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President Obama's FY 2013 budget includes business and individual tax increase proposals

Overview

President Barack Obama today proposed an FY 2013 federal budget that calls for $3.8 trillion in overall federal spending for that year. The Administration is projecting a $1.33 trillion federal deficit for current FY 2012, which ends September 30, or 8.5 percent of GDP. The Administration is projecting a $905 billion federal deficit for FY 2013, or 5.5 percent of GDP.

The Administration proposes $3 trillion in deficit reduction over ten years, of which $1.5 trillion would come from increases in certain business and individual taxes. The Administration projects that under the President's proposals the federal deficit would be reduced to three percent of GDP by FY 2018.

The Administration's budget features tax proposals President Obama outlined in his recent State of the Union address, including new tax incentives for domestic manufacturing and elimination of "tax deductions for shipping jobs overseas." The business and individual tax increase proposals in the President's budget include a number of "loophole closers" and other revenue changes that have been previously proposed by the Administration. The budget also contains several new revenue-raising proposals (listed below).

Tax reform

White House officials have indicated that release of President Obama's "framework" for corporate tax reform will be delayed until late February. The Administration is expected to outline its proposal for a minimum tax on overseas profits as part of its corporate reform framework. In his budget statement, President Obama states that the "tax system should be simplified and work for all Americans with lower individual and corporate tax rates and fewer tax brackets."

The President comments that the United States has "one of the highest statutory rates" among developed countries but asserts that "special interest loopholes" result in the U.S. tax code generating about the same amount of corporate tax revenue as a share of GDP as other developed countries. He also cites the temporary nature of many tax provisions as adding to uncertainty and complicating the fiscal outlook.

Incentives for domestic manufacturing

As outlined in the President's State of the Union address, the President's FY 2013 budget includes tax incentives for domestic manufacturing and job creation. The Administration would limit the domestic manufacturing deduction by excluding certain income from the production of oil, gas, coal, other hard mineral fossil fuels, and "certain other non-manufacturing activities." Revenue from this limitation is proposed to be used to increase the deduction rate for domestic manufacturing activity, and to provide an enhanced rate of approximately 18 percent for activities involving the manufacture of certain advanced technology property.

The Administration also proposes to provide a 20-percent credit for expenses paid or incurred in connection with "insourcing" a U.S. trade or business, and to disallow deductions for expenses paid or incurred in connection with "outsourcing" a U.S. trade or business.

Additional domestic investment tax incentives include proposals that would:

- Provide a temporary 10-percent tax credit for new jobs and wage increases;
- Provide additional tax credits for investment in certain qualified advanced energy manufacturing property;
- Replace the current deduction for energy-efficient commercial building expenditures with a tax credit; and
- Reform and extend Build America Bonds.

Expired and expiring tax provisions

The Administration's budget proposes to extend retroactively a number of business tax provisions that expired at the end of 2011. The Administration's budget proposes to expand and make permanent the research credit. The budget also proposes to extend a number of other expiring provisions through the end of 2013, including CFC look-through, Subpart F active financing, and 15-year depreciation recovery for qualified leasehold improvements. Temporary provisions related to fossil fuel production would not be extended under the Administration's budget.

The Administration also proposes extending full expensing for qualified property through the end of 2012, as well as an extension of the current two-percent employee payroll tax reduction for the rest of 2012. A House-Senate conference committee has been negotiating on how to offset the approximately $160 billion cost of extending the payroll tax reduction, extended unemployment benefits, and Medicare physician pay rates. Those three provisions last year were extended through February 29; under current law, 50-percent "bonus" depreciation is in effect for 2012.

Business tax increase proposals

Specific international tax measures include proposals from previous Administration budgets that would:

- Defer deductions of interest expense related to deferred income of 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; and
- Disallow deductions for excess non-taxed reinsurance premiums paid to foreign affiliates.

Other Administration revenue-raising proposals would:

- Impose a financial crisis responsibility fee;
- Eliminate certain oil and gas preferences, including expensing of intangible drilling costs, percentage depletion, and domestic manufacturing deduction for oil and natural gas companies;
- Eliminate certain coal preferences;
- Reinstate Superfund taxes;
- Modify treatment of insurance companies and products, including dividends-received deduction for life insurance company separate accounts;
- Tax "carried interest" as ordinary income;
- Repeal gain limitation for dividends received in reorganization exchanges;
- Deny deduction for punitive damages;
- Repeal LIFO method of accounting;
- Repeal lower-of-cost-or-market inventory accounting method;
- Make permanent the FUTA surtax;
- Increase certainty with respect to worker classification; and
- Eliminate special depreciation rules for corporate purchases of aircraft.

New revenue-raising proposals

In addition to reviving international and business tax increases from previous budgets, the President's FY 2013 budget includes several new proposals to:

- Tax gain from the sale of a partnership interest on look-through basis;
- Prevent the 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;
- Expand the definition of built-in loss for purposes of partnership loss transfers;
- Extend partnership basis limitation rules to non-deductible expenditures; and
- Limit the importation of losses under section 267(d).

Individual tax increases proposed for "upper-income" taxpayers

The Administration has renewed its proposal that individual tax cuts first enacted in 2001 and 2003 should expire after 2012 for upper-income taxpayers, defined as single filers with incomes above $200,000 and joint filers with incomes above $250,000. This would result in a top tax rate of 39.6 percent on ordinary income. The Administration also would reinstate the limitation on itemized deductions (the "Pease" provision) and the personal exemption phase-out (the "PEP" provision). In addition, the value of itemized deductions and other tax preferences would be limited to 28 percent for upper-income taxpayers.

The Administration proposes a 20-percent tax rate for the capital gains income of upper-income taxpayers, but, in a departure from past budgets, proposes to tax as ordinary income the qualified dividends of upper-income individuals. In addition, estate taxes, gift taxes, and generation-skipping taxes would be set at 2009 levels. Current tax rates for taxpayers with incomes below the upper-income thresholds would be made permanent.

The Administration states that its budget proposals would move toward the "Buffett rule," under which those making more than $1 million should pay no less than 30 percent of their income in taxes. The budget states that President Obama supports tax reform so that individuals making over $1 million "should not pay lower taxes than the middle class." The budget also states that President Obama believes tax reform should eliminate certain tax deductions, credits, and exclusions, including tax preferences for housing, health care, and retirement, for taxpayers with income above $1 million.

Click here for the Administration's summary of its revenue proposals. Click here for the Treasury Department's general explanation of the President's revenue proposals.

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