# Obama Administration FY 2014 budget focuses on tax reform, deficit reduction, and new initiatives

*April 10, 2013*

## In brief

President Obama today submitted to Congress a $3.77 trillion federal budget for Fiscal Year 2014. The budget separates the Administration's revenue proposals into three categories – tax reform, deficit reduction, and offsets for certain tax relief proposals and new programs.

The budget asks Congress to "immediately begin the process of reforming the individual and business tax systems." As a "starting point for comprehensive reform," the budget reserves more than $300 billion in international and domestic tax increase proposals for "revenue-neutral business tax reform," including some new proposals such as mark-to-market rule for derivatives.

The budget proposes specific provisions to make permanent as part of tax reform, including a modified research credit, certain renewable energy tax provisions, and several temporary individual and small business tax provisions. Unlike previous Administration budgets, CFC look-through, active financing, leasehold improvements, and other temporary business tax provisions are not included in the President's FY 2014 budget. The budget states that the President's proposals for revenue neutral-tax reform will "prevent hundreds of billions of dollars from being added to the deficit if Congress continues to extend temporary business tax incentives without paying for them." Congress extended most of the traditional business tax extenders through the end of 2013 as part of the 2012 'fiscal cliff' legislation.

The President's budget calls for $583 billion in increased revenues from upper-income individuals for deficit reduction, as part of $1.8 trillion in new deficit reduction proposals. The Administration projects that the federal deficit to be reduced to 1.7 percent of GDP by FY 2023 under its budget.

The budget also includes a cigarette tax increase and other revenue-raising proposals to offset the cost of "middle-class" tax relief proposals and spending on infrastructure and education programs.

The Treasury Department released a 256-page General Explanation of the Administration's FY 2014 Revenue Proposals (Green Book). Click here for a copy of the Treasury Green Book.

## In detail

### Tax reform

While not providing a specific tax reform plan, the Administration's budget states that President Obama is calling on Congress to work with the Administration on "corporate tax reform that will close loopholes, lower the corporate tax rate, encourage investment at home, and not add a dime to the deficit."

Citing the President's support for "revenue-neutral business tax reform," the budget proposes that a number of revenue-raising provisions be reserved for tax reform.

*Specific international tax measures reserved in the budget for tax reform include proposals that would:*

- Defer deductions of interest expense related to deferred income from foreign subsidiaries.
- Require pooling of foreign tax credits.
- Tax currently "excess returns" associated with transfers of intangibles offshore.
- Limit shifting of income through intangible property transfers.
- Modify tax rules for dual capacity taxpayers.
- Limit earnings stripping by expatriated entities.
- Disallow deductions for excess non-taxed reinsurance premiums paid to foreign affiliates.
- Tax gain from the sale of a partnership interest on look-through basis.
- Prevent use of leverage distributions from related foreign corporations to avoid dividend treatment.
- Extend section 338(h)(16) to certain asset acquisitions.
- Remove foreign taxes from a section 902 corporation's foreign tax pool when earnings are eliminated.

***Note***: The President's budget reaffirms the Administration's support for a minimum tax on foreign earnings, but does not include a proposal to achieve this objective.

*Other Administration revenue-raising proposals to be reserved for tax reform would:*

- Eliminate certain oil and gas preferences, including the domestic manufacturing deduction, expensing of intangible drilling costs, and percentage depletion.
- Eliminate certain coal preferences, including the domestic manufacturing deduction.
- Require that derivative contracts be marked to market with the resulting gain or loss treated as ordinary income. A similar mark-to-market proposal is included in a broader financial products tax reform discussion draft released in late January by House Ways and Means Committee Chairman Dave Camp (R-MI). For more information on the financial products discussion draft, see the February 12, 2013 "WNTS Insight – Ways and Means 'Discussion Draft' proposes major changes to taxation of financial products."
- Modify treatment of insurance companies and products, including dividends-received deduction for life insurance company separate accounts.
- Repeal LIFO method of accounting
- Repeal lower-of-cost-or-market inventory accounting method.
- Modify depreciation rules for non-commercial general aircraft.
- Repeal gain limitation for dividends received in reorganization exchanges
- Expand the definition of built-in loss for purposes of partnership loss transfers.
- Extend partnership basis limitation rules to non-deductible expenditures.
- Limit the importation of losses under related-party loss limitation rules.
- Deny deduction for punitive damages

***Observation***: The budget does not propose a target corporate tax rate reduction, but does note the President's 2012 framework for business reform, which called for a 28-percent top corporate rate and reduced rates for certain domestic manufacturing activities. However, the President's FY 2014 budget also does not include proposals from last year that called for targeting the section 199 domestic manufacturing deduction. For more information on the President's 2012 tax reform proposals, see the February 22, 2012 "WNTS Insight – Obama Administration releases business tax reform framework."

***Deficit reduction individual tax increases***

While not seeking any additional individual tax rate increases beyond those enacted as part of the 2012 'fiscal cliff' legislation, the President's budget proposes to reduce the federal deficit by:

- Limiting to 28 percent the value of all itemized tax deductions and certain tax exclusions, including tax-exempt interest, employer-sponsored health insurance, and retirement contributions, for individuals with taxable incomes in the 33-percent, 35-percent, or 39.6-percent tax brackets. A similar limitation would apply under the alternative minimum tax. The Treasury Department estimates this proposal to raise $529 billion over 10 years.

- Implementing a "Buffett Rule" 30-percent minimum tax on modified adjusted gross income over $1 million, with carve-out for charitable giving. This proposal is estimated to raise $53 billion over 10 years.

### *Other proposals*

The budget identifies several revenue-raising proposals to offset the cost of "middle-class" tax relief proposals and infrastructure tax incentives, including a new proposal to exempt certain foreign pension funds from FIRPTA rules.

These proposed revenue offsets include proposals to:

- Tax 'carried interest' partnership income as ordinary income.
- Impose a $3 million limit on an individual's total balance across all individual retirement accounts (IRAs) and other tax-preferred retirement accounts.
- Reinstate the estate tax at 2009 levels, with a top rate of 45 percent and a $3.5 million exemption.
- Establish a "financial crisis responsibility fee" on large financial institutions.
- Require current inclusion in income of accrued market discount and limit the accrual amount of distressed debt.
- Require that the cost basis of portfolio stock that is a covered security must be determined using the average basis method.
- Reinstate Superfund taxes.
- Make permanent the FUTA surtax.
- Increase certainty with respect to worker classification.
- Restrict deductions for certain conservation easements.
- Expand 'tax gap' compliance requirements.

### *Chained CPI*

The President's budget also proposes to use a 'chained CPI' method of inflation indexing that would affect both federal benefit programs and tax provisions, while preserving benefit levels for certain lower-income individuals. Treasury estimates that the President's chained CPI proposal would reduce the deficit by $230 billion over 10 years; White House officials previously have projected that $130 billion in savings would come from spending reductions and $100 billion would come from increased revenues (in addition to other specific Administration revenue-raising proposals).

## *House and Senate action*

Both the House and Senate in March passed budget resolutions that differ significantly on how to address federal deficits, but both chambers expressed support for pursuing tax reform legislation. President Obama today stated that he hopes his proposed budget will help Congress to find “common ground” on deficit reduction and enact reforms that promote economic growth.

The House approved an FY 2014 budget resolution that calls for revenue-neutral tax reform, and would balance the federal budget in 10 years with only spending cuts and no additional tax increases. For more information on the House budget resolution, see the March 12 “WNTS Insight – House Republican budget calls for business and individual tax reform.”

The Senate budget resolution calls for a $975 billion tax increase over 10 years as part of a “balanced” package of revenue increases and spending cuts that together would reduce projected federal deficits by $1.85 trillion by FY 2023. The Senate-approved budget resolution also calls for “deficit-neutral” tax relief and tax reform. For more information on the Senate budget resolution, see the March 14 “WNTS Insight – Senate Budget Committee calls for tax increase; Senate Finance Committee prepared for tax reform.”

Meanwhile, the House Ways and Means Committee is continuing its consideration of tax reform issues. The Ways and Means Committee in February formed 11 tax reform working groups to seek public input on various tax issues. There is an April 15, 2013 deadline to submit comments to the working groups, with a final Joint Committee on Taxation staff report to be delivered by May 6, 2013. Ways and Means Committee staff will continue to accept comments after those dates.

Senate Finance Chairman Max Baucus (D-MT) and Ranking Member Orrin Hatch (R-UT) in March outlined plans for the committee to develop tax reform legislation. Finance Committee members recently began holding weekly sessions to discuss tax reform issues.

## *The takeaway*

Although Congress and President Obama continue to debate how to address federal deficits, all parties are interested in significant tax reform legislation. Thus, businesses and individuals should review the tax reform proposals and continue to provide input to tax policymakers.

## *Let's talk*

For a deeper discussion of how this might affect your business, please contact:

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