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In this issue:

White House releases FY 2016 budget proposal

President Obama on February 2 released a budget blueprint for fiscal year 2016 that, among other things, fleshes out proposals from his 2012 corporate tax reform framework to use revenue from a one-time deemed repatriation tax to pay for infrastructure spending and adds new detail around proposals he outlined in his most recent State of the Union message to increase taxes on upper-income individuals and highly leveraged financial institutions to offset the cost of tax relief and spending targeted to the middle class.

As part of the budget process, the White House also released what's known as the "Greenbook," which provides the Treasury Department's explanations of the revenue provisions in the budget proposal.
URL: http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf

Many of the revenue provisions are repeated from previous Obama administration budget proposals; however, there are several significant new provisions affecting both corporate and individual taxpayers. This report briefly highlights those provisions.

Notable multinational, corporate tax provisions

The FY 2016 budget proposal includes two related, large revenue raisers directed at multinationals.

- **Minimum tax –** The first would impose a per-country 19 percent minimum tax on the foreign income of domestic companies and their controlled foreign corporations. The 19 percent tax would be reduced by 85 percent of the foreign effective tax rate in each country where the income is earned. Thus, income already taxed where earned at a rate at least as high as the proposed minimum tax rate would generally not be subject to any further tax in the U.S. when repatriated. The administration estimates this proposal would raise almost $206 billion over 10 years.

- **Repatriation –** The second, as part of the transition to the 19 percent minimum tax, would impose a one-time 14 percent tax on previously untaxed foreign earnings. The tax would be payable ratably over five years. The proposal does not appear to make any distinction between earnings held as cash or other assets. A foreign tax credit (calculated using a ratio of the 14 percent rate to the top U.S. statutory corporate rate) would be allowed, and no further tax would be due on any earnings that are repatriated. The administration says this proposal would raise $268 billion over 10 years, of which $238 billion would be set aside to fund infrastructure spending with the remaining $30 billion used for deficit reduction.

Fee on financial institutions: Similar to past budgets, the administration proposes to levy a fee on large financial institutions. This year's version would apply a fee of 7 basis points (.07 percent) on certain liabilities of financial institutions with worldwide consolidated assets of more than $50 billion. According to the Treasury explanation, financial institutions would include banks, insurance companies, exchanges, asset managers, and broker-dealers. The administration estimates this proposal would raise almost $112 billion over 10 years.

Information reporting: In addition to past information reporting proposals to improve compliance, the administration adds two new provisions that would:

- Require businesses to obtain a taxpayer identification number (TIN) from contractors and match that TIN with the IRS or withhold a flat-rate percentage of payments (of $600 or more) to the contractor; and
- Require enhanced Form 1098 reporting for mortgage interest to include outstanding principal amounts, address of the property, refinancing information, taxes paid from escrow, and the loan origination date.

Energy: The budget includes many provisions from past budgets that would eliminate fossil fuel preferences, but it adds a new one this year that would treat fossil-fuel publicly traded partnerships (PTPs) as C corporations for income tax purposes. This proposal, however, would not apply to these PTPs until 2021.

Recycled provisions: Some notable corporate offsets carried over from previous budget packages include proposals to:

- Tighten the international tax rules, including provisions to restrict deductions for "excessive" interest by members of financial reporting groups, limit the ability of domestic entities to expatriate (modified from previous versions), curtail the use of leveraged distributions to avoid dividend treatment, and limit shifting of income through intangible property transfers;
- Repeal the nonqualified preferred stock designation, and eliminate the "boot-within-gain" limitation under section 356(a);
- Repeal the last in, first out (LIFO) and lower of cost or market (LCM) accounting methods; and
- Slow the depreciation schedule for corporate jets.

Notable individual provisions

Following through on the “middle-class economics agenda” he laid out in his January 20 State of the Union message, the president includes proposals in his budget package that would provide a tax credit of up to $500 for low-and middle-income two-earner households and increase the maximum Child and Dependent Care Tax Credit from $1,050 to $3,000 for each child under 5 years old.

