

Decision Points for Tax Policy 2012 Tax Legislative Outlook

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The heart of the matter

The 2012 elections for control of the White House and Congress will mark a key decision point for tax policy. Election-year competition over tax policy priorities may serve to define key business and individual tax issues and provide direction for the first major overhaul of US tax laws since 1986.

Congress returns for its 2012 session to face key tax issues left unresolved from last year, including expiration of the research credit and other business tax provisions and the scheduled expiration of individual tax rates at the end of this year. Politics as well as policy differences may limit prospects in 2012 for Congress and the Obama Administration to reach compromises on major tax and budget issues.

Overview

Leading the list of open issues this year will be continued debate over a two-percent reduction in the 6.2-percent employee payroll tax, along with extensions of expanded federal unemployment benefits and Medicare physician pay rates.

The House last year on December 13 passed legislation extending the payroll tax reduction through the end of 2012, extending and modifying federal unemployment benefits, and extending Medicare physician pay rates for two years; the House-passed bill was fully offset by a mix of spending reductions and increased government fees, but did not include any tax increases. The Senate on December 17 passed a two-month extension of the payroll tax reduction, federal unemployment benefits, and Medicare physician pay rates, after being unable to reach an agreement on how to offset the cost of extending those measures for all of this year. The House responded on December 20 by rejecting the Senate measure and insisting on a conference to reach an agreement on legislation that would be in effect through the end of 2012. Subsequently, Congress agreed on a two-month extension bill, which President Barack Obama signed into law on December 23.

As a result, approximately 160 million individuals will have the benefit of the reduced payroll tax reduction only through February 29 unless Congress takes further action. A House and Senate conference committee was appointed to resolve disagreements on these issues.

Congressional consideration of a further payroll tax reduction extension may be marked by renewed Democratic efforts to offset that proposal and others by imposing a surtax on modified adjusted gross income in excess of \$1 million. Senate Democrats had set aside the “millionaire surtax” proposal in order to reach an agreement on a short-term extension of the payroll tax reduction. House and Senate Republicans have stated that they will continue to focus on proposals to reduce federal spending as an alternative to any tax increase proposals.

Apart from extending the employee payroll tax reduction for two months, the House and Senate last year agreed on relatively few tax issues. Tax bills that did reach the President’s desk last year included a measure repealing Form 1099 information reporting for business-to-business transactions and a bill repealing three-percent withholding on government payments to businesses for goods or services. Congress and the Administration last year also reached final agreements on certain foreign trade agreements.

On most other issues, the House and Senate often were unable to agree. Republican leaders last year noted that the House had passed more than 25 “economic growth” bills—including numerous measures to limit federal regulations and repeal the 2010 health care law—that the Senate did not adopt.

Having only a 53-vote majority, Senate Democratic leaders last year responded that Senate Republicans generally were able to block Democratic-supported “job creation” proposals—including measures to fund highway infrastructure spending and assistance to states for hiring teachers that were offset by tax increases—by requiring effectively that such legislation secure 60 votes to advance in the Senate.

President Obama is expected to re-propose many of his Administration’s individual and business tax policy priorities when he submits a FY 2013 budget to Congress in early February. The President’s tax policy agenda has included business revenue-raising proposals as well as proposals to allow current tax rates to expire after 2012 for upper-income individuals. At the same time, President Obama is expected to reaffirm his support for individual and business tax reform. White House officials on January 11 announced that in coming weeks President Obama “will put forward new tax proposals to reward companies that choose to invest or bring back jobs to the United States, and to eliminate tax advantages for companies moving jobs overseas.”

Later this year, national elections for control of the White House and Congress will mark a key decision point for tax policy. Election-year competition over tax policy priorities may serve to define key business and individual tax issues and provide direction for the first major overhaul of US tax laws since 1986.

Federal deficits remain a key concern

Efforts to reduce the federal deficit are expected to be a major factor in tax policy deliberations again this year. As part of the Budget Control Act of 2011, which provided for increases in the federal debt limit, Congress last year established a Joint Select Committee on Deficit Reduction (“Select Committee”) to propose a \$1.2 trillion deficit reduction plan that would be voted on by Congress without amendment. However, the Select Committee was unable to reach a bipartisan agreement on an acceptable mix of spending cuts, mandatory spending reductions, and revenue increases.

As a fallback, the Budget Control Act provided for an equal amount of deficit reduction through automatic across-the-board spending cuts over nine years beginning in January 2013. While some in Congress have proposed revisiting these required spending cuts, in particular for the Defense Department, President Obama has said he would veto any such legislation unless a “balanced” agreement can be reached on revenue and spending issues.

Congress later this month will have another occasion to debate an increase in the federal debt limit. The federal debt is effectively at the \$15.194 trillion statutory limit as of the beginning of January 2012.

The Budget Control Act provided specific authority for President Obama to request two separate increases in the federal debt limit that altogether were projected to be sufficient to finance the government’s debt obligations through 2012. The first installment of an increase in the debt limit totalling \$900 billion was effective

last September when the House passed a resolution of disapproval but the Senate did not. Administration officials recently indicated that President Obama soon will request the second debt limit increase of \$1.2 trillion authorized by the Budget Control Act, which will go into effect automatically unless a resolution of disapproval is enacted.

Building the case for corporate tax reform

The need to strengthen the competitiveness of US firms in the global marketplace—together with slow economic growth, a continuation of high unemployment rates, and projections of significant future budget deficits under current policies—have increased bipartisan interest in tax reform as a way of promoting US economic growth, controlling federal deficits, and spurring job creation. While it is unlikely that Congress is prepared to complete action on tax reform in advance of the 2012 elections, key tax policy leaders in the House and Senate this year are expected to continue laying a foundation for tax reform to be prepared for any opportunity that may arise to overhaul US tax laws this year or in following years.

The House Ways and Means Committee and the Senate Finance Committee last year held more than twenty hearings altogether on tax reform issues (see Appendix E). Many of these hearings focused on the fact that the United States has one of the highest corporate tax rates in the world and that most of our major trading partners have adopted territorial tax systems, which generally exempt from tax the active business earnings of foreign subsidiaries. These hearings also have examined a range of other business

tax issues, including enhanced incentives for innovation, the tax treatment of debt and equity, and the tax treatment of financial products.

As an important step in the tax reform process, Ways and Means Chairman Dave Camp (R-MI) last year released for public comment an international tax reform discussion draft that would be one component of a future comprehensive tax reform bill also addressing individual and other business tax issues. The discussion draft, examined in greater detail below, proposed a 25-percent top corporate tax rate and a 95-percent exemption for active foreign business earnings. Chairman Camp's discussion draft marked a significant milestone in advancing tax reform because it is a detailed proposal to restructure the way the United States taxes global business operations.

The draft reflects an objective that international corporate tax reform should be revenue neutral on its own. To achieve this objective, the draft included a "toll charge" tax on accumulated earnings of controlled foreign corporations, a limitation on interest deductions, and three alternative proposals designed to protect the US tax base against income being moved abroad.

Designing a comprehensive tax reform proposal for full consideration by Congress will necessitate considerable additional efforts, and details on domestic business and individual reform proposals are expected in the future. One common element in many discussions of tax reform is the goal of lowering individual and corporate tax rates, with the cost offset by "base broadening" changes to the tax code.

Base broadening would be accomplished primarily by repealing or limiting targeted tax deductions, credits, and preferences. Examples of business tax provisions that some have cited as potential tax reform base-broadening proposals include repealing or limiting accelerated depreciation and the domestic manufacturing deduction. Because businesses could be affected significantly by emerging tax reform efforts, many companies and trade associations are engaged in assessing the potential benefits and risks of tax reform, and have been participating in ongoing Congressional hearings and meetings with members of Congress and their staff. Such efforts are expected to continue in 2012.

2012 elections may crystallize tax policy debate

With Presidential and Congressional election activities well underway, there will be an opportunity this year for candidates from both parties to define specific options for tax reform.

President Obama last year in his State of the Union Address called for reforming the tax code, including corporate tax provisions, without adding to the federal deficit. While Treasury Department officials last year indicated that work has been underway on a business tax reform white paper, the Obama Administration has yet to release any detailed reform proposals. Last September, as part of his deficit reduction plan, President Obama reaffirmed his support for individual and corporate tax reform but also stated that deficit reduction should be one goal of any future tax reform legislation.

The fate of expiring individual tax rates is expected to be a key focus of the 2012 elections. The 2001 and 2003 tax act provisions were extended temporarily through December 31, 2012, as part of legislation signed in late 2010 after that year's mid-term Congressional elections. President Obama and many Democrats in Congress have called for extending current tax rates only for individuals with incomes below \$200,000 (\$250,000 for joint filers). Republicans generally have expressed support for tax reform that would lower tax rates for all individuals on a permanent basis while also reforming business tax provisions. The Republican-controlled House of Representatives last year called for a top rate of 25 percent for individuals as well as corporations.

If no action is taken before the elections to address expiring individual tax rates, it is possible that a "lame-duck" Congress and President Obama could agree to extend temporarily some or all of the expiring individual tax rates to allow time for action on tax reform or other decisions on tax rates by the next Congress. Congress also could address the research credit and other expired business tax provisions at that time. Ultimately, the outcome of the 2012 elections will be the critical factor in determining what might happen on tax legislation during a lame-duck session. In the next Congress, the prospects for the United States to overhaul its tax laws will depend on whether a consensus can emerge on the need for and direction of lasting tax reform.

An in-depth discussion

Politics as well as policy differences may limit prospects for Congress and the Obama Administration to reach compromises on major tax and budget issues.

Balance of Power

Current House and Senate

Under House rules, a 218-vote majority generally enables the party in control to pass its legislative agenda. House Republicans last year held a 242-seat majority, which allowed the GOP House leadership to pass many of the bills supported by Republican members. At the same time, House Republican leaders last year on several occasions had to rely on the votes of some House Democrats to pass spending bills and other measures to which a significant number of House Republicans objected. Democrats currently hold 192 seats in the House. One vacant seat, formerly held by Rep. David Wu (D-OR), is scheduled to be filled in a January 31 special election.

In the Senate, Democrats have a 53-seat majority (including two Independents). Republicans hold 47 seats in the Senate. As a practical matter, 60 votes generally are needed to approve legislation in the Senate.

Republicans in Congress generally are in a position to block passage of Obama Administration proposals. At the same time, President Obama can veto legislation he opposes, with a two-thirds majority of both the House and Senate required for a veto override. While the White House has issued statements on several occasions warning that particular bills would be vetoed in their current form, President Obama did not veto any bills in 2011 because the Democratic-led Senate generally modified or blocked bills passed by the Republican-controlled House that President Obama had threatened to veto.

Figure 1: Current Composition of the 112th Congress

	Republicans	Democrats	Vacancies
House	242	192	1
Senate	47	53*	

* Includes two Independents: Senators Joe Lieberman (I-CT) and Bernie Sanders (I-VT)

Looking Ahead to the 2012 Elections

As President Obama seeks re-election, most economists project that the unemployment rate will remain well above eight percent throughout the year. It is expected that economic concerns will play a key role in the 2012 elections, but the eventual outcome also will be influenced on how voters perceive President Obama compared to the eventual Republican nominee.

All 435 seats in the House are up for election every two years. Democrats would need to achieve a net gain of 25 seats to gain control of the House, assuming they retain the Oregon seat in the special election being held later this month. A number of House seats will be open as a result of Members leaving office due to retirement, seeking another office, or other reasons. At this writing, nine House Democrats and four House Republicans have announced plans to retire. In addition, eight House Democrats and seven House Republicans have announced plans to run for the Senate

or some other office. At least three House Ways and Means Committee members will be leaving the House at the end of 2012, with Rep. Shelley Berkley (D-NV) running for the Senate and Reps. Wally Herger (R-CA) and Geoff Davis (R-KY) retiring.

Roughly one-third of all Senate seats are subject to election every two years. In this particular election cycle, 23 seats currently held by Democrats (including Independents who caucus with Senate Democrats) are subject to election, while only 10 seats currently held by Republicans are up for election. The large number of seats being defended by Democrats is seen by most political analysts as providing a competitive opportunity for Republicans to take control of the Senate in the next Congress. Republicans would need a net gain of four seats to win a 51-seat majority in the Senate.

A listing of all Senators whose seats are subject to election in 2012 is included in Appendix B. At the end of last year, six Senate Democrats along with Senator Joe Lieberman (I-CT) had announced plans to retire, while only two Republicans had announced similar plans. Three Senate Finance Committee members were among those planning to retire: Senators Jeff Bingaman (D-NM), Kent Conrad (D-ND), and Jon Kyl (R-AZ).

Finance Committee members currently running for re-election are Senators Maria Cantwell (D-WA), Thomas Carper (D-NE), Robert Menendez (D-NJ), Bill Nelson (D-FL), Debbie Stabenow (D-MI), Finance Committee Ranking Member Orrin Hatch (R-UT), and Olympia Snowe (R-ME).

Tax Policymakers

House and Senate Leadership

Rep. John Boehner (R-OH) is the Speaker of the House. Rep. Eric Cantor (R-VA) is Majority Leader, and Rep. Kevin McCarthy (R-CA) is Majority Whip. Rep. Nancy Pelosi (D-CA) serves as Minority Leader. Rep. Steny Hoyer (D-MD) is the Minority Whip, and Rep. Jim Clyburn (D-SC) is the Assistant Minority Leader.

Senator Harry Reid (D-NV) holds the top leadership position in the Senate as Majority Leader. Senator Dick Durbin (D-IL) is Assistant Majority Leader, and Senator Charles Schumer (D-NY) holds the third-ranking Senate Democratic leadership position as Democratic Conference Vice Chair and Chair of the Democratic Policy Committee.

Senator Mitch McConnell (R-KY) leads Senate Republicans as Minority Leader. Senate Finance Committee member Jon Kyl (R-AZ) currently serves as Assistant Minority Leader, but his retirement will create an opening in the second-ranking Republican leadership position in the next Congress. Senator Lamar Alexander (R-TN) last year announced that he was stepping down as the third-ranking Republican leader in the Senate, but he remains in the Senate. Senator Alexander's position as Republican Conference Chair was filled last December by Senator Roy Blunt (R-MO).

