members of Congress, and Rep. Camp in particular, will serve as important foundations for the difficult discussion to come.

Tax Incentives

The tax incentives in this year's budget are largely aimed at increasing employment and investment in renewable energy. The budget also contains some long-supported provisions such as permanently extending the research and experimentation (R&E) credit. Highlights of the FY2014 budget's tax incentive provisions include:

- *Enhance and make permanent the R&E tax credit*. This proposal would make the R&E credit under section 41 of the Code[3] permanent and would increase the rate of the alternative simplified research credit from 14 percent to 17 percent, effective after December 31, 2013, when the current credit expires.
- *Modify and permanently extend renewable electricity production tax credit*. This proposal would permanently extend the section 45 tax credit available to renewable energy facilities and make the credit refundable. It also would make the full 1.5 cent per kilowatt-hour credit available to solar facilities. The credit would be available for property on which construction begins after December 31, 2013.[4]

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1 Max Baucus and Dave Camp, "Tax Reform Is Very Much Alive and Doable," *Wall Street Journal,* Apr. 7, 2013.

2 A Jan. 29, 2013, Skadden *Insights* mailing addressing Rep. Camp's business tax reform proposal is available at: http://www.skadden.com/insights/house-ways-and-means-committees-tax-reform-proposals-financial-products. A March 29, 2013, Skadden *Insights* mailing addressing his small business tax reform proposal is available at: http://www.skadden.com/insights/house-ways-and-means-proposal-would-change-tax-treatment-partnerships-and-s-corporations.

3 All section references are to the Internal Revenue Code of 1986, as amended.

4 An April 15, 2013 Skadden *Insights* mailing addressing Treasury guidance on "commencement of construction" is available at: http://www.skadden.com/insights/irs-guidance-commencement-construction-requirements-tax-credits-qualified-energy-facilities.

- *Provide additional tax credits for investment in qualified property used in a qualifying advanced energy manufacturing project*. This proposal would authorize an additional $2.5 billion of tax credits under section 48C for investments in eligible property used in qualifying advanced energy projects. Under the proposal, taxpayers would be able to apply for a credit with respect to part or all of their qualified investment. Application for the additional credits would be made during the two-year period beginning on the date on which the additional authorization is enacted.

- *Provide small businesses a temporary 10 percent tax credit for new jobs and wage increases*. This proposal would provide a temporary tax credit for small employers whose wage expenses increase, whether because of increased hiring or increased wages paid to existing workers. The amount of the credit would equal 10 percent of the eligible increase in wages. Only OASDI wages would be eligible for the credit, and the maximum credit per employer would be $500,000. The credit would be available to employers with eligible wages in 2012 of less than $20 million. This proposal would be effective for the 12-month period following the date of enactment.

- *Extend increased expensing for small businesses.* This proposal would permanently extend and index to inflation the $500,000 limit on expensing investment expenditures. In so doing, it would extend current law, which expires at the end of 2013. The maximum that can be expensed under the proposal is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $2 million.

- *Provide tax incentives for locating jobs and business activity in the U.S. and reduce tax deductions for shipping jobs offshore*. This proposal would create a new business tax credit equal to 20 percent of the eligible expenses paid or incurred in connection with moving a business or line of business from a foreign country to the United States. While the creditable costs may be incurred by a foreign subsidiary of a U.S.-based multinational company, the tax credit would be claimed by the U.S. parent company. The proposal would also reduce the tax benefits associated with moving jobs offshore by disallowing deductions for expenses paid or incurred in connection with moving a business or line of business from the United States to a foreign country. The proposal would be effective for expenses paid or incurred after the date of enactment.

- *Extend and modify the new markets tax credit*. This proposal would extend the allocation of new market tax credits under section 45D permanently, with an allocation of $5 billion in tax credits per year. The proposal also would permit new market tax credits resulting from qualified equity investments made after December 31, 2013, to offset a taxpayer's alternative minimum tax liability.

- *Provide new manufacturing communities tax credit*. The proposal would create a new allocated tax credit to support investments in communities that have suffered a major job loss event, such as occurs when a military base closes or a major employer closes or substantially reduces a facility or operating unit that results in a long-term mass layoff. Applicants for the credit would be required to consult with relevant state or local Economic Development Agencies (or similar entities) in selecting those investments that qualify for the credit. The proposal indicates that the credit could operate in a manner similar to the new markets tax credit or the qualifying advanced energy project credit. The proposal would provide approximately $2 billion in credits for qualified investments approved in each of 2014-2016.