These tax relief provisions, among other budget initiatives, would be offset by proposals to:

- Increase the top rate on long-term capital gains and qualified dividends from 20 percent to 24.2 percent. (Including the 3.8 percent surtax on net investment income enacted as part of the Patient Protection and Affordable Care of 2010, the total top rate would rise to 28 percent.)
- Eliminate stepped-up basis for appreciated assets at death, subject to various exemptions including a $100,000 per-person capital gain exclusion that is portable between spouses.

The administration estimates these proposals together would raise almost $208 billion over 10 years.

Charitable giving: The budget package includes a new revenue-raising provision that would disallow the deduction for charitable contributions that are a prerequisite for purchasing tickets to college sporting events.

Returning provisions: Among the key individual tax revenue raisers carried over from previous budget packages are proposals to:

- Implement the so-called “Buffett Rule” – now referred to as the “Fair Share Tax” – which would require households with incomes over $1 million to pay at least 30 percent of their income (after charitable giving) in taxes.
- Cap the value of itemized deductions and certain income exclusions for high-income taxpayers at 28 percent.
- Restore the estate tax parameters to those in effect in 2009 – i.e., a 45 percent top rate and a $3.5 million exclusion. (Under the president’s plan, the exclusion amount would not be indexed for inflation, but would be portable between spouses.)
- Tax income from carried interests at ordinary rates;
- Limit tax benefits for high-balance, tax-favored retirement plans;
- Require non-spouse beneficiaries of deceased IRA owners and retirement plan participants to take inherited distributions over no more than five years;
- Expand the Earned Income Tax Credit for workers without qualifying children.

Limited ‘extenders’ included

The budget package does not explicitly address many of the several dozen temporary tax deductions, credits, and exclusions that expired at the end of 2014; however, it does include provisions that would renew or make permanent a number of these so-called tax “extenders.” Most notably, the budget proposal would:

- Permanently extend the subpart F exception for active financing income and the lookthrough treatment of payments between related controlled foreign corporations. (This is new in this year's budget proposal. Past budgets called for a temporary extension).
- Expand and permanently extend the research and experimentation credit.
- Modify and permanently extend the renewable energy production tax credit and investment tax credit.
- Modify and permanently extend the New Markets Tax Credit and the Work Opportunity Tax credit.
- Modify and extend the tax credit for the construction of energy-efficient new homes.
- Modify and permanently extend the deduction for energy-efficient commercial building property.
- Permanently extend the increased section 179 expensing and investment limitations.
- Modify and extend the tax credit for cellulosic biofuels.
- Enhance and make permanent (with modifications) the deduction for contributions of conservation easements.
- Extend the exclusion from income for cancellation of certain home mortgage debt.

Congressional action unlikely

Presidential budgets are often considered "Dead on Arrival" on Capitol Hill, and this one is no different. Many provisions are strongly opposed by the GOP and are unlikely to be even voted on. Congressional Republican leaders rejected key elements of the middle-class economics agenda that the president previewed in the days leading up to his State of the Union message, and the tone on Capitol Hill has not changed with the release of the full budget blueprint.

House Ways and Means Committee Chairman Paul Ryan, R-Wis., stated in a February 2 news release that "[t]he American people are working harder than ever to get ahead, and this administration wants to put up yet another roadblock: $2.1 trillion in new taxes. And despite this massive tax hike, the president's budget never balances, adding $8.5 trillion in more debt. This is simply unacceptable."

Senate Finance Committee Chairman Orrin Hatch, R-Utah, likewise dismissed the president's proposal as "[a] $4 trillion government spending spree propped up by massive new take hikes." According to Hatch, the blueprint "lacks fiscal responsibility, not ever reaching a balance, and does nothing to reform the greatest drivers of our debt – Medicare, Medicaid, and Social Security."

Congressional taxwriters will have an opportunity to critique the president's budget proposals at a House Ways and Means Committee hearing scheduled for February 3 and a Senate Finance Committee hearing set for February 5. Treasury Secretary Jack Lew will be the sole witness at both hearings.

More details to come

Deloitte Tax LLP will release a detailed discussion of significant new revenue provisions in the president's budget proposal later this week.

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