Figure 2: House Leadership in the 112th Congress

Speaker of the House	John Boehner (R-OH)
Majority Leader	Eric Cantor (R-VA)
Majority Whip	Kevin McCarthy (R-CA)
Chief Deputy Whip	Peter Roskam (R-IL)
Republican Caucus Chair	Jeb Hensarling (R-TX)
Republican Caucus Vice Chair	Cathy McMorris Rodgers (R-WA)
Republican Campaign Committee Chair	Pete Sessions (R-TX)
Republican Conference Secretary	John Carter (R-TX)
Republican Leadership Chair	Greg Walden (R-OR)
Minority Leader	Nancy Pelosi (D-CA)
Minority Whip	Steny Hoyer (D-MD)
Assistant Minority Leader	Jim Clyburn (D-SC)
Democratic Conference Chair	John Larson (D-CT)
Democratic Policy Committee Chair	George Miller (D-CA)
Democratic Campaign Committee Chair	Steve Israel (D-NY)

Figure 3: Senate Leadership in the 112th Congress

President of the Senate	Vice-President Joe Biden (D)
President Pro Tempore	Daniel Inouye (D-HI)
Majority Leader	Harry Reid (D-NV)
Assistant Majority Leader	Richard Durbin (D-IL)
Democratic Conference Vice Chair and Chair of the Democratic Policy Committee	Charles Schumer (D-NY)
Democratic Conference Secretary and Democratic Senatorial Campaign Committee Chair	Patty Murray (D-WA)
Chief Deputy Whip	Barbara Boxer (D-CA)
Minority Leader	Mitch McConnell (R-KY)
Assistant Minority Leader	Jon Kyl (R-AZ)
Republican Conference Chair	Roy Blunt (R-MO)
Republican Conference Vice Chair	John Barrasso (R-WY)
Republican Senatorial Campaign Committee Chair	John Cornyn (R-TX)

Tax-Writing Committees

House Ways and Means Committee

Rep. Dave Camp (R-MI) is the chairman of the Ways and Means Committee, and Rep. Sander Levin (D-MI) is Ranking Minority Member. The Ways and Means Committee membership currently is composed of 22 Republicans and 15 Democrats.

Figure 4: House Ways and Means Committee Members, 112th Congress

Republicans	Democrats
Dave Camp (R-MI), chairman	Sander Levin (D-MI), ranking minority member
Wally Herger (R-CA)*	Charles Rangel (D-NY)
Sam Johnson (R-TX)	Pete Stark (D-CA)
Kevin Brady (R-TX)	Jim McDermott (D-WA)
Paul Ryan (R-WI)	John Lewis (D-GA)
Devin Nunes (R-CA)	Richard Neal (D-MA)
Patrick Tiberi (R-OH)	Xavier Becerra (D-CA)
Geoff Davis (R-KY)*	Lloyd Doggett (D-TX)
Dave Reichert (R-WA)	Mike Thompson (D-CA)
Charles Boustany (R-LA)	John Larson (D-CT)
Peter Roskam (R-IL)	Earl Blumenauer (D-OR)
Jim Gerlach (R-PA)	Ron Kind (D-WI)
Tom Price (R-GA)	Bill Pascrell (D-NJ)
Vern Buchanan (R-FL)	Shelley Berkley (D-NV)*
Adrian Smith (R-NE)	Joe Crowley (D-NY)
Aaron Schock (R-IL)	
Lynn Jenkins (R-KS)	
Erik Paulsen (R-MN)	
Kenny Marchant (R-TX)	
Rick Berg (R-ND)	
Diane Black (R-TN)	
Tom Reed (R-NY)	

* Not running for re-election.

Senate Finance Committee

Senate Finance Committee Chairman Max Baucus (D-MT) leads the Senate tax-writing committee. Senator Orrin Hatch (R-UT) is Ranking Minority Member. The Finance Committee membership currently is composed of 13 Democrats and 11 Republicans. As noted above, there will be at least three open seats on the Finance Committee following the 2012 elections due to the retirements of Senators Bingaman, Conrad, and Kyl.

Figure 5: Senate Finance Committee Members, 112th Congress

Democrats	Republicans
Max Baucus (D-MT), chairman	<i>Orrin Hatch (R-UT), ranking minority member</i>
John Rockefeller (D-WV)	Charles Grassley (R-IA)
Kent Conrad (D-ND)*	<i>Olympia Snowe (R-ME)</i>
<i>Jeff Bingaman (D-NM)*</i>	<i>Jon Kyl (R-AZ)*</i>
John Kerry (D-MA)	Mike Crapo (R-ID)
Ron Wyden (D-OR)	Pat Roberts (R-KS)
Charles Schumer (D-NY)	Michael Enzi (R-WY)
<i>Debbie Stabenow (D-MI)</i>	John Cornyn (R-TX)
<i>Maria Cantwell (D-WA)</i>	Tom Coburn (R-OK)
<i>Bill Nelson (D-FL)</i>	John Thune (R-SD)
<i>Robert Menendez (D-NJ)</i>	Richard Burr (R-NC)
<i>Thomas Carper (D-DE)</i>	
<i>Benjamin Cardin (D-MD)</i>	

*Not running for re-election
Finance Committee members up for election in 2012 shown in *italics*

Key Treasury and Other Administration Officials

Treasury Secretary Timothy Geithner continues as the leader of the Administration's economic team. He is the last remaining member of Obama's original senior economic advisory team assembled in 2008. Before becoming Treasury Secretary, Geithner served as the New York Federal Reserve Bank president.

Gene Sperling serves as director of the National Economic Council and assistant to the president for Economic Policy. Before his appointment as NEC director in January 2011, Sperling worked as an adviser to Secretary Geithner.

Jacob Lew has served as head of the White House Office of Management and Budget since November 2010. Lew also served in the same capacity under the Clinton administration. President Obama on January 9, 2012 announced that

Lew will become White House Chief of Staff at the end of January, succeeding William Daley who has stepped down from that position. At this writing, President Obama has not yet announced who will succeed Lew at OMB.

Alan Krueger last year became chairman of the White House Council of Economic Advisers. He replaced Austan Goolsbee, who returned to the University of Chicago. Dr. Krueger previously served as Treasury Assistant Secretary for Economic Policy and Chief Economist (2009–2010), and as Chief Economist at the US Department of Labor (1994–1995).

The President's Council on Jobs and Competitiveness, which was established in early 2011, is led by General Electric Company chief executive Jeffrey Immelt. The term of the President's Economic Recovery Advisory Board, formerly chaired by Paul Volcker, expired in February 2011.

Last November, President Obama nominated Mark Mazur to serve as Treasury Assistant Secretary for Tax Policy. If confirmed by the Senate, he will fill the position formerly held by Michael Mundaca, who left Treasury last May. Mazur currently serves as Deputy Assistant Secretary for Tax Analysis, a position he has held since 2009. Emily McMahon has been serving as Acting Assistant Secretary for Tax Policy.

Douglas Shulman remains as IRS Commissioner; he was appointed in 2008 to serve a five-year term and is expected to complete his service at the end of this year. William (Bill) Wilkins also continues as IRS Chief Counsel.

Figure 6: Key Members of the Obama Administration Economic and Tax Policy Team

Treasury Secretary	Timothy Geithner
Director, National Economic Council	Gene Sperling
Director, Office of Management and Budget	Jacob Lew
Chair, Council of Economic Advisers	Alan Krueger
Chair, Council on Jobs and Competitiveness	Jeffrey Immelt
Treasury Assistant Secretary for Tax Policy	Emily McMahon, <i>acting</i> Mark Mazur, <i>nominated</i>
IRS Commissioner	Douglas Shulman
IRS Chief Counsel	William (Bill) Wilkins

2012 Congressional Legislative Schedule

112th Congress begins Second Session	House: January 17 Senate: January 23
President's State of the Union address	January 24
President's budget to be submitted	February 6 (tentative)
Presidents' Day recess	February 20–24
House recess	March 12–16
Spring House/Senate recess	April 2–13
Budget resolution deadline	April 15
House/Senate recess	April 30–May 4
House recess	May 21–25
Senate recess	May 28–June 1
House recess	June 11–15
Independence Day House/Senate recess	July 2–6
August House/Senate recess	August 6–September 7
House recess	September 24–28
House recess	October 9–November 13
Thanksgiving House recess	November 19–26
Target adjournment	House: December 14 Senate: TBD

Note: Senate Leadership has not yet announced a Fall 2012 legislative schedule.

Tax Reform

President Obama, leading Members of Congress, and the business community generally agree that substantive tax reform is needed. Some supporters see tax reform as an opportunity to improve the competitiveness of American businesses, attract investment to the United States, and increase job growth. Others—eyeing projections of significant future deficits—believe tax reform could be an important element of an overall deficit reduction package in which spending cuts are combined with revenue increases.

Expiring tax provisions may propel both individual and corporate tax reform. Unless Congress acts, individual tax reductions enacted in 2001 and 2003 under President George W. Bush and extended in December 2010 under President Obama will expire at the end of this year. The budget costs of permanently extending those provisions, together with the cost of associated relief from the alternative minimum tax, are estimated to be approximately \$4.5 trillion over the 10-year budget period 2013-2022, excluding debt service costs. For those concerned about the revenue cost of extending current individual provisions, tax reform proposals that include base-broadening provisions may be viewed as an attractive option.

On the corporate side, the US tax system is viewed as out of line with the tax systems of other developed countries. The combined federal and state statutory corporate tax rate in the United States will become the highest in the OECD on April 1, 2012, when recently enacted rate reductions in Japan take effect. The US system of worldwide taxation also stands in contrast to the territorial tax systems employed by most other OECD countries. Proposals encompassing rate reduction, reforms to the US system of international

taxation, and base broadening are intended to increase US competitiveness, investment, and job growth without reducing tax collections.

There is limited time in 2012—a legislative year shortened by Presidential and Congressional elections—for Congress to engage in the difficult and time-consuming process of reviewing the tax code and developing tax reform proposals. By way of reference, the Tax Reform Act of 1986 was enacted after almost 18 months of Congressional work, including 30 days of hearings and 26 days of markup in the House Ways and Means Committee; 36 days of hearings and 17 days of markup in the Senate Finance Committee; and 12 days of Senate floor consideration. While most observers believe it is unlikely for substantive reforms to be enacted in 2012, the groundwork will continue to be laid through Congressional hearings, possible Administration reports, and the introduction of additional tax reform bills.

Congressional and Administration Developments

Ways and Means Chairman Camp released a discussion draft on corporate tax reform in October 2011. That proposal would reduce the corporate tax rate to 25 percent in a revenue-neutral manner through unspecified base broadening and would provide a territorial tax system exempting 95 percent of foreign earnings from US taxation. Materials released with the discussion draft state that individual tax reform lowering the top tax rate to 25 percent also would be addressed as part of comprehensive tax reform legislation. Chairman Camp in coming months may release revisions to the territorial proposal and could provide

details on the individual and corporate base broadening that would be necessary to achieve revenue neutrality.

The failure of the Select Committee to approve a deficit reduction plan eliminated the possibility that the committee would advance tax reform proposals as part of its work. Senator Rob Portman (R-OH), one of the 12 members of the Select Committee, last year announced his intent to introduce a corporate tax reform plan based on bipartisan plans developed with other Select Committee members. Senator Portman said that a conceptual corporate tax reform proposal, featuring a 25-percent corporate rate and a territorial system, has been scored as deficit neutral by the Joint Committee on Taxation (JCT) staff.

Senator Ron Wyden (D-OR) last year reintroduced a revised version of his comprehensive reform plan, the Bipartisan Tax Fairness and Simplification Act of 2011 (S. 727), co-sponsored by Senators Dan Coats (R-IN) and Mark Begich (D-AK). For individuals, the Wyden plan would repeal the alternative minimum tax and maintain the current-law top rate of 35 percent. The top corporate rate would be lowered to 24 percent and would be offset by significant base broadening. Of key concern to many multinational corporations, the plan would repeal deferral of active foreign business income and tax all foreign income on a current basis, with a per-country limitation on foreign tax credits.

President Obama included individual and corporate tax reform as a priority in his State of the Union address last year. Treasury Secretary Geithner

last year stated that Treasury has developed corporate tax reform options in a white paper, which was initially expected to be released in 2011. The white paper reportedly recommends corporate rate reduction offset by base-broadening reforms. Treasury officials have not confirmed the details of the white paper recommendations, but it has been reported that Treasury is considering a “tough” territorial tax system, which could potentially expand current-law subpart F provisions and contain other new provisions that might increase current US tax payments on foreign earnings.

President Obama’s National Commission on Fiscal Responsibility and Reform (“Fiscal Commission”), co-chaired by former Senator Alan Simpson (R-WY) and former White House chief of staff Erskine Bowles, developed a reform plan against which future reform plans may be measured. The Fiscal Commission’s plan would reduce statutory tax rates to between 23 and 29 percent for both individuals and corporations, while expanding the tax base through the repeal or limitation of nearly all tax deductions and credits.

One potential difficulty in undertaking the kind of base broadening proposed by the Fiscal Commission is that many of the most significant deductions and credits in the tax code today have a strong constituency, such as the individual income tax deductions for home mortgage interest, state and local taxes, and charitable contributions. These deductions generally were left in place by the Tax Reform Act of 1986. The Fiscal Commission plan was not supported by the two chairmen of the tax-writing committees who served as members of

the Commission in 2010, and it is unclear whether a plan as sweeping as that of the Fiscal Commission’s plan could garner sufficient political support.

Components of Individual and Corporate Tax Reform Proposals

While the details for a number of expected reform proposals have not yet been released—including the Administration’s white paper, the additional components of Chairman Camp’s reform proposal, and the reform proposal of Sen. Portman—the proposals are likely to share three basic components: rate reduction, base broadening, and international reforms for the taxation of foreign business income. It is unclear whether tax reform proposals will be developed as vehicles for deficit reduction through net revenue increases or will be revenue neutral. There are also differences in opinion over how revenue neutrality should be measured—for example, relative to current law that allows for the expiration of significant tax provisions or assuming the extension of the 2001 and 2003 individual tax rates and other expiring provisions, and whether macroeconomic “feedback” effects on tax revenues should be taken into account. Ultimately, how revenue neutrality is defined will be a key decision point for future tax reform legislation.

Individual Tax Reform

The elements of possible base-broadening proposals for the individual income tax may be drawn at least in part from the plans proposed by the Fiscal Commission. One plan of the Fiscal Commission retained certain deductions and credits that would have been eliminated under other options. The plan set a

top rate of 28 percent. It would raise approximately \$1 trillion in revenue over 10 years relative to a baseline used by the Commission that assumed extension of the 2001 and 2003 tax cuts for families with income under \$250,000 (singles under \$200,000) and continued indexation of relief for the alternative minimum tax. Scored relative to current law, the plan would reduce revenue collections by more than \$3 trillion over the 10-year budget period.