While each of these tax incentive proposals reflects particularized policy goals that the Administration supports, it is noteworthy that each of them also runs contrary to the broader reform goal of broadening the tax base to facilitate lower rates and tax simplification. This conflict may reflect the reality that tax reform, while laudable, is politically difficult to obtain.

Domestic Tax Changes

With respect to domestic tax issues related to corporations and partnerships, the Obama Administration continues to support taxing carried interests as ordinary income and imposing a risk-related fee on large financial institutions. New this year are: (1) a proposal to mark all derivative contracts to market each year and treat all gain or loss with respect thereto as ordinary income; (2) a proposal to shift from using the consumer price index (CPI) for inflation-indexed tax provisions to using the chained CPI; and (3) a proposal to subject debt purchased on the secondary market with market discount to the OID regime. Highlights of the proposals in this area include:

- *Tax carried interests as ordinary income*. The proposal would tax as ordinary income a partner's share of income from a carried interest in an investment partnership that the partner receives in exchange for providing services to the partnership, regardless of the character of the income at the partnership level, as well as gain on the sale of the partnership interest itself. The proposal would only apply to a partnership if: (1) "substantially all of its assets" are investment-type assets (certain securities, real estate, interests in partnerships, commodities, cash or cash equivalents, or derivative contracts with respect to those assets); and (2) "over half of the partnership's contributed capital is from partners in whose hands the interests constitute property not held in connection with a trade or business." The proposal notes that the Obama Administration "remains committed to working with Congress to develop mechanisms to assure the proper amount of income recharacterization where the business has goodwill or other assets unrelated to the services" of the carried interest holder. The proposal would be effective for taxable years ending after December 31, 2013.

- *Require that derivative contracts be marked to market with resulting gain or loss treated as ordinary*. This proposal, which is similar to part of a corporate tax reform proposal put forward by Rep. Camp in January,[5] would require that gain or loss from a derivative contract be reported on an annual basis, as if the contract were sold for its fair market value no later than the last business day of the taxpayer's taxable year, with all resulting gain or loss treated as ordinary. A derivative contract would be broadly defined to include: "(1) any contract the value of which is determined, directly or indirectly, in whole or in part, by the value of actively traded property; and (2) any contract with respect to a contract that is described in (1)." The proposal also would apply to any financial instrument that is part of a straddle transaction with a derivative contract. An exception would be provided for business hedging transactions. The proposal also would eliminate or curtail a number of recent Code provisions addressing taxation of derivatives, including sections 1256 and 1092. The proposal would apply to contracts entered into after December 31, 2013.

- *Require current inclusion in income of accrued market discount and limit the accrual amount for distressed debt*. This proposal, which also is similar to part of Rep. Camp's January corporate tax reform proposal,[6] would treat market discount on debt purchased in the secondary market in much the same way that OID is treated on newly issued debt. Taxpayers would have to accrue market discount into income currently rather than deferring it until the instrument matures or is sold. The accrual amount would be limited to the greater of: 1) the bond's yield to

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5 A Jan. 29, 2013, Skadden *Insights* mailing addressing Rep. Camp's proposal is available at: http://www.skadden.com/insights/house-ways-and-means-committees-tax-reform-proposals-financial-products.

6 A Jan. 29, 2013, Skadden *Insights* mailing addressing Rep. Camp's proposal is available at: http://www.skadden.com/insights/house-ways-and-means-committees-tax-reform-proposals-financial-products.

maturity at issuance plus five percentage points; or 2) the applicable federal rate plus 10 percentage points. The proposal would apply to debt securities issued after December 31, 2013.

- *Require that the cost basis of "portfolio stock"*[7] *must be determined using an average basis method*. This proposal would require the use of average basis for all identical shares of portfolio stock held by a taxpayer that have a long-term holding period. Thus, the provision would require that the cost of any stock sold, exchanged or otherwise disposed of be determined in accordance with the average basis method now permitted for regulated investment company stock. The proposal would apply to stock acquired on or after January 1, 2014.

- *Impose a financial crisis responsibility fee*. This proposal would impose a "financial crisis responsibility fee" on U.S.-based bank holding companies, thrift holding companies and certain broker dealers. The fee would be imposed on "covered liabilities," which are "generally the consolidated risk-weighted assets of a financial firm, less its capital, insured deposits, and certain loans to small business." The rate of the fee would be 17 basis points, and the fee would be deductible. The fee would be effective on January 1, 2015.

- *Replace the CPI with the chained CPI for purposes of indexing tax provisions for inflation*. This proposal would replace the CPI as the index to which inflation-indexed tax parameters are linked with the chained CPI. The chained CPI tends to rise at a slower rate than the CPI because it takes into account shifts in consumer behavior resulting from changes in relative differences in prices of different goods. This proposal would be effective for tax years beginning after December 31, 2014.

- *Repeal gain limitation for dividends received in reorganization exchanges*. In the case of a reorganization transaction, the proposal would repeal the boot-within-gain limitation in section 356(a)(1) where the exchange has the effect of the distribution of a dividend, as determined under section 356(a)(2). The proposal would be effective for taxable years beginning after December 31, 2013.

- *Expand the definition of "built-in" loss for purposes of partnership loss transfers.* This proposal would measure "substantial built-in loss" for purposes of section 743 by reference to whether the transferee would be allocated a loss in excess of $250,000 if the partnership sold all of its assets immediately after the sale or exchange, rather than whether the partnership itself would recognize a loss under those circumstances. The proposal would apply to sales or exchanges after the date of enactment.

- *Extend partnership basis limitation rules to nondeductible expenses*. This proposal would amend section 704(d) to allow as a deduction a partner's distributive share of expenditures not deductible in computing the partnership's taxable income and not properly chargeable to capital account only to the extent of the partner's adjusted basis in its partnership interest at the end of the partnership year in which such expenditure occurred. It would apply to a partnership's taxable year beginning on or after the date of enactment.

- *Repeal technical termination of partnerships*. Under section 708(b)(1)(B), a sale or exchange of 50 percent or more of the total interest in partnership capital and profits results in a technical termination of the partnership, which can affect depreciation schedules, among other issues. This proposal would repeal section 708(b)(1)(B) effective for transfers on or after December 31, 2013.

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7 "Portfolio stock" is not defined in the proposal.

- *Eliminate oil and gas tax preferences*. This proposal would repeal: 1) the enhanced oil recovery credit for costs attributable to a qualified enhanced oil recovery project; 2) the credit for oil and gas produced form marginal wells; 3) the expensing of intangible drilling costs; 4) the deduction for costs paid or incurred for any tertiary injectant used as part of a tertiary recovery method; 5) the exception to passive loss limitations provided to working interests in oil and natural gas properties; 6) the use of percentage depletion with respect to oil and gas wells; 7) the ability to claim the domestic production manufacturing deduction against income derived from the production of oil and gas; and 8) the two-year amortization of independent producers' geological and geophysical expenditures, instead allowing amortization over the same seven-year period as for integrated oil and gas producers. These proposals would go into effect for tax years beginning after December 31, 2013.

- *Eliminate coal preferences*. This proposal would repeal: 1) expensing of exploration and development costs related to coal production; 2) percentage depletion for hard mineral fossil fuels; 3) capital gains treatment for coal royalties; and 4) the ability to claim the domestic manufacturing deduction against income derived from the production of coal and other hard mineral fossil fuels. These proposals would go into effect for tax years beginning after December 31, 2013.

- *Repeal LIFO and LCM inventory accounting methods.* This proposal would repeal the last-in, first-out (LIFO) and lower-of-cost-or-market (LCM) inventory accounting methods. The increase in income resulting from conversion from LIFO to first-in, first-out (FIFO) accounting would be taxed ratably over 10 years, beginning with the year of change. Similarly, the impact of the LCM repeal would be taken into account ratably over four years, also beginning with the year of change.

- *Deny deduction for punitive damages*. This proposal would deny deduction for punitive damages paid or incurred by a taxpayer. Where the punitive damage liability is covered by insurance, the damages would be included in the income of the insured person. This proposal would apply to damages paid or incurred after December 31, 2014.

- *Make the Low Income Housing Tax Credit (LIHTC) beneficial to Real Estate Investment Trusts (REITs)*. This proposal would permit a REIT that receives LIHTCs to designate some dividends it distributes as tax-exempt. These dividends would be excluded from the gross income of the shareholders that receive them. The amount of tax-exempt dividends could not exceed the quotient of the REIT's LIHTCs for the year divided by the highest corporate tax rate in section 11(b). The proposal would be effective for taxable years of a REIT that end after the date of enactment.

- *Repeal preferential dividend rule for publicly traded and publicly offered REITs*.[8] This proposal would repeal the prohibition on "preferential dividends" for publicly traded and publicly offered REITs. A similar rule was repealed with respect to RICs in 2010. The proposal would apply to distributions made in taxable years after the date of enactment.

- *Reinstate and extend Superfund excise taxes*. This proposal would extend the three Superfund excise taxes — taxes on 1) domestic crude oil, 2) listed hazardous materials and 3) certain imported substances — through December 31, 2023, and extend the excise tax on domestic crude oil and imported petroleum products to other crudes such as those produced from bituminous deposits as well as kerogen-rich rock.

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8 The proposal defines a publicly offered REIT as a REIT: (a) that is required to file periodic reports with the SEC; (b) that is no more than one-third owned by a single person; and (c) the stock of which is the subject of a currently effective offering registration, or such registration has been effective with respect to that stock within the immediately preceding 10-year period.

- *Reinstate Superfund environmental income tax.* This proposal would reinstate the corporate environmental income tax for taxable years beginning December 31, 2013, and ending December 31, 2023.

- *Repeal Non-Qualified Preferred Stock (NQPS) designation.* This proposal would repeal the NQPS designation of section 351(g), effective December 31, 2013.

- *Repeal anti-churning rules of section 197*. Under section 197(f)(9), intangibles are not treated as amortizable if they meet certain conditions. This proposal would repeal section 197(f)(9) for acquisitions after December 31, 2013.

The vast majority of these proposals can be described as efforts to broaden the tax base, which would further the President's stated goal of working towards a more efficient Code. Several others, such as the proposed repeal of the partnership termination and anti-churning rules, can be viewed as small, yet important, steps towards simplification. One proposal that does not fall into either of those categories, however, is the proposal to make the LIHTC beneficial to REITs. While that proposal is intended to expand the sources of capital available for investing in tax-favored residential real estate projects, it will be interesting to see how the tax-writing committees react to this concept when there appears to be growing support in Congress to allow master limited partnerships to invest more broadly in tax-favored renewable energy projects.

International Tax Changes

The budget includes a number of proposals affecting the tax treatment of income earned outside the United States, most of which are similar if not identical to proposals from earlier years. One exception is a new proposal to exempt foreign-based pension funds from Foreign Investment in Real Property Tax Act (FIRPTA). Highlights of the Administration's international tax proposals include:

- *Defer deduction of interest expense related to deferred income of foreign subsidiaries*. This proposal would defer the deduction of interest expense properly allocated and apportioned to stock of a foreign corporation that exceeds an amount proportionate to the taxpayer's *pro rata* share of income from such subsidiaries that is currently subject to U.S. tax. Directly earned foreign source income, such as income earned by a taxpayer through a branch, would be considered currently subject to U.S. tax for these purposes. Interest expense that is deferred under the proposal would be deductible in a subsequent tax year to the extent that the amount of interest expense allocated and apportioned to stock of foreign subsidiaries in that year is less than the annual limitation for that year. The proposal would be effective for taxable years beginning after December 31, 2013.

- *Determine the foreign tax credit on a pooling basis.* This proposal would require a U.S. taxpayer to compute its deemed paid foreign tax credit based on a single pool reflecting the aggregate foreign taxes and earnings and profits of all foreign subsidiaries for which it could claim the credit. The foreign tax credit for a taxable year would be limited to an amount proportionate to the taxpayer's *pro rata* share of the consolidated earnings and profits of such foreign subsidiaries repatriated in that taxable year that are currently subject to U.S. tax. Foreign taxes deferred under this proposal in prior years would be creditable in a subsequent taxable year to the extent that the amount of deemed paid foreign taxes in the subsequent year are less than the annual limitation for that year. The proposal would be effective for taxable years beginning after December 31, 2013.

- *Tax currently excess returns associated with transfers of intangibles offshore.* This proposal provides that "if a U.S. person transfers (directly or indirectly) an intangible asset from the United States to a related CFC (a 'covered intangible'), then certain excess income from transactions connected with or benefitting from the covered intangible would be treated as subpart F income if the income is subject to" a foreign effective tax rate of 15 percent or less. The proposal would be effective for transactions in taxable years beginning after December 31, 2013.

- *Limit shifting of income through intangible property transfers.* This proposal would expand the definition of intangible property for purposes of sections 367(d) and 482 to include workforce in place, goodwill and going concern value. The proposal also would allow the Commissioner to value a group of intangible properties as a group rather than as individual intangibles. The proposal would be effective for taxable years beginning after December 31, 2013.

- *Disallow the deduction for non-taxed reinsurance premiums paid to affiliates*. This proposal would deny an insurance company a deduction for premiums and other amounts paid to affiliated foreign companies with respect to reinsurance of property and casualty risks to the extent that the foreign reinsurer (or its parent company) is not subject to U.S. income tax with respect to the premiums received. At the same time, it would exclude from the insurance company's income (in the same proportion in which the premium deduction was denied) any return premiums, ceding commissions, reinsurance recovered or other amounts received with respect to reinsurance policies for which a premium deduction is wholly or partially denied. The proposal would apply to policies issued after December 31, 2013.

- *Tax gain from the sale of a partnership interest on a look-through basis.* This proposal would provide that gain or loss from the sale or exchange of a partnership interest is effectively connected with the conduct of a trade or business in the U.S. to the extent attributable to the transferor partner's distributive share of the partnership's unrealized gain or loss that is attributable to effectively connected income property. Subject to a variety of exceptions, the transferee of the partnership interest would be required to withhold 10 percent of the amount realized on the sale or exchange of the partnership interest after December 31, 2013.

- *Limit earnings stripping by expatriated entities.* This proposal would revise section 163(j) to tighten the limitation on the deductibility of interest paid by an expatriated entity to related persons. The current law debt-to-equity safe harbor would be eliminated. The 50 percent adjusted taxable income threshold for the limitation would be reduced to 25 percent. The carryforward for disallowed interest would be limited to ten years, and the carryforward of excess limitation would be eliminated. The proposal would be effective for taxable years beginning after December 31, 2014.

- *Modify tax rules for dual capacity taxpayers.* This proposal would replace regulatory guidelines that determine the amount of a foreign levy that qualifies as a creditable tax in the case of a foreign levy paid by taxpayers that also receive a specific economic benefit from the levying country ("dual capacity taxpayers"). It also would treat as a creditable tax a portion of the levy not in excess of the foreign levy that would be paid if the taxpayer were not a dual capacity taxpayer. The proposal would also incorporate the limitation rules of section 907 into a separate category in section 904 for foreign oil and gas income. Treaties that allow a credit for taxes paid or accrued on certain oil or gas income would not be affected by the proposal. The proposal would be effective for taxable years beginning after December 31, 2013.

- *Prevent use of leveraged distributions from related foreign corporations to avoid dividend treatment.* This proposal would provide that to the extent a foreign corporation (the "funding corporation") funds a second, related foreign corporation (the "foreign distributing corporation") with a principal purpose of avoiding dividend treatment on distributions to a U.S. shareholder, the U.S. shareholder's basis in the stock of the distributing corporation will not be taken into account for the purpose of determining the treatment of the distribution under section 301. The proposal would apply to distributions after December 31, 2013.

- *Extend section 338(h)(16) to certain asset acquisitions.* section 338(h)(16), which generally provides that a deemed asset sale resulting from a section 338 election is not treated as occurring for purposes of determining the source or character of any item for purposes of applying the foreign tax credit rules to a seller, does not presently apply to certain types of covered asset acquisitions subject to the credit disallowance rules under section 901(m). The proposal would extend the application of section 338(h)(16) to any covered asset acquisition (within the meaning of section 901(m)) completed after December 31, 2013.

- *Exempt certain foreign pension funds from the application of FIRPTA*. This proposal would exempt certain gains of foreign pension funds from the disposition of U.S. property from U.S. tax under FIRPTA, bringing the treatment of those gains in line with the treatment of gains of U.S. pension funds from the disposition of U.S. property. The proposal would be effective for dispositions of U.S. real property interests occurring after December 31, 2013.

- *Remove foreign taxes from a section 902 corporation's foreign tax pool when earnings are eliminated*. This proposal would reduce the amount of foreign taxes paid by a foreign corporation in the event a transaction results in the elimination of a foreign corporation's earnings and profits other than a reduction of earnings and profits by reason of a dividend or deemed dividend, or by reason of a section 381 transaction. The amount of foreign taxes that would be reduced in such a transaction would equal the amount of foreign taxes associated with the eliminated earnings and profits. This proposal would be effective for transactions occurring after December 31, 2013.

Like the domestic tax changes proposed in the FY2014 budget, most of the international proposals described above can be viewed as base broadeners that would raise revenue. As the tax-writing committees focus on proposals to move closer toward a territorial system, it will be interesting to observe whether the Administration's specific proposals gain traction.

Changes to Taxation of Individuals

The list of individual tax proposals is somewhat shorter this year, with recent legislation having resolved some high-visibility issues from the FY2013 budget. Two additions to the list are a detailed version of the Buffet Rule, which aims to ensure that high-income earners pay tax at a rate of at least 30 percent, and a limit on the accrual of tax-favored retirement benefits. Highlights in this area include:

- *Implement the Buffet Rule by imposing a new "Fair Share Tax"*. This proposal would impose a "tentative" 30 percent tax on a taxpayer's adjusted gross income (AGI) as reduced by a charitable credit equal to 28 percent of itemized charitable contributions. It would then impose a "final" tax on the amount by which the tentative tax exceeds the taxpayer's income and employee's share of payroll taxes. The tax is phased in linearly starting at $1 million of AGI ($500,000 for a married individual filing separately), and is fully phased in for taxpayers with AGI above $2 million ($1 million for a married individual filing separately). The threshold is indexed for inflation. The proposal would be effective for taxable years beginning after December 31, 2013. This proposal is very similar to proposed legislation originally sponsored by Sen. Sheldon Whitehouse (D-RI) in February of 2012 and taken up by Democrats in both houses in the time since.

- *Limit the total accrual of tax-favored retirement benefits*. This proposal would limit the deduction or exclusion for contributions to tax-favored retirement plans for an individual who has total balances or accrued benefits under those plans that are sufficient to provide an annuity equal to the maximum allowed defined benefit plan benefit. If a taxpayer reached the maximum permitted accumulation, no further contributions or accruals would be permitted, though the balance could continue to grow with investment earnings and gains. If a taxpayer's account received an accrual or contribution above the limit, the taxpayer would have to include that amount in income. Currently, the maximum defined benefit is $205,000/year, which corresponds with savings of roughly $3.4 million for an individual at age 62. The limit would be determined at the end of a calendar year and would apply to deductions and accruals for the following calendar year. This proposal would be effective for taxable years beginning after December 31, 2013.

- *Reduce the value of certain tax expenditures.* This proposal would limit the tax value of specified deductions or exclusions from AGI and all itemized deductions to 28 percent of the specified exclusions and deductions that would otherwise reduce taxable income in the 33 percent, 35 percent and 39.6 percent tax brackets. A similar limitation would apply to the Alternative Minimum Tax (AMI). Note that this limitation would affect not only itemized deductions but also the exclusion for state and local bond interest, employer-sponsored health insurance, and contributions to defined contribution retirement plans and IRAs, among other things. The proposal would apply to itemized deductions after they have been reduced by the statutory (Pease) limitations on certain itemized deductions for higher income taxpayers. The proposal would be effective for taxable years beginning after December 31, 2013.
- *Restore the estate, gift and generation-skipping transfer tax parameters in effect in 2009.* This proposal would set the maximum estate tax and generation skipping transfer tax rates at 45 percent with a lifetime exclusion of $3.5 million. Gifts also would be taxed at a 45 percent rate, with a lifetime exclusion of $1 million. Currently, all three are taxed at a 40 percent rate with a lifetime exclusion of $5 million. The proposal would be effective for the estates of decedents dying, and for transfers made, after December 31, 2017.