Under this plan, dividends and capital gains would be taxed at ordinary income rates. Itemized deductions would be eliminated; the standard deduction would be retained at current levels. The alternative minimum tax would be repealed. The deduction for mortgage

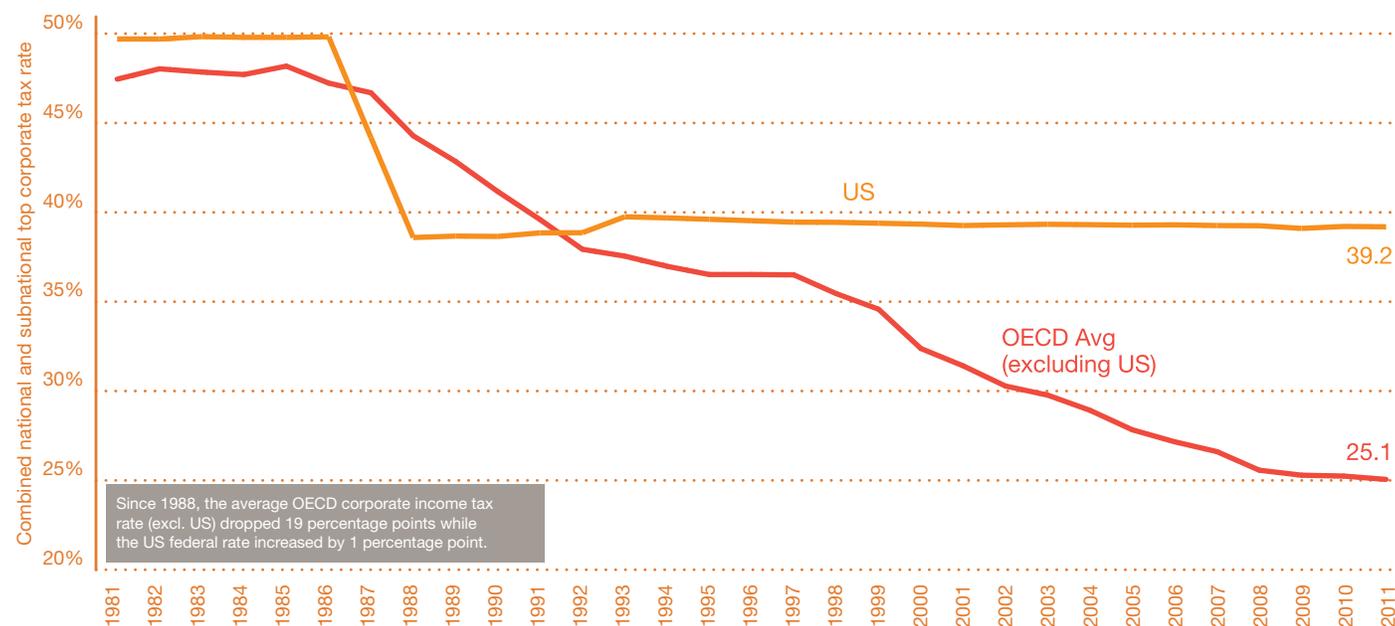
interest would be converted to a 12-percent nonrefundable tax credit, and interest on mortgage principal exceeding \$500,000 would not be eligible for the credit; interest on second home and home equity loans also would not be eligible. Charitable contributions in excess of two percent of adjusted gross income would be eligible for a 12-percent nonrefundable tax credit. The exclusion for employer-provided health insurance would be capped and slowly phased out. Nearly all other itemized deductions and exclusions for individuals would be eliminated. The plan would retain current rules for employer-provided pensions and retain the child credit and earned income tax credit.

Corporate Tax Rate Reduction

The dynamics of corporate tax reform principally revolve around how low the rate should be reduced in order to promote US investment and job creation, the required trade-off in terms of base broadening, and whether the United States should adopt a territorial tax system or make other more limited reforms to its worldwide system of taxation.

Including state taxes, the US combined statutory tax rate of 39.2 percent is more than 50 percent higher than the 25.1 percent average statutory corporate tax rate of other OECD countries in 2011. The average rate in the rest of the OECD, which includes national and local

Figure 7: US and Average OECD Corporate Tax Rates, 1981–2011



Source: OECD Tax Database, 2011.

US rate is based on the 35-percent federal tax rate and average state taxes of 6.44 percent, which are deductible from federal taxes.

taxes, declined by 19 percentage points between 1988 and 2011, while the US rate increased slightly over this same period (Figure 7). A major bipartisan objective of corporate tax reform is to provide significant rate reduction to improve the attractiveness of the United States for investment and job growth.

Ways and Means Chairman Camp's proposal for a 25-percent federal corporate rate would result in a combined federal and state rate of just under 30 percent. This would bring the United States from having the highest tax rate in the 34-country OECD to the eighth highest, and from the highest in the G-7 to the fourth highest.

Based on preliminary estimates from JCT staff, the 10-year revenue cost of a 10-percentage point reduction in the corporate tax rate is approximately \$1 trillion—roughly 25 percent of expected corporate tax receipts under current law.

Among major developed countries with scheduled rate reductions to take effect in the near future, Japan's corporate rate will decline by approximately 2.5 percentage points in April 2012 and an additional 2.5 percentage points in 2015. (The full rate reduction in 2015 takes effect following the expiration of a temporary surtax intended to raise revenue for the reconstruction effort from last year's earthquake and tsunami.) The United Kingdom reduced its rate from 28 percent in 2010 and 26 percent in 2011 to 25 percent in 2012, with a planned rate of 23 percent in 2014 after further annual one-percentage point reductions. Canada, the United States' largest trading partner, reduced its federal corporate tax rate to 15 percent in 2012. Including provincial taxes, the combined corporate rate in Canada is approximately 25 percent, roughly 15 percentage points lower than its rate in 2000.

Corporate Base Broadening

To offset the revenue loss from rate reduction, reform proposals are expected to broaden the corporate tax base by limiting deductions and credits. Base broadening proposals are likely to focus on tax expenditures, which JCT staff define as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." The JCT and the Administration annually publish separate, but very similar, lists of tax expenditures.

The revenue potential from the elimination of various business tax expenditures can be seen in a JCT staff analysis prepared last October at the request of Ways and Means Ranking Minority Member Sander Levin (D-MI). In that analysis, the JCT staff estimates that elimination of approximately forty corporate tax expenditures—accounting

Figure 8: Estimated Revenue Increase from Repealing Largest Tax Expenditures Attributable to C Corporations (2012–2021)

Provision	10-Year Amount (\$ billions)
Repeal MACRS and apply Alternative Depreciation System	506.8
Repeal expensing of research and experimental expenditures	152.2
Repeal Section 199 domestic production activities deduction	127.0
Repeal LIFO	62.7
Repeal credit for low-income housing	33.0
Repeal deferral of gain on like-kind exchanges	16.0
Repeal completed contract method	13.9

Note: Various effective dates. JCT staff also report that estimates currently are unavailable for numerous other tax provisions. Source: Joint Committee on Taxation (October 27, 2011 letter to Rep. Levin)

for most of the major corporate tax expenditures—would raise sufficient revenue to reduce the corporate tax rate to 28 percent in a revenue-neutral manner. At the same time, JCT staff noted that estimates currently are unavailable for numerous other provisions.

Seven corporate tax expenditures account for 95 percent of the base broadening achieved in the JCT staff analysis: accelerated depreciation, the expensing of research and experimental expenditures, the section 199 domestic production activities deduction, the last-in first-out inventory accounting method (LIFO), the tax credit for low-income housing, deferral of gain on like-kind exchanges, and the completed contract method. A “very preliminary” JCT staff estimate of the 10-year revenue gain from the repeal of these seven provisions is shown in Figure 8.

While tax reform sometimes is described as repealing “loopholes” in exchange for rate reduction, this listing of major tax expenditures reflects that the bulk of potential revenue offsets are attributable to widely used tax provisions explicitly provided by Congress in the tax code.

JCT staff also estimate that approximately \$300 billion in additional revenue would be raised over the 10-year budget period if the business tax expenditures were repealed for entities operating in pass-through form (sole proprietorships, partnerships, and S corporations). If this additional revenue were applied to reduce the corporate tax rate further, the corporate rate could be reduced below 26 percent. However, unless individual rates also were reduced as part of tax reform, using this additional revenue to reduce corporate tax rates would leave pass-through entities with a net tax increase from tax reform.

How pass-through entities would be treated under tax reform remains to be determined. Recent estimates are that pass-through entities account for more than half of all business income. Some believe that corporate tax reform cannot proceed independently of individual tax reform because of the potential adverse impact on pass-through entities if the business tax base is broadened but there is no rate reduction for these businesses.

Ways and Means Chairman Camp, for example, has stated that he will undertake comprehensive reform including both individuals and corporations, in part for this reason.

In Congressional hearings last year, both Treasury Secretary Geithner and Senate Finance Chairman Baucus raised questions about whether pass-through entities above a certain size should be taxed as corporations.

Figure 9: 26 of 34 OECD Countries Have Territorial Tax Systems

Home country tax treatment of foreign-source dividend income received by resident corporations			
Exemption		Foreign Tax Credit	
Australia	Germany	Portugal	Chile
Austria	Hungary	Slovak Republic	Greece
Belgium	Iceland	Slovenia	Ireland
Canada	Italy	Spain	Israel
Czech Republic	Japan	Sweden	Korea
Denmark	Luxembourg	Switzerland	Mexico
Estonia	Netherlands	Turkey	Poland
Finland	New Zealand	United Kingdom	United States
France	Norway		

Note: Some countries limit dividend exemption to substantial shareholders (e.g., 5% or 10% owners). In some cases, dividend exemption is limited to treaty countries that impose corporate income tax above a minimum rate. A few countries (e.g., France, Germany, Belgium, and Japan) exempt 95% rather than 100% of foreign dividends.
Source: PwC Worldwide Tax Summaries, <http://www.pwc.com/gx/en/worldwide-tax-summaries/index.jhtml>

In the absence of a shift in tax revenue from pass-through entities or a new revenue source, it appears that any effort to reduce the corporate tax rate in a revenue-neutral manner to the 25-percent target of Chairman Camp and others could require that base broadening go beyond elimination of provisions specifically identified as tax expenditures by the Joint Committee on Taxation and the Administration. For example, former Ways and Means Chairman Charles Rangel (D-NY) proposed extending the amortization period for intangibles under section 197 from 15 to 20 years as part of his tax reform proposal in 2007. The current law 15-year recovery period is not classified as a tax expenditure.

International reform

Many analysts believe the US system of international taxation is in urgent need of reform. Some—stressing global competitiveness—believe the present US worldwide system reduces the ability of American companies to compete effectively in foreign markets. Others highlight that the present system imposes a substantial tax barrier to repatriation of earnings back for use in the US economy, noting that more than \$1 trillion in foreign earnings is held by foreign subsidiaries that cannot be remitted to their US parents without incurring an additional tax liability. And others note that the current system results in a relatively small amount of tax collections by the United States relative to the foreign income of US companies.

As noted above, the United States is one of the few developed countries to tax foreign earnings under a worldwide tax

system. All other G-7 countries and 26 of the 34 OECD countries use territorial tax systems under which all or most foreign dividends are exempt from domestic taxation (Figure 9). The other countries within the OECD using a worldwide system have low corporate tax rates, averaging approximately 21.5 percent in 2011.

The United Kingdom and Japan are two of the most recent OECD countries to adopt territorial tax systems, with each switching from worldwide systems in 2009.

Chairman Camp's international reform discussion draft

The most detailed proposal to date for a US territorial system was provided by Ways and Means Chairman Camp in a discussion draft with legislative language and a technical explanation released in October 2011. That proposed territorial tax system is intended to be revenue neutral over the 10-year budget period.

The territorial system in the discussion draft provides a 95-percent dividends received deduction (DRD) for qualified foreign-source dividends received by a corporate 10-percent US shareholder from a controlled foreign corporation (CFC), provided the stock of the CFC has been held for at least one year. The DRD would be effective for tax years of foreign corporations beginning after December 31, 2012, and to tax years of US shareholders in which such tax years of foreign corporations end. Given the 25-percent corporate tax rate assumed in the discussion draft, the tax rate on

qualifying foreign-source dividends would be 1.25 percent (25 percent of five percent). No foreign tax credits would be available to offset this tax.

As part of a transition to the new territorial system, previously untaxed earnings and profits (E&P) of foreign subsidiaries would be included in the current income of 10-percent-or-greater US shareholders as of the last tax year ending before 2013. An 85-percent DRD would be allowed, and credits for a corresponding portion of indirect foreign taxes would be allowed. Thus, the maximum tax rate on pre-enactment income would be 5.25 percent (35 percent of 15 percent). A taxpayer could elect to spread the tax owed over a period of up to eight years with an interest charge.

The proposal treats all previously untaxed E&P the same, whether held in cash and equivalents or reinvested in plant and equipment. At the end of 2010, it has been reported that an estimated \$1.4 trillion in foreign earnings was declared permanently reinvested outside the United States on company financial statements.

The discussion draft has three alternative options that would expand subpart F to address concerns that increased income shifting may occur under a territorial tax system, particularly with respect to intangible property:

- **Excess returns proposal.** The first option is the Administration's "excess returns" FY 2012 budget proposal, which would create a new subpart F category of foreign base company

excess intangible income for income relating to transferred intangible property earning a high rate of return and subject to a low foreign effective tax rate. The discussion draft version of the proposal is the same as the Administration's proposed change to current law except that the discussion draft option would not create a separate foreign tax credit basket for this income.

- **Subpart F inclusion of all low-taxed cross-border income proposal.** CFC income subject to a foreign effective tax rate (based on US principles) of 10 percent or less (determined on a country-by-country basis) would be treated as subpart F income, with an exception for same-country active income. This proposal has been likened to Japan's CFC rules, although it does not provide for the active business income exception included in the Japanese rule.
- **"Carrot and stick" approach to intangible income.** This option creates a new category of subpart F income for low-taxed worldwide income derived by a CFC from intangibles (the "stick") and provides a 40-percent deduction to the domestic corporation for income attributable solely to the foreign exploitation of intangibles (the "carrot").

The new category of subpart F income, foreign base company intangible income (FBCII), would be defined as all intangible income earned by a CFC from the sale, lease, or license of property in which intangible property

(IP) is used directly or indirectly, or the provision of services related to IP without regard to where the intangibles are exploited. FBCII would be eligible for a modified subpart F high-tax exception that would apply where the effective tax rate of the income exceeds 13.5 percent. The 40-percent deduction provided under the "carrot" (resulting in a 15-percent effective tax rate) applies only to foreign intangible income earned directly by a domestic corporation and indirectly through a CFC in which it is a shareholder. Foreign intangible income is defined as intangible income derived in connection with property sold, used, consumed or disposed of outside the United States or in connection with services provided with respect to persons or property outside the United States.

The discussion draft also would address US base erosion concerns by limiting deductions for net interest expense of a US corporation that is a US shareholder with respect to a CFC if both the US corporation and the CFC are members of a worldwide affiliated group. The limitation would apply if US net interest expense exceeds an unspecified percentage of adjusted taxable income and the domestic debt-to-equity ratio is higher than the debt-to-equity ratio of the taxpayer's entire worldwide group. The lesser of the amounts determined under the percentage of taxable income test and the relative leverage test is the amount by which deductible interest is reduced.

Other international proposals

Chairman Camp's discussion draft represents one direction of potential international reforms. The Administration's anticipated white paper may recommend expansions to subpart F, potentially as part of a territorial tax proposal that would increase tax revenues relative to current law. A 2005 JCT staff dividend exemption territorial proposal would have disallowed deductions for domestic expenses allocable to exempt foreign earnings; the JCT staff proposal was estimated at that time to increase tax revenues by \$54.8 billion over 10 years.

The Administration's FY 2012 budget proposals would modify the present worldwide tax system by deferring the deduction for the portion of domestic interest expense allocable or apportionable to untaxed foreign earnings. The Administration's FY 2012 budget also would limit the foreign tax credit by adopting a blending approach that reflects the rate of foreign tax on unremitted foreign earnings. In addition, the Administration proposed the "excess returns" modification to subpart F discussed above.

As noted above, Sen. Wyden's proposed tax reform legislation would repeal deferral and apply a per-country limitation to the foreign tax credit. A preliminary JCT staff estimate of this proposal estimates an increase in tax collections of \$583 billion over 10 years. In contrast to Sen. Wyden's proposal, active foreign business income generally qualifies for deferral or exemption under the tax systems of all other OECD countries.

Administration and Congressional Priorities

Note: Administration tax proposals and proposed effective dates discussed below were included in the President's FY 2012 budget released in February 2011. In certain cases noted below, the original FY 2012 budget proposals were modified by the President's Plan for Economic Growth and Deficit Reduction ("the President's deficit reduction plan") released on September 19, 2011. Except where noted, revenue estimates cited below for the President's previous tax proposals were provided last year by JCT staff (JCX-19-11) in their analysis of the President's FY 2012 budget.

The President's budget for FY 2013 is expected to be released the week of February 6, 2012 and may modify the Administration's tax proposals discussed below.

Individual Taxes

A majority of individual, estate, and gift tax provisions remain in effect through 2012, including a 35-percent top individual tax rate and repeal of the individual limitations on itemized deductions ("Pease") and personal exemption phase-outs ("PEP"). The scheduled expiration of these individual tax provisions will be a significant focus of the election debate this year.

Separately, an individual AMT "patch" expired last year on December 31, 2011. If Congress does not take action to extend

higher AMT exemption amounts, more than 25 million additional households are projected to pay the AMT when they file their 2012 tax returns next year.

President Obama has proposed that the lower tax rates and expanded tax credits originally enacted in 2001 and 2003 should be made permanent for families with incomes below \$250,000 (single individuals below \$200,000), but should expire as scheduled for taxpayers with incomes above those levels. The top tax rate for ordinary income would be 39.6 percent. In addition, he has proposed to reinstate the Pease and PEP provisions for such higher income taxpayers and raise the top rates for both capital gain income and qualified dividend income from 15-percent to 20-percent for such taxpayers. President Obama also has proposed making the AMT patch permanent.

Last September, as part of his deficit reduction plan, President Obama proposed to raise \$400 billion by limiting the tax value of otherwise allowable itemized deductions and exclusions to 28 percent. This proposed limitation would apply after 2012 to married couples filing a joint return with modified adjusted gross income (AGI) above \$250,000 (single individuals above \$200,000). President Obama included a similar proposal in his FY 2012 budget, but the version proposed in September

was expanded to apply to certain other specified deductions and exclusions, such as interest income from tax-exempt obligations and the value of employer-provided health insurance. A similar limitation would apply for the AMT.

President Obama also said last year that Congress should adopt a “Buffett rule” so that individuals with income above \$1 million would “not pay a smaller share of their income in taxes than middle-class families pay.” The details of how to define such a concept were left to Congress; no specific proposal was included in the President’s deficit reduction plan last September.

Senate Democrats last year proposed a “millionaire” surtax as an offset for various proposals. Senate Majority Leader Reid in October 2011 as part of S. 1660 proposed a 5.6-percent surtax on the modified AGI of single and joint filers in excess of \$1 million to offset the full cost of the President’s “American Jobs Act” proposals. A millionaire surtax at various levels later was proposed in order to offset the cost of separate elements of the President’s legislation, including highway infrastructure funding, federal assistance

to State and local governments for hiring teachers and public safety employees, and a payroll tax reduction for employees and employers. Senate Republicans and a handful of Senate Democrats consistently blocked efforts to gain the 60 votes needed to advance such proposals.

Individual Income Tax Rates

Congress in 2001 created a new 10-percent regular income tax bracket, adjusted the 15-percent tax bracket, and reduced other regular income tax rates to 25 percent, 28 percent, 33 percent, and 35 percent; in 2010 these rates were extended through 2012.

As noted above, a temporary AMT patch expired in 2011 but may be renewed by Congress at some point this year. The patch for 2011 provided an exemption threshold of \$74,450 for married filing joint returns, and \$48,450 for individuals. At this time, the AMT thresholds for 2012 have dropped to \$45,000 for married couples filing joint returns (\$33,750 for individuals).

Beginning in 2013, taxpayers filing married joint returns with AGI in excess of \$250,000 (single individuals

above \$200,000) will be subject to new Medicare health insurance (HI) taxes. An increased 0.9-percent tax on ordinary income will apply to taxpayers with AGI above the threshold amounts; this increased tax is in addition to the current 1.45-percent Medicare HI tax paid by all employees. A new 3.8-percent Medicare HI tax will apply to net investment income of taxpayers with AGI above the threshold amounts. (Net investment income is interest, dividends, royalties, rents gross income from a trade or business involving passive activities, and net gain from disposition of property, other than property held in a trade or business.) This new tax was enacted as part of the 2010 health care law with a delayed effective date to offset a significant part of the future cost of implementing the health care legislation.

Capital Gain and Dividend Rates

Currently, an individual’s qualified dividend income is taxed at the same rates that apply to net capital gain. The top rate for capital gain and qualified dividends has been 15 percent. This provision currently is set to sunset on December 31, 2012.

Federal Income Tax Rates for 2012

Single	Married (filing joint return)	Rate
Not over \$8,500	Not over \$17,000	10%
\$8,500 - \$34,500	\$17,000 - \$69,000	15%
\$34,500 - 83,600	\$69,000 - \$139,350	25%
\$83,600 - \$174,400	\$139,350 - \$212,300	28%
\$174,400 - \$379,150	\$212,300 - \$379,150	33%
Over \$379,150	Over \$379,150	35%

If Congress does not act prior to 2013, qualified dividend income will be taxed at ordinary income rates beginning in 2013, and the top rate on capital gain will revert to 20 percent. In addition, as discussed above, a 3.8-percent Medicare HI tax on an individual's net investment income also will be effective in 2013, resulting in a 23.8-percent tax rate on capital gain income and a 43.4-percent rate on dividend income (39.6 percent top rate on ordinary income plus 3.8 percent HI tax on net investment income). As noted above, President Obama has proposed that both capital gain income and qualified dividend income should be taxed at a top rate of 20 percent.

Estate and Gift Taxes

Congress in 2010 reinstated through 2012 estate and generation-skipping transfer taxes, effective for individuals dying and transfers made after December 31, 2009. Because the estate tax had been repealed temporarily for 2010, Congress provided an election for executors of estates of individuals who died in 2010 to apply previous 2010 law or the rules under the new legislation.

A top tax rate of 35 percent and a \$5,120,000 exemption is provided for 2011 and 2012 estate taxes, as well as exemption portability between spouses and a deduction for estate taxes paid to any State or the District of Columbia.

For gifts made in 2011 and 2012, the gift tax is unified with the estate tax, with a 35-percent rate and \$5,120,000 exemption.

Absent action by Congress, estate and gift tax rates in 2013 are set to revert to pre-2001 levels, with a top rate of 55 percent with a \$1 million per-person exemption. President Obama has proposed to make the estate tax permanent at 2009 levels, with a top rate of 45 percent and a \$3.5 million per-person exemption.

Business Tax Proposals

Enhancing Incentives for Innovation

President Obama in his FY 2012 budget again proposed to extend permanently the research credit, and also proposed to increase the alternative simplified credit (ASC) from 14 percent to 17 percent. This proposal is estimated to reduce revenues by \$87.6 billion over 10 years.

Senate Finance Chairman Baucus and Finance Ranking Minority Member Hatch last year introduced a proposal to modify the research credit and provide a permanent research incentive. Their legislation, the Greater Research Opportunities with Tax Help Act of 2011 (The "GROWTH" Act, S. 1577), proposes to:

- Eliminate the traditional credit, and increase the rate of the ASC to 20 percent;

- Simplify rules on how to divide the group credit between a parent corporation and its subsidiaries; and
- Allow acquired companies, and not their acquirers, to claim the credit for qualified research expenditures during the year of acquisition.

In addition to these initiatives to make the United States more competitive in the global economy, there have been discussions about a "patent box" or "innovation box" regime that would reduce the corporate tax rate on qualifying IP income. Countries that currently have such regimes include Belgium, France, Hungary, Luxembourg, the Netherlands, and Spain. The United Kingdom has committed to enacting a patent box regime effective in April 2013.

As noted above, the international tax reform discussion draft released by Ways and Means Chairman Camp includes a variation of the patent box concept—a reduced tax rate for IP-related income—within one of the draft's anti-base erosion options.

While a number of other bills have been introduced in recent years to make permanent as well as modify the research credit, the research credit has been extended on a temporary basis numerous times since it was enacted in 1981. The most recent extension was through the

end of 2011. The House and Senate may consider reinstating the research credit on a retroactive basis at some point during 2012. When the credit expired in the past, Congress has approved a full retroactive extension of the research credit in all occasions but one.

Repeal of the Last-In, First-Out (LIFO) Inventory Accounting Method

President Obama has proposed to repeal the LIFO method of accounting for inventories, effective for tax years beginning after 2012. Under the President's proposal, taxpayers currently using LIFO would be required to write up their beginning LIFO inventory to its first-in, first-out (FIFO) value in their first tax year beginning after 2012. The resulting increase in gross income would be taken into account ratably over a 10-year period beginning with the first taxable year beginning on or after January 1, 2013. This proposal is estimated to raise \$69.7 billion over 10 years.

Repeal of the Lower-of-Cost-or-Market (LCM) Inventory Accounting Method

President Obama also has proposed to repeal the LCM inventory accounting method and the subnormal goods method. In addition, the President's proposal calls for appropriate wash-sale rules to prevent taxpayers from circumventing the proposal. The proposal treats the change as a change in the taxpayer's method of accounting

for inventories; any resulting section 481(a) adjustment would be taken into account ratably over a four-year period beginning in the year of change. This proposal, which would be effective for tax years beginning on or after January 1, 2013, is estimated to raise \$2.9 billion over 10 years.

Other Revenue-Raising Business Tax Proposals

President Obama is expected to re-propose in his FY 2013 budget other revenue-raising proposals remaining from his FY 2012 budget. These include:

- Eliminating certain tax provisions for oil, gas, and coal companies;
- Imposing a "Financial Crisis Responsibility Fee";
- Reinstating Superfund excise taxes; and
- Modifying worker classification rules.

The President's proposals to eliminate certain tax provisions available to oil, gas, and coal companies altogether are estimated to raise \$40.7 billion over 10 years. The Administration's energy proposals are discussed in greater detail below.

President Obama also is expected to include in his FY 2013 budget a proposal to tax "carried interest"—the profits interest received by investment fund managing partners—as ordinary rather than capital gain income. The Administration limited the scope of its carried interest proposal in statutory language provided as part of the President's deficit reduction plan.

This revised Administration proposal is estimated by Treasury staff to raise \$13.2 billion over 10 years.

For a list of potential revenue-raising tax provisions proposed in past bills, Administration budgets, the Congressional Budget Office (CBO), or JCT staff reports, see Appendix D.

International

In September 2011, the Obama Administration released legislative language for both new and previously described international tax proposals. Although many of these proposals have been carried over from previous years, observers had speculated as to the technical details. The Administration's proposed language generally differed from previous versions of such concepts, including the proposals regarding the deferral of deduction for interest expense and FTC pooling in legislation that had been introduced by former House Ways and Means Committee Chairman Charles Rangel (D-NY) in 2007.

These Administration proposals, offered as modifications to the current worldwide tax system, may provide an important window into President Obama's approach to comprehensive corporate tax reform.

The following are some of the Administration's significant international proposals that may be re-proposed this year.

Deferral of Interest Expense Deduction Allocable to Deferred Foreign Earnings

Under this Administration proposal, deductions for interest expense allocable to foreign assets would be allowed only to the extent that foreign-source income (“FSI”) is earned by the US taxpayer. The proposal was modified in the President’s deficit reduction plan to be effective for tax years beginning on or after January 1, 2013. This proposal is estimated by Treasury staff to raise \$35.6 billion over 10 years.

Any such deduction that is properly allocable or apportionable to FSI that is not currently taxed in the United States would be deferred until an equivalent amount of deferred FSI becomes taxable in the United States. This proposal seeks to match more closely the timing of interest expense deductions with income inclusion. Because worldwide allocation of interest expense is not effective until taxable years beginning after December 31, 2020, the proposal would apply only to US interest expense prior to that date.

An earlier 2009 Administration proposal was much broader, deferring deductions for “foreign-related deductions.” Some commentators questioned whether that approach would have a negative impact on jobs in this country, and, as stated above, the most recent proposal was narrowed to include only interest expense.

Determine the Foreign Tax Credit on a Pooling Basis

This Administration proposal would restrict “deemed-paid” FTCs of a US-based multinational corporation to the average rate of total foreign tax actually paid on total foreign earnings, thus eliminating cross-crediting of high-tax and low-tax foreign income. The proposal was modified in the President’s deficit reduction plan to be effective for foreign income taxes paid or accrued in taxable years beginning on or after January 1, 2013. This proposal is estimated by Treasury staff to raise \$52.8 billion over 10 years.

The Administration’s “blended foreign tax pool” approach would fundamentally change the existing rules, which treat each foreign subsidiary of a US taxpayer as having its own pool of earnings and taxes. The US parent can claim an indirect FTC for foreign taxes paid by those subsidiaries; if each subsidiary has its own pool, the US parent may be able to choose when to claim the credits for the respective high- or low-tax foreign income. Under the Administration proposal, that flexibility would be lost with respect to these deemed-paid FTCs for taxes paid by foreign subsidiaries, but the proposal would not apply to foreign taxes paid directly by a US taxpayer.

Current Tax on “Excess” Returns Associated with Transfers of IP Offshore

This proposal reflects concern in the Administration and by some in Congress about IP transferred offshore from the United States to a related person. The Administration proposes a new category of subpart F income associated with certain outbound IP transfers to low-taxed CFCs.

Under the proposal, if a US person has transferred IP from the United States to a related CFC that is subject to a low foreign effective tax rate in circumstances that are deemed to evidence excessive income shifting, then an amount equal to the excessive return would be treated as subpart F income in a separate FTC limitation basket. As modified by the President’s deficit reduction plan, the proposal applies to income from transactions connected with or benefiting from covered intangibles in taxable years beginning on or after January 1, 2013. This proposal is estimated by Treasury staff to raise \$19.7 billion over 10 years. Chairman Camp’s international reform discussion draft includes a similar proposal, without the separate FTC basket provision, as one of the anti-base erosion options discussed above.

Limit Income Shifting Through IP Transfers

This carryover proposal to limit income shifting through IP transfers would prevent what the Administration considers inappropriate shifting of income outside the United States by “clarifying” the definition of IP subject to an outbound toll tax. The proposal specifically includes workforce-in-place, goodwill, and going concern value as subject to potential tax on an outbound transfer. The proposal also authorizes the IRS to value IP on an aggregate basis in the case of the transfer of multiple intangibles, and provides that IP must be valued at its highest and best use. This proposal is estimated by JCT staff to raise \$566 million over 10 years.

Limit Earnings Stripping by Expatriated Entities

This proposal would further limit the deductibility of related-party interest expense by “expatriated” entities. The Administration budget proposal defines an expatriated entity by reference to the 2004 anti-corporate inversion legislation (section 7874) as if it were effective for tax years beginning after July 10, 1989 (rather than March 4, 2003). The earnings stripping issue was raised at

a June 2011 tax reform hearing held by the House Ways and Means Committee, and at a July 2011 joint hearing on tax reform held by the Ways and Means and Senate Finance Committees. As modified by the President’s deficit reduction plan, the proposal is effective for taxable years beginning on or after January 1, 2013. This proposal is estimated by Treasury staff to raise \$3.9 billion over 10 years.

Expired International Tax Provisions

The Obama Administration’s FY 2012 budget included a proposal to extend both the CFC look-through rule and the active financing exception to subpart F for an additional year, ending on December 31, 2012 for calendar-year taxpayers. Most recently, these provisions expired at the end of 2009 and were extended on a retroactive basis in late 2010 through the end of 2011. Congress may consider extending these provisions again on a retroactive basis at some point during 2012.

Other Administration International Tax Proposals

The Administration’s FY 2012 budget included several other international tax proposals that were not enacted in 2011 and could be carried over to the FY 2013 budget. These include proposals that would:

- disallow deductions for excess non-taxed reinsurance premiums paid to affiliates,
- modify the tax rules for dual-capacity taxpayers, and

- repeal gain limitation for certain dividends received in reorganizations, thus limiting the use of “cash D” reorganizations.

Additional International Proposals

Repatriation

A number of bills were introduced last year to provide a temporary foreign repatriation tax incentive, similar to the section 965 provision enacted in 2004. JCT staff estimate that a repatriation tax incentive similar to the 2004 provision providing an 85-percent dividends-received deduction would reduce federal revenues by \$79 billion over 10 years, but raise \$26 billion in the first three years (2011–2013).

The following bills are among those proposed in 2011:

- Rep. Kevin Brady (R-TX) introduced The Freedom to Invest Act of 2011 (H.R. 1834) on May 11, 2011 to reinstate the section 965 temporary dividends-received deduction and reduce the benefits provided if the taxpayer does not maintain an average employment level at least equal to the taxpayer’s prior average employment level.
- Senators Kay Hagan (D-NC) and John McCain (R-AZ) on October 6, 2011 proposed a temporary dividend repatriation amendment to a job creation bill being considered at the time by the Senate. This proposed

amendment included an 8.75-percent effective rate on repatriated earnings with the opportunity to lower that rate to 5.25 percent if the company expanded its US payroll. Like the Brady bill, this amendment would reduce the benefits if the average employment level of the taxpayer decreases.

Obama Administration officials have expressed opposition to temporary repatriation proposals. Ways and Means Chairman Camp has stated that he does not oppose temporary repatriation efforts but would prefer to address the issue of repatriation as part of international reform.

An October 2011 report by the majority staff of the Senate Permanent Subcommittee on Investigations (PSI), chaired by Senator Carl Levin (D-MI), criticizes the 2004 provision as “a substantial revenue loss, failed jobs stimulus, and added incentive for US corporations to move jobs and investment offshore.” Chairman Levin late last year issued a PSI majority staff addendum report that cited the amount of unrepatriated earnings that are held in US bank accounts or US financial instruments to counter claims that the US tax system “locks out” income earned abroad.

Companies supportive of the tax incentive point to a number of studies by academics and economists that find benefits from the repatriation of foreign earnings with respect to US employment, investment, and GDP, including a study issued last year by a Clinton Administration economic advisor, Dr. Laura Tyson.

Anti-Haven Legislation

Bills have been introduced in the House and Senate to treat certain foreign corporations primarily managed and controlled in the United States as domestic corporations for tax purposes, with no exception for foreign corporations located in tax treaty countries.

A management and control provision is included in anti-tax haven legislation (H.R. 2669 and S. 1346, the Stop Tax Haven Abuse Act) introduced by Ways and Means Committee member Lloyd Doggett (D-TX) and Senate PSI Chairman Levin, and in international tax legislation (H.R. 62 and S. 1373, the International Tax Competitiveness Act) introduced by Rep. Doggett and Finance Committee member Jay Rockefeller (D-WV). Rep. Doggett discussed the management and control legislation at a May 12, 2011 Ways and Means hearing on tax reform.

Energy

With Congressional action on comprehensive energy or climate change legislation not expected during 2012, attention likely will focus on a variety of tax provisions that provide incentives for both traditional and alternative energy production.

Renewable Energy Tax Incentives

Congress may consider extending the production tax credit for wind energy, which currently equals 2.2 cents/kilowatt hour for electricity produced by wind facilities for sale to third parties in their first 10 years of commercial operation. The credit is set to expire at the end of 2012.

Other energy-related provisions expired at the end of 2011, including:

- Biodiesel and renewable diesel credit;
- Refined coal credit;
- Alternative fuel and alternative fuel mixtures credit;
- Temporary rule for sales or dispositions to implement FERC or state electric restructuring policy for qualified electric utilities;
- Suspension of limitation on percentage depletion for oil and gas from marginal wells;
- Ethanol credit;
- Energy-efficient appliances credit;
- Energy-efficient home credit; and
- Alternative vehicle refueling property credits.

The expired provisions also include the cash grant program created under section 1603 of the American Recovery and Reinvestment Act of 2009. The grant program provides companies an opportunity to seek cash grants from Treasury in lieu of claiming renewable energy investment tax credits under section 48, but only for projects on which construction began by December 31, 2011. It is unclear whether this deadline might be further extended as part an overall tax extenders package.

In addition, currently, fuel-cell vehicles are the only vehicles for which the Section 30B credit still is available, and few, if any, such vehicles are available commercially.

On December 14, 2011, the Senate Finance Subcommittee on Energy Natural Resources, and Infrastructure held a hearing on extending many of these provisions, perhaps setting the stage for action during 2012.

Oil and Gas Tax Incentives

In its FY 2012 Budget, the Administration proposed ending a number of “fossil fuel subsidies,” including percentage depletion and the availability of section 199 for the oil and gas industries. These proposed changes were incorporated in several Congressional proposals in 2011, and similar proposals could resurface in 2012.

Other Energy Policy Issues

The Environmental Protection Agency (EPA) continues to pursue regulatory projects on reporting and, in some cases, mitigating greenhouse gas (GHG) emissions and in late 2011 issued new emissions standards on mercury that will affect coal-fired power plants. In 2011, the House considered several measures intended to limit the EPA’s ability to regulate further in these areas, and several lawsuits have been filed against these new rules. If the courts do not block the EPA rules, Congress may again consider action in this area.

Congress also may consider proposals for a national renewable energy standard (RES). Many states already have RES targets, which require that a certain percentage of a state’s energy be produced from renewable resources. Several national RES proposals have been introduced in the current Congressional session.

Regulatory approval of a Keystone XL oil pipeline between Canada and the United States last year became part of the debate over extending a temporary payroll tax reduction. The Obama Administration last year announced that a decision on the planned pipeline would be delayed until at least 2013 to allow for the consideration of alternative routes. The two-month payroll tax reduction bill passed by Congress late last year included language requiring a decision by the Administration within 60 days of the measure’s December 23 enactment.

At the state level, California continues to move toward implementation of a statewide cap-and-trade system for GHG emissions, with a target date for compliance of January 1, 2013. Large emitting companies in California are likely to start trading contracts on emissions allowances in 2012 ahead of that deadline. Both California and other state governments continue to pursue a wide variety of incentive programs for the development and deployment of renewable energy technologies.

Trade

Congress in 2012 may address the issue of expired Trade Promotion Authority (TPA, formerly known as fast-track trade negotiating authority) for the Administration.

Free trade agreements (FTAs) with South Korea, Colombia, and Panama were signed into law by President Obama on October 21, 2011, along with Trade Adjustment Assistance reforms, the Generalized System of Preferences, and the Andean Trade Preferences Act, following Congressional approval of those measures on October 12. The three new FTAs were considered under the now-expired TPA because they were signed before that authority expired on July 1, 2007.

The new US-South Korea FTA includes, among other measures, language to increase the number of US-made cars and trucks that would be eligible for entry into the Korean market.

The fate of Senate-passed legislation that would allow the Administration to impose additional duties on products from countries that subsidize exports by undervaluing their currencies (commonly referred to as the China currency bill)

remains unclear. Concerns have been raised that the bill would violate World Trade Organization rules, and House Speaker Boehner has said the bill poses a “very severe risk” of starting a trade war between the United States and China.

With regard to trade in the Pacific Rim, the Obama Administration continues to work on a multinational agreement called the Trans-Pacific Strategic Economic Partnership (TPP). The negotiations involve Australia, New Zealand, Vietnam, Chile, Malaysia, Peru, Singapore, and Brunei; Japan, Canada, and Mexico may join the talks as well. The United States and Australia already have a bilateral FTA that entered into force on January 1, 2005. On November 12, 2011, the leaders of the nine current TPP nations announced the completion of the broad outlines of a TPP agreement and pledged to dedicate the resources necessary to complete the agreement as quickly as possible.

Expired and Expiring Business Tax Provisions

A number of business tax provisions expired at the end of 2011, including the research credit, CFC look-through, subpart F exception for active financing income, and depreciation rules for leasehold improvements. Congress this year again may consider retroactively extending some or all of these expired provisions.

Congress in late 2010 provided a period of 100-percent full expensing through the end of 2011. President Obama last September proposed an additional year of full expensing as part of his American Jobs Act. The House included this proposal in their initial bill to extend the payroll tax reduction, but the provision was not included in the final two-month extension legislation. Although current law provides for 50-percent bonus depreciation through 2012, it remains possible that Congress this year could revisit the issue of full expensing.

In addition to the specific provisions mentioned above, numerous other business tax provisions expired on December 31, 2011, including:

- 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements;
- Work opportunity tax credit;
- New markets tax credit;
- Railroad track maintenance credit;
- Election to expense mine safety equipment;
- Special expensing rules for certain film and television productions;
- Expensing of “Brownfields” environmental remediation costs;
- Modification of tax treatment of certain payments to controlling exempt organizations;
- Treatment of certain dividends of a regulated investment company (RIC);
- RIC qualified investment entity treatment under FIRPTA;
- Reduction in S corporation recognition period for built-in gain;
- Basis adjustment to stock of S corporations making charitable contributions of property;
- Empowerment zone tax incentives;
- Biodiesel and renewable diesel credit;
- Refined coal credit;
- Alternative fuel and alternative fuel mixtures credit;
- Temporary rule for sales or dispositions to implement FERC or state electric restructuring policy for qualified electric utilities;
- Suspension of limitation on percentage depletion for oil and gas from marginal wells;
- Ethanol credit;
- Energy-efficient appliances credit;
- Energy-efficient home credit; and
- Alternative vehicle refueling property credits.

Business tax provisions that are set to expire on December 31, 2012 include:

- Additional first-year depreciation for 50 percent of basis of qualified property;
- Election to accelerate AMT credits in lieu of additional first-year depreciation; and
- Production tax credit for wind energy.

Other Legislation

Tax Treaties

The United States signed new income tax treaties with Hungary and Chile during 2010. In June 2011, the Senate Foreign Relations Committee held a treaty hearing at which the treaty with Hungary was considered, as well as protocols to existing treaties with Switzerland and Luxembourg. The Committee reported out the three pacts to the full Senate with the recommendation that they be approved. However, Senator Rand Paul (R-KY) late last year placed a “hold” on Senate floor consideration of the three pacts, leaving their fate and timing uncertain.

The treaty with Chile was not considered at the June hearing. It was delayed by the State Department with no indication of when it will move forward.

Hungary Treaty

The US-Hungary Treaty, which was signed on February 4, 2010, would replace the 1979 treaty currently in effect. The principal focus of the new treaty is addition of a limitation on benefits (LOB) article that is consistent with other recent US treaties. The US-Hungary Treaty also provides an exemption from tax withheld at source for royalties and interest (except contingent interest, which is subject to a 15-percent tax rate). Unlike newer treaties with other EU countries, the US-Hungary Treaty does not contain an exemption from tax for certain parent/subsidiary dividends.

Hungary is one of three jurisdictions that had been identified by the US Treasury on the ground that their lack of an anti-treaty shopping article (the LOB article) and internal tax laws accommodated their use by residents of third countries as a means of accessing the benefits

of a US income tax treaty. The other jurisdictions were Iceland and Poland. A new treaty with Iceland that added on LOB article entered into effect in 2008. Negotiations with Poland for a new treaty are discussed below.

Chile Treaty

The pending US-Chile Treaty represents only the second US income tax treaty with a South American country. (A US income tax treaty with Venezuela was signed in 1999.) The new US-Chile Treaty is based broadly on the 2006 US Model Income Tax Treaty, except that it has a more restrictive LOB article and higher rates of taxation of dividends, interest, and royalties than those in the US Model Treaty. Similar to the US-Hungary Treaty, the US-Chile Treaty does not provide an exemption from tax for parent/subsidiary dividends. While the benefits of the treaty are limited, its entry into effect could create a stimulus for other South American countries, particularly Brazil, to enter into tax treaties with the United States.

Swiss Protocol

The Swiss protocol to the existing treaty is aimed primarily at updating the exchange of information provision and also includes a requirement for binding arbitration for double tax disputes that are not resolved by agreement between the competent authorities of the two countries. It has been widely reported that the United States and Switzerland have agreed to return to the negotiating table two years after the signing of the protocol, which occurred in 2009; however, it is not expected that formal negotiations will take place prior to the entry into effect of the pending protocol. Although the details of the agreement

have not been made public, it is expected that among the items to be discussed are possible elimination of tax withheld at source on certain parent/subsidiary dividends and a potential revision to the LOB article to be more in line with recent US tax treaties that have tightened the requirements for eligibility.

Luxembourg Protocol

The Luxembourg protocol is aimed at updating the exchange of information provision in the existing US-Luxembourg Treaty.

Poland Treaty

Treasury is actively pursuing renegotiation of the 1974 US-Poland Treaty, the only remaining US tax treaty with a jurisdiction often used as an intermediary for holding and finance companies that lacks a robust LOB article. It has been reported that work on the treaty has been concluded and that the document is awaiting signature.

Other Treaties

A third round of treaty negotiations has been completed with *Spain*. Two rounds of negotiations with the *United Kingdom* have been held, pursuant to an agreement between the two countries to meet periodically regarding treaty matters, and two rounds of negotiations have been held with *Vietnam*. The first round of negotiations related to revising the current US treaty with *Japan* to bring the treaty into closer conformity with the current US and Japanese tax treaty policies has been held.

Agreement for a new or revised treaty with *Norway* is substantially complete but indefinitely delayed. Negotiations are underway with *Brazil* and *Colombia*.

Negotiations have stalled with *Israel*. There has been correspondence with *South Korea*, but negotiations are not anticipated in the near term. Discussions are underway with *Venezuela* and the *Netherlands Antilles*, and early discussions are underway with *Malaysia*. Treasury apparently has not concluded that it should pursue a treaty with *Singapore* or *Hong Kong* despite strong support from the business community for such treaties.

New US Model Treaty, Other Guidance

Treasury has announced that it is planning to publish a new model treaty, which would supersede the existing US Model Treaty that was published in 2006. Separately, the 2011-2012 Treasury-IRS Priority Guidance Plan includes a project to provide guidance on issues under income tax treaties, including beneficial ownership.

Currently, the only guidance on treaty interpretation equivalent to regulations interpreting the Internal Revenue Code is the Treasury Technical Explanation that accompanies the submission of a treaty or protocol to the US Senate during the ratification process. There is no procedure for modifying a treaty explanation to clarify statements or reflect the most recent thinking of the IRS or Treasury. Treasury Technical Explanations are accorded limited weight by the courts, although more weight is given in the exceptional cases where the treaty partner has indicated its acceptance of the US interpretations (such as in the case of the Fifth Protocol to the US-Canada Treaty). In addition, the 2011-2012 Priority Guidance Plan includes a project to update Rev. Proc. 2006-54, which provides procedures for requesting Competent Authority assistance under tax treaties.

Trends in US Tax Treaty Policy

The United States is expected to continue to strive in its treaties for effective protection against “treaty shopping.” Such policies include LOB articles and monitoring the use of US tax treaties by inverted companies. Other priorities include strong exchange of information commitments, modernization of the treatment of cross-border retirement plans, and changes to the personal services articles of treaties (mainly, the policy of eliminating the independent personal services article as being redundant of the business profits article). In addition, Treasury likely will continue its recent policy of including binding arbitration as a means of deciding Competent Authority cases that otherwise are unresolved.

Both the model treaty and the pending regulations project offer opportunities for businesses to provide input to the government on ways to improve treaty guidance as well as to affect the future direction of US tax treaty policy. Some areas on which comments could be offered are concepts of beneficial ownership; application of fiscal transparency rules beyond the treatment of dividends, interest, and royalties (including the impact of hybrid entity structures on accessing treaty benefits for business profits and reductions in the branch profits tax); and improvements to the LOB article.

State Tax Legislation

Bills that would make significant changes to state and local tax policy continue to be considered by Congress, and actions taken in 2011 may signal the potential for further progress in 2012.

Wireless Tax Fairness Act

Legislation (H.R. 1002) that would place a five-year moratorium on the discriminatory taxation of mobile services, service providers, or property passed in the House by voice vote on November 1, 2011. Companion legislation (S. 543) was introduced in the Senate and referred to the Senate Finance Committee.

Business Activity Tax Simplification Act of 2011

Legislation (H.R. 1439) that would adopt a “physical presence” threshold for the imposition of state and local income, franchise, and other direct taxes—as well as expand existing protections under Public Law 86-272 for in-state sales solicitation activities—was approved by the House Judiciary Committee by voice vote on July 7, 2011. On September 13, CBO released its cost estimate on the proposal, estimating that state and local revenues would be about \$2 billion lower in the first year after enactment and at least that amount in subsequent years.

Marketplace Fairness Act

A bipartisan group of Senators on November 9, 2011 introduced this bill (S. 1832), which would grant authority to require collection of sales tax by out-of-state sellers to states that are members of the Streamlined Sales Tax

Government Board and to other states that meet certain minimum simplification requirements. The legislation has been described as a compromise between the Main Street Fairness Act (S. 1452/H.R. 2701), which is a Streamlined Sales Tax-only bill, and the Marketplace Equity Act (H.R. 3179), which provides fewer simplifications and does not require Streamlined Sales Tax membership.

Mobile Workforce State Income Tax Simplification Act

Legislation (H.R. 1864) intended to provide administrative simplification and aid compliance with respect to non-resident withholding and individual income tax reporting was approved by the House Judiciary Committee by voice vote on November 17, 2011. The legislation would implement a 30-day threshold for both the state taxation of non-resident employees’ income and for the requirement to withhold taxes from such non-resident employees’ wages. In most states, losses from reduced non-resident withholding could be offset in whole or in part by residents claiming fewer credits for taxes paid to other states.

Other Action on State Tax Issues

On December 1, 2011, legislation (S. 1934) was introduced that, like other pending bills, would repeal the federal telecommunications excise tax, but also would make the Internet Tax Freedom Act permanent and prohibit state and local taxation of certain charges for travel-related services. Other bills on state tax issues that bear watching include the Digital Goods and Services Tax Fairness Act (H.R. 1860/S. 971); the End Discriminatory State Taxes for

Automobile Renters Act (H.R. 2469); the Permanent Internet Tax Freedom Act (S. 135); the State Video Tax Fairness Act (H.R. 1804); and the Telecommuter Tax Fairness Act (S. 1811).

Other Legislation

Aviation and Surface Transportation Reauthorization Legislation

On September 16, 2011, President Obama signed into law a bill (H.R. 2887) providing another short-term extension of the Federal Aviation Administration (FAA) and highway programs. H.R. 2887 extends the Airport and Airway Trust Fund taxes and expenditure authority until January 31, 2012, and extends the Highway Trust Fund taxes and expenditure authority until March 31, 2012. The extensions provide additional time for Congress to consider multi-year FAA and highway reauthorization bills in 2012.

On November 19, 2011, the Senate Environment and Public Works Committee approved a two-year, \$109 billion highway reauthorization bill (S. 1813) with a \$12 billion funding shortfall.

House Transportation and Infrastructure Committee Chairman John Mica (R-FL) has indicated that while Republican leadership and the committee remain committed to moving an infrastructure bill, House leadership postponed introduction and consideration of a surface transportation reauthorization bill until this year.

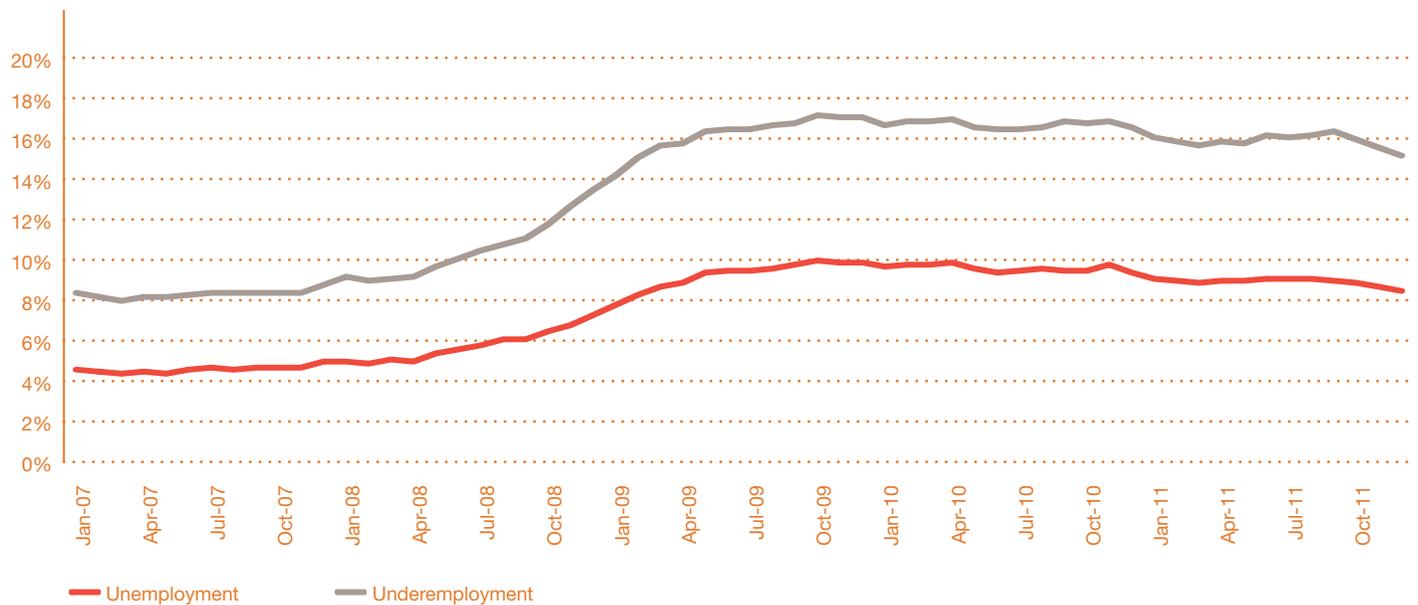
Economic and Budget Outlook

Throughout 2011, Congress and the Administration sought to address the twin challenges of lagging economic growth and continuing budget deficits. The outlook for 2012 presents the same issues. Projections of modest economic growth in 2012 and new threats to financial markets from the European Union may lead policymakers to compare potential short-term benefits of expansionary fiscal policy with long-term benefits of addressing the federal government's budget imbalance.

Current Economic Outlook

The US economy continues to suffer from historically high unemployment. The unemployment rate in December 2011 was 8.5 percent, well above the 30-year average of 6.3 percent and approximately twice as high as pre-recession levels. The underemployment rate—which incorporates individuals seeking full-time work but only able to obtain part-time work and other unemployed individuals with only marginal attachments to the labor force—was 15.2 percent in December 2011.

Figure 10: Unemployment and Underemployment Rates, 2007-2011



Source: Bureau of Labor Statistics, January 2012.

Current projections by most economists assume modest improvement over the coming years. The OECD projects that the unemployment rate in the United States will fall gradually over the next two years. Beyond 2013, both the CBO and the Administration expect unemployment to decline slowly, remaining above six percent until 2016.

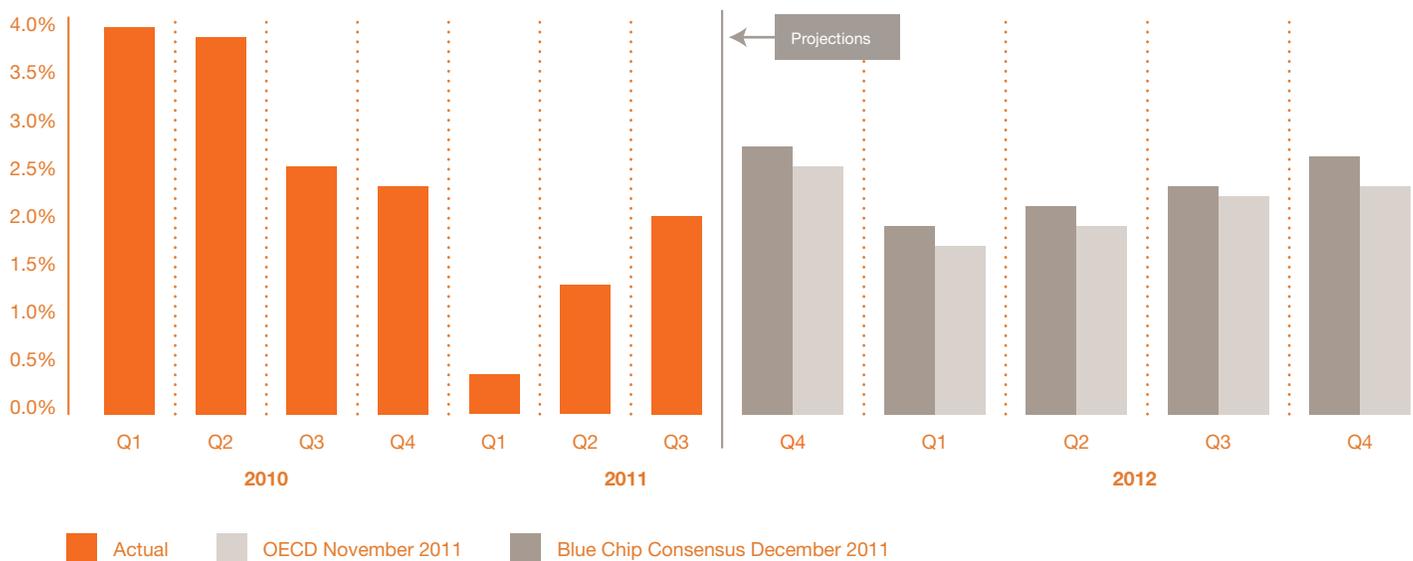
The slow labor market improvements are driven by modest economic growth. Since the official end of the recession in July 2009, inflation-adjusted GDP growth has averaged 2.4 percent per quarter on an annualized basis. For 2012, GDP growth is expected to remain modest, reaching approximately 2.5 percent by the final quarter of the year, still below the 30-year average of 2.7 percent.

Interest rates and inflation generally are assumed to remain low in 2012 and 2013.

Current Budget Outlook

In fiscal year 2011, the federal government's budget deficit was \$1.299 trillion, or 8.7 percent of GDP, compared to the FY 2010 level of \$1.294 trillion (9.0 percent of GDP). A modest improvement in revenue collections caused the decrease in the ratio of the deficit to the size of the economy.

Figure 11: Quarterly Real GDP Growth



Source: OECD Economic Outlook, Volume 2011 Issue 2-No. 90, November 2011; Wolters and Kluwer, Blue Chip Economic Indicators, Vol. 36, No. 12, December 10, 2011.

Going forward, the path of the deficit will depend on actions taken by the federal government in several key areas. CBO's baseline projections assume current law remains in place over the coming 10 years, meaning:

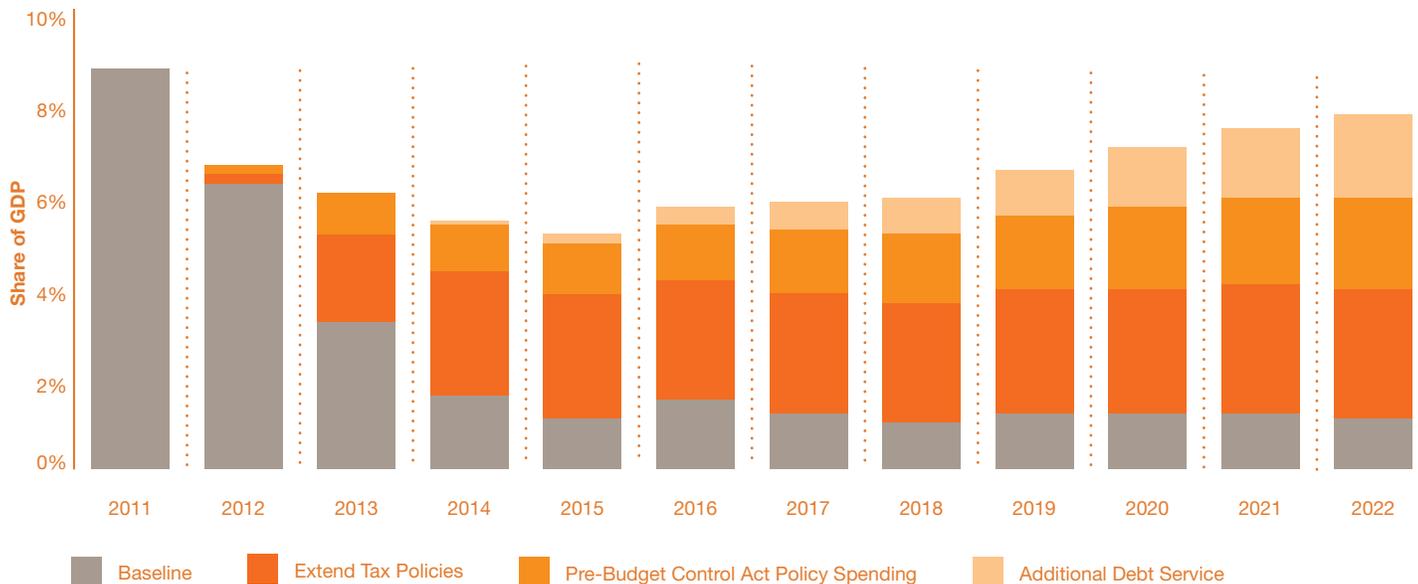
- The tax cuts originally enacted between 2001 and 2003 and extended in 2010 are assumed to expire after 2012;
- Business tax provisions such as the research tax credit expire as scheduled;
- Medicare physician reimbursement rates decrease significantly; and
- Automatic reductions in spending begin in 2013 under the Budget Control Act's sequester provision, triggered by the failure of Congress to enact at least \$1.2 trillion in deficit reduction in late 2010.

Under these "current law" assumptions, deficits as a share of GDP fall rapidly over the budget window, falling below three percent in 2014 and beyond. Federal government revenues would reach 20.9 percent of GDP by 2021, well above the 30-year historical average of 17.9 percent, and federal spending would be 22.1 percent of GDP by 2021, slightly higher than its historical average of 21.1 percent. As a result, the deficit would be 1.2 percent of GDP by 2021.

By contrast, if Congress and the President decide to extend current policies, revenues, spending, and the resulting deficit would be quite different (see Figure 12 below). Extension of all tax provisions scheduled to expire between 2011 and 2021 would increase the

deficit by \$6.5 trillion between 2013 and 2022, including debt service. Assuming discretionary spending grows with the overall economy (disregarding limits in effect under the Budget Control Act) and scheduled cuts in Medicare physician payments are eliminated, spending would be almost \$3.5 trillion higher between 2013 and 2022. As a result of these "current policy" assumptions, deficits would exceed five percent of GDP for the entire period and would climb to 7.7 percent by 2022.

Figure 12: Alternative Deficit Projections (By Fiscal Year)



Source: Congressional Budget Office, Economic and Budget Outlook: An Update, August 2011, and PwC calculations.

Deficits under current policy assumptions would cause federal government debt to climb sharply: federal government debt held by the public would increase from 67 percent of GDP in 2011 to approximately 97 percent by 2021.

Impact of Budget Decisions on the US Economy

The long-run prospects of the US economy will be influenced by the federal government's budget policy. First, although interest rates remain at historic lows, continued deficits could drive up government and private sector borrowing costs. CBO research suggests that sustained increases in federal deficits of one percent of GDP would increase interest rates by approximately 30 basis points.

The European Union spent much of 2011 addressing problems associated with sovereign debt crises in several countries. In addition, the loss of investor confidence can have a significant impact on government borrowing costs. For example, yields on 10-year sovereign debt in Greece increased from approximately six percent in January 2010 to almost 24 percent in October 2011. The size and importance of US financial markets may make such a dramatic increase in interest rates unlikely in the United States, but a decline in investor confidence still could result in a measurable increase in borrowing costs for the federal government.

Increased government borrowing costs would affect interest rates across the entire economy, and the increased borrowing by the government would limit the ability of the economy to grow and create new employment. Recent economic research has found that countries with excessive debt-to-GDP ratios have experienced median declines in GDP growth of one percentage point.

In light of the risks imposed on the economy by the excessive budget deficits, the federal government is likely to consider some form of fiscal reforms. As Congress and the Administration discuss potential changes, certain elements will influence their decisions.

Short-Run vs. Long-Run Deficit Reduction

Given the current economic weakness, some research finds that implementing significant deficit reduction in the short run could slow the current recovery. The OECD estimated that significant deficit reduction—as would occur under current law with the expiration of the 2001-2003 tax cuts and a \$1.2 trillion across-the-board reduction in federal discretionary spending under the Budget Control Act “sequester”—would increase unemployment by 0.6 percentage points in both 2012 and 2013.

However, other economists have found that policy uncertainty can lead to slower economic growth. The downgrade in the outlook for federal government debt by Standard & Poor’s in August 2011 occurred primarily because of doubts over the government’s ability to address the deficit situation in a meaningful way (the downgrade actually occurred after agreement to the provisions of the Budget Control Act). The uncertainty associated with the lack of resolution in current policy debates could be slowing economic growth.

Spending Reductions vs. Tax Increases

Deficit reduction can be achieved through tax increases, spending cuts, or a combination of the two. Successful budget control efforts will decrease future deficits while minimizing contractionary impacts on the economy. Some research has found that budget control efforts that relied on spending cuts rather than tax increases are more likely to result in lasting deficit reduction. Specifically, cuts in transfer payments, as opposed to government investment, are found to be the most effective. In the case of the United States, much of the long-term budget challenge is being driven by entitlement programs like Social Security, Medicare, and Medicaid. By 2038, these programs will combine to represent 18 percent of GDP, the historical average of total federal revenues.

The economic and budgetary challenges facing the federal government are significant. While policy action on these issues may not occur in 2012, the path of the economy and the budget are linked, and they will continue to be key concerns for Congress and the Administration.

What this means for your business

Many companies and trade associations are actively engaged in assessing the potential benefits and risks of tax reform, and have been participating in ongoing Congressional hearings.

Unsustainable increases in federal deficits and continued uncertainty resulting from expired or expiring tax provisions continue to be tax policy drivers. At the same time, divided government may limit action this year by the current Congress on significant tax legislation that impacts businesses and individuals.

The 2012 elections for control of the White House and Congress will mark a key decision point for tax policy. Election-year competition over tax policy priorities may serve to define business and individual tax issues and provide direction for the first major overhaul of US tax laws since 1986, including consideration of adopting a territorial tax system for business taxation in the United States.

Designing a comprehensive tax reform proposal may necessitate considerable additional efforts, particularly in light of federal budget constraints. Details on domestic business and individual reform proposals are expected this year, along with discussion of potential base-broadening revenue offsets. Because there is a potential for businesses to be affected significantly by emerging tax reform efforts, many companies and trade associations are actively engaged in assessing the potential benefits and risks of tax reform.

This year is expected to provide ongoing opportunities for business leaders to participate in Congressional tax reform hearings that may lay the foundation for future tax reform legislation. It will be critical for the business community both to monitor and participate in the legislative process as it unfolds in 2012. Business leaders need to have an active voice in shaping tax legislation and share their knowledge of how best to promote economic growth in the United States.

Appendix A

Congressional Budget Process

Congressional hearings on the President's budget proposals typically take place in February and March, after which Congress generally adopts a budget plan ("budget resolution") that provides an overall framework for consideration of subsequent tax and spending legislation for the budget period.

The Obama Administration is expected to submit its proposed federal budget for FY 2013 by the statutory due date of the first Monday in February (February 6, 2012). The statutory deadline for Congress to pass a budget resolution for FY 2013 is April 15, but this date often has slipped in the past. Because a budget resolution binds only Congress, it does not require the President's approval.

Spending and revenue levels for FY 2013 will be set by the House and Senate, assuming agreement on a joint budget resolution can be reached between the Republican-controlled House and the Democratic-led Senate. If the House and Senate do not adopt a joint budget resolution, each chamber could pass separate budget resolutions with different spending and revenue targets. Differences between the House and Senate ultimately would need to be resolved in specific legislation funding federal departments and agencies for FY 2013, which starts on October 1, 2012.

Budget Reconciliation Process

Originally intended to apply to legislation that would reduce federal budget deficits, the reconciliation process at times has facilitated consideration of other legislation that otherwise would be faced with filibusters or other procedural delays. Reconciliation bills receive expedited consideration and have special procedural protections that facilitate passage. In the Senate, reconciliation bills cannot be filibustered and require a simple majority (i.e., 51 votes) to pass.

At the same time, there are important limitations associated with budget reconciliation bills. Tax cuts enacted as part of a reconciliation bill generally must "sunset" at the end of the budget period unless offset in future years. For example, the 2001 and 2003 tax rate reductions were enacted using budget reconciliation, and therefore were set to expire at the end of 2010 until Congress that year extended them through the end of 2012.

It is unclear whether the House and Senate might consider use of the budget reconciliation process this year given election-year competition between Congressional Democrats and Republicans. The process in recent years has been utilized most often when one party controls both the White House and both chambers of Congress. For example, key revenue-raising provisions of the 2010 health care law were enacted using the budget reconciliation process. Tax increases enacted as part of a reconciliation bill generally are not subject to a sunset rule.

PAYGO

Congress in 2010 passed a pay-as-you-go law ("PAYGO") generally requiring tax increases or reductions in permanent spending to offset the cost of tax cuts or new mandatory spending programs. The PAYGO statute had several temporary exceptions, including an exemption for the cost of making current temporary tax rate reductions permanent for families with incomes below \$250,000 (\$200,000 for individuals) that expired on December 31, 2011.

Congress can waive the PAYGO law by declaring specific spending or tax reductions to be emergency legislation. Congress also can amend the PAYGO statute to accommodate future legislative action.

While not affecting the PAYGO statute, the House on January 5, 2011 adopted a new "cut-as-you-go" House rule that requires any bill that increases mandatory spending to be offset by spending reductions and not by tax increases. The new House rule provides an exception for certain measures designated as emergency under the statutory PAYGO Act. The rule does not require tax increases to offset tax reductions. No similar rule exists in the Senate.

The Budget Control Act of 2011 and Federal Debt Limit Increases

The Budget Control Act provides authority for President Obama to request two separate increases in the federal debt limit that altogether are projected to be sufficient to finance the government's debt obligations through the 2012 election. The BCA provides that the President may submit a written certification to Congress when the debt subject to the limit is within \$100 billion of the debt limit. The limit is automatically increased 15 days after the request unless Congress enacts a resolution of disapproval under expedited procedures. A resolution of disapproval is subject to Presidential veto, which would require a two-thirds majority in each chamber to override.

The first installment of an increase in the debt limit totalling \$900 billion was requested last August. Under the BCA, \$400 billion went into effect immediately and the remaining \$500 billion was effective last September, when the House passed a resolution of disapproval but the Senate did not.

Administration officials indicated in January 2012 that President Obama will request the second debt limit increase of \$1.2 trillion authorized by the Budget Control Act, which will go into effect automatically unless a resolution of disapproval is enacted.

As part of the BCA, Congress last year established a Joint Select Committee on Deficit Reduction to propose a \$1.2 trillion deficit reduction plan that would have been voted on by Congress without amendment by December 23, 2011. However, the Select Committee was unable to reach a bipartisan agreement on an acceptable mix of spending cuts, mandatory spending reductions, and revenue increases.

As a fallback, the BCA provided for an equal amount of deficit reduction through automatic across-the-board spending cuts over nine years beginning in January 2013. While some in Congress have proposed revisiting these required spending cuts, in particular for the Defense Department, President Obama has said he would veto any such legislation unless a "balanced" agreement can be reached on revenue and spending issues.

Appendix B

Senators with Seats Subject to Election in 2012

Democrats	Republicans
Akaka, Daniel K. (D-HI)**	Barrasso, John (R-WY)
Bingaman, Jeff (D-NM)**	Brown, Scott P. (R-MA)
Brown, Sherrod (D-OH)	Corker, Bob (R-TN)
Cantwell, Maria (D-WA)	Heller, Dean (R-NV)
Cardin, Benjamin L. (D-MD)	Hatch, Orrin G. (R-UT)
Carper, Thomas R. (D-DE)	Hutchison, Kay Bailey (R-TX)**
Casey, Robert P., Jr. (D-PA)	Kyl, Jon (R-AZ)**
Conrad, Kent (D-ND)**	Lugar, Richard G. (R-IN)
Feinstein, Dianne (D-CA)	Snowe, Olympia J. (R-ME)
Gillibrand, Kirsten E. (D-NY)	Wicker, Roger F. (R-MS)
Klobuchar, Amy (D-MN)	
Kohl, Herb (D-WI)**	
Manchin, Joe, III (D-WV)	
McCaskill, Claire (D-MO)	
Menendez, Robert (D-NJ)	
Nelson, Ben (D-NE)**	
Nelson, Bill (D-FL)	
Stabenow, Debbie (D-MI)	
Tester, Jon (D-MT)	
Webb, Jim (D-VA)**	
Whitehouse, Sheldon (D-RI)	
Independents*	
Lieberman, Joseph I. (I-CT)**	
Sanders, Bernard (I-VT)	

*Currently caucus with Senate Democrats

** Not running for re-election

Source: United States Senate website, <http://www.senate.gov>

Appendix C

Selected Federal Tax Expenditures

Tax Expenditures	5-Year FY 2010–2014 Tax Expenditure Estimate (\$ billions)
Corporations	
Deferral of active income of controlled foreign corporations	70.6
Exclusion of interest on public purpose State and local government bonds	45.3
Deduction for income attributable to domestic production activities	43.2
Inventory property sales source rule exception	38.0
Depreciation of equipment in excess of the alternative depreciation system	37.1
Inclusion of income arising from business indebtedness discharged by the reacquisition of a debt instrument	28.8
Credit for low-income housing	27.0
Expensing of research and experimental expenditures	25.6
Last-in, first-out inventory method (“LIFO”)	20.0
Reduced rates on first \$10,000,000 of corporate taxable income	15.9
Exclusion of investment income on life insurance and annuity contracts	12.9
Credit for increasing research activities (section 41)	12.0
Special treatment of life insurance company reserves	12.2
Deferral of gain on non-dealer installment sales	11.5
Deferral of gain on like-kind exchanges	10.0
Deduction for charitable contributions to health organizations	9.4
Credits for electricity production from renewable resources (section 45)	8.5

Note: The methodology used by Joint Committee on Taxation staff to estimate tax expenditures differs from the methodology used to estimate revenue-raising proposals

**5-Year FY 2010–2014
Tax Expenditure Estimate
(\$ billions)**

Tax Expenditures

Individuals

Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	659.4
Deduction for mortgage interest on owner-occupied residences	484.1
Reduced rates of tax on dividends and long-term capital gains	402.9
Net exclusion of pension contributions and earnings for defined benefit plans	303.2
Earned income credit	268.8
Deduction of non-business State and local government income taxes, sales taxes, and personal property taxes	237.3
Net exclusion of pension contributions and earnings for defined contribution plans	212.2
Exclusion of capital gains at death	194.0
Deduction for charitable contributions, other than for education and health	182.4
Exclusion of Medicare Benefits: Hospital Insurance (Part A)	175.8
Exclusion of untaxed Social Security and railroad retirement benefits	173.0
Exclusion of benefits provided under cafeteria plans	163.1
Exclusion of investment income on life insurance and annuity contracts	132.1
Exclusion of Medicare Benefits: Supplementary medical insurance (Part B)	124.5
Credit for children under age 17	121.9
Deduction for property taxes on real property	120.9
Exclusion of interest on public purpose State and local government bonds	116.3
Exclusion of capital gains on sales of principal residences	86.3
Individual retirement arrangements: Traditional IRAs	85.6
Net exclusion of pension contributions and earnings for plans covering partners and sole proprietors (“Keogh plans”)	81.1

Tax Expenditures	5-Year FY 2010–2014 Tax Expenditure Estimate (\$ billions)
Deduction for medical expenses and long-term care expenses	77.6
Exclusion of miscellaneous fringe benefits	38.7
Credits for tuition for post-secondary education: Hope and Lifetime Learning Credits	37.8
Exclusion of Medicare Benefits: Prescription drug insurance (Part D)	35.1
Carryover basis of capital gains on gifts	32.1
Deduction for charitable contributions to educational institutions	31.5
Deduction for health insurance premiums and long-term care insurance premiums by the self employed	27.9
Exclusion of foreign earned income: Salary	27.1
Exclusion of veterans' disability compensation	27.0
Exclusion of benefits and allowances to armed forces personnel	24.7
Individual retirement arrangements: Roth IRAs	23.9
Credits and subsidies for participating in health insurance exchanges	22.4
Exclusion of employer-paid transportation benefits	21.8
Depreciation of rental housing in excess of alternative depreciation system	21.0
Exclusion of cash public assistance benefits	20.8
Exclusion of income earned by voluntary employees' beneficiary associations	20.2
Exclusion of workers' compensation benefits (disability and survivors payments)	19.5
Tax credit for small businesses purchasing employer insurance	19.2
Deduction for income attributable to domestic production activities	18.9
Exclusion of employment benefits for premiums on accident and disability insurance	17.8

Tax Expenditures	5-Year FY 2010–2014 Tax Expenditure Estimate (\$ billions)
Exclusion of workers' compensation benefits (medical benefits)	17.4
Deduction for charitable contributions to health organizations	15.9
Credit for child and dependent care and exclusion of employer-provided child care	13.1
Exclusion of medical care and TRICARE medical insurance for military dependents, retirees, and retiree dependents not enrolled in Medicare	13.1
Additional standard deduction for the blind and the elderly	12.4
Exclusion of scholarship and fellowship income	11.9
Exclusion of interest on State and local government qualified private activity bonds for private nonprofit and qualified public educational facilities	11.5
Parental personal exemption for students aged 19 to 23	10.4
Build America bonds	9.1

Source: Joint Committee on Taxation. Estimates of Federal Tax Expenditures for Fiscal Years 2010–2014. Washington: GPO 2010. Print

Appendix D

Selected Potential Revenue–Raising Proposals

Provision	Source of proposal	10–Year FY 2012–FY 2021 Revenue Estimate (\$ millions)
International		
Tax the worldwide income of US corporations as it is earned	CBO	114,200
Exempt active foreign dividends from US taxation and change the tax treatment of overhead expenses	CBO	76,200
Eliminate the source–rules exception for exports	CBO	53,700
Determine the foreign tax credit on a pooling basis	Administration FY 2012 Budget	53,149
Defer deduction of interest expense related to deferred income	Administration FY 2012 Budget	42,666
Tax currently excess returns associated with transfers of intangibles offshore	Administration FY 2012 Budget	14,211
Disallow the deduction for non–taxed reinsurance premiums paid to affiliates	Administration FY 2012 Budget	11,759
Modify tax rules for dual capacity taxpayers	Administration FY 2012 Budget	9,201
Limit earnings stripping by expatriated entities	Administration FY 2012 Budget	1,598
Limit shifting of income through intangible property transfers	Administration FY 2012 Budget	566
Tax Accounting and Corporate		
Impose a 5–percent value–added tax:		
Broad Base	CBO	2,500,000
Narrow Base		1,390,000
Repeal MACRS and apply Alternative Depreciation System		
C corporations and Pass-throughs	JCT	724.1
C corporations only		506.8
Repeal the deduction for domestic production activities		
C corporations and Pass-throughs	JCT	163.9
C corporations only		127
Increase corporate income tax rates by 1 percentage point	CBO	100,600

Provision	Source of proposal	10-Year FY 2012–FY 2021 Revenue Estimate (\$ millions)
Repeal last-in, first-out (“LIFO”) method of accounting for inventories	Administration FY 2012 Budget	69,665
Make the 0.2-percent unemployment insurance surtax permanent	Administration FY 2012 Budget	14,449
Increase certainty with respect to worker classification	Administration FY 2012 Budget	7,446
Repeal gain limitation for dividends received in reorganization exchanges	Administration FY 2012 Budget	460
Financial Services		
Impose a financial crisis responsibility fee	Administration FY 2012 Budget	30,000
Tax carried (profits) interest in investment partnerships as ordinary income	Administration FY 2012 Budget	20,659
Reinstate superfund environmental income tax	Administration FY 2012 Budget	12,884
Reinstate superfund excise taxes	Administration FY 2012 Budget	6,519
Require ordinary treatment of income from day-to-day dealer activities for certain dealers of equity options and commodities	Administration FY 2012 Budget	2,980
Repeal lower-of-cost-or-market (“LCM”) inventory accounting method	Administration FY 2012 Budget	2,910
Require accrual of income on forward sale of corporate stock	Administration FY 2012 Budget	146
Modify the definition of “control” for purposes of section 249 of the Internal Revenue Code	Administration FY 2012 Budget	88
Employee Benefits		
Tax Social Security and railroad retirement benefits like defined-benefit pensions	CBO	438,400
Include employer-paid benefits for income-replacement insurance in employees’ taxable income	CBO	311,500
Employment Taxes		
Increase the maximum taxable earnings for the Social Security Payroll Tax	CBO	456,700
Expand Social Security coverage to include newly hired State and Local government employees	CBO	96,000

Provision	Source of proposal	10-Year FY 2012– FY 2021 Revenue Estimate (\$ millions)
Energy		
Impose a price on emissions of greenhouse gases	CBO	1,178,900
Increase excise taxes on motor fuels by 25 cents	CBO	291,000
Repeal domestic manufacturing deduction for oil and natural gas companies	Administration FY 2012 Budget	15,899
Repeal percentage depletion for oil and natural gas wells	Administration FY 2012 Budget	10,795
Repeal expensing of intangible drilling costs (“IDCs”)	Administration FY 2012 Budget	8,345
Repeal domestic manufacturing deduction for coal and other hard mineral fossil fuels	Administration FY 2012 Budget	2,266
Repeal percentage depletion for coal and hard mineral fossil fuels	Administration FY 2012 Budget	1,262
Increase geological and small integrated geophysical amortization for independent producers to seven years	Administration FY 2012 Budget	1,006
Repeal capital gains treatment for royalties	Administration FY 2012 Budget	625
Increase the Oil Spill Liability Trust Fund financing rate to 9 cents per barrel effective 2012 and 10 cents per barrel effective 2017 and thereafter	Administration FY 2012 Budget	453
Repeal expensing of exploration and development costs	Administration FY 2012 Budget	268
Repeal exception to passive loss limitation for working interests in oil and natural gas properties	Administration FY 2012 Budget	209
Repeal deduction for tertiary injectants	Administration FY 2012 Budget	68
Excise Taxes		
Accelerate and modify the excise tax on high-cost health care coverage	CBO	309,500
Tax Administration		
Require a certified taxpayer identification number (“TIN”) from contractors and allow certain withholding	Administration FY 2012 Budget	400

Provision	Source of proposal	10-Year FY 2012–FY 2021 Revenue Estimate (\$ millions)
Individual		
Limit the tax benefit of itemized deductions to 15 percent	CBO	1,180,800
End the current itemized deduction for State and Local taxes	CBO	862,200
Raise all ordinary tax rates, AMT rates, and dividend and capital gains rates by 1 percentage point	CBO	715,000
Raise all ordinary tax rates and AMT rates by 1 percentage point	CBO	702,400
Cap the deduction for State and Local taxes at 2 percent of adjusted gross income	CBO	629,300
Raise all tax rates on ordinary income by 1 percentage point	CBO	480,400
Impose 5.6-percent surtax on modified adjusted gross income in excess of \$1 million	Senate	452,708
Include investment income from life insurance and annuities in taxable income	CBO	259,500
Curtail the deduction for charitable giving	CBO	219,000
Eliminate the mortgage interest deduction	CBO	214,600
Replace the tax exclusion for interest income on State and Local bonds with a direct subsidy for the issues	CBO	142,700
Raise the top three ordinary tax rates by 1 percentage point	CBO	139,100
Eliminate the child tax credit	CBO	116,700
Raise the top two ordinary tax rates by 1 percentage point	CBO	115,000
Raise the top ordinary tax rate by 1 percentage point	CBO	83,900
Use an alternative measure of inflation to index some parameters of the tax code	CBO	71,800
Raise tax rates on capital gains	CBO	48,500
Eliminate certain tax preferences for educational expenses	CBO	47,700
Reduce limits on contributions to retirement plans	CBO	45,900
Provide short-term tax relief to employers and expand Federal Unemployment Tax Act (“FUTA”) base	Administration FY 2012 Budget	32,961
Eliminate the refundable portion of the child tax credit	CBO	27,100

Provision	Source of proposal	10-Year FY 2012– FY 2021 Revenue Estimate (\$ millions)
Insurance		
Increase the payroll tax rate for Medicare hospital insurance by 1 percentage point	CBO	650,800
Expand pro rata interest expense disallowance for corporate-owned life insurance	Administration FY 2012 Budget	6,824
Modify the dividends–received deduction (“DRD”) for life insurance company separate accounts	Administration FY 2012 Budget	4,940
Modify rules that apply to sales of life insurance contracts	Administration FY 2012 Budget	990
Estate and Gift		
Require a minimum term for grantor retained annuity trusts (“GRATs”)	Administration FY 2012 Budget	3,600
Require consistency in value for transfer and income tax purposes	Administration FY 2012 Budget	1,142
Other		
Increase all taxes on alcoholic beverages to \$16 per proof gallon	CBO	59,900
Levy a fee on the production of hardrock minerals to restore abandoned mines	Administration FY 2012 Budget	1,350
Increase levy authority for payments to Medicare providers with delinquent tax debt	Administration FY 2012 Budget	807
Deny deduction for punitive damages	Administration FY 2012 Budget	325
Increase duck stamp fees	Administration FY 2012 Budget	105

Source: Administration’s FY 2012 Budget, February 2011; Congressional Budget Office “Reducing the Deficit: Spending and Revenue Options,” March 2011; Joint Committee on Taxation, Letter to Rep. Sander Levin (D–MI), October 21, 2011; Senate, Congressional Budget Office, “Budgetary Effects of S. 1660, The American Jobs Act of 2011 as Introduced in the Senate on October 5, 2011,” October, 2011. Revenue estimates for Administration proposals are from Joint Committee on Taxation, JCX-19-11, Estimated Budget Effects of the Revenue Provisions In the President’s Fiscal Year 2012 Budget Proposal,” March 17, 2011, except in the case of the Administration’s proposed financial crisis responsibility fee for which Treasury estimates are used; JCT staff reported that the proposal requires additional specification to estimate.

Appendix E

Tax Reform Hearings in the 112th Congress¹

January 20, 2011: House Ways and Means Committee hearing on “Fundamental Tax Reform.”

Witnesses: Nina Olson, IRS National Taxpayer Advocate; Robert McDonald, Procter & Gamble CEO (appearing as Chairman, Business Roundtable Fiscal Policy Initiative); Warren Hudak, President, Hudak & Company; Kevin Hassett, Senior Fellow & Director of Economic Policy Studies, American Enterprise Institute; and Martin Sullivan, Contributing Editor, Tax Analysts.

February 2, 2011: Senate Budget Committee hearing on “Tax Reform: A Necessary Component for Restoring Fiscal Responsibility.”

Witnesses: Dr. C. Eugene Steuerle, The Urban Institute; Dr. Donald Marron/Director, Urban Institute and Brookings Institution Tax Policy Center; Dr. Rosanne Altshuler, Professor, Rutgers University; and Dr. Lawrence Lindsey, President and Chief Executive Officer, The Lindsey Group.

March 1, 2011: Senate Finance Committee hearing on “How Did We Get Here? Changes in the Law and Tax Environment Since the Tax Reform Act of 1986.”

Witnesses: Fred Goldberg Jr., Former Assistant Secretary of the Treasury for Tax Policy, 1992; Jonathan Talisman, Former Assistant Secretary of the Treasury for Tax Policy, 2000–2001; Mark Weinberger, Former Assistant Secretary of the Treasury for Tax Policy, 2001–2002; Pamela Olson, Former Assistant Secretary of the Treasury for Tax Policy, 2002–2004; and Eric Solomon, Former Assistant Secretary of the Treasury for Tax Policy, 2006–2009.

March 3, 2011: House Ways and Means Select Revenue Measures Subcommittee hearing on “Small Businesses and Tax Reform.”

Witnesses: Dr. Robert Carroll, Principal, Qualitative Economics and Statistics, Ernst & Young LLP; Patricia A. Thompson, Chair, Tax Executive Committee, American Institute of Certified Public Accountants; Dennis Tarnay, Chief Financial Officer, Lake Erie Electric, Inc; and Donald B. Marron, Director, Urban Institute and Brookings Institution Tax Policy Center.

¹ Hearings on tax reform also were held during the 111th Congress:

September 23, 2010, Senate Finance Committee hearing on “Tax Reform: Lessons from the Tax Reform Act of 1986.”

Witnesses: Former Rep. Richard Gephardt, President and CEO, Gephardt Group; Former Rep. Bill Archer, Senior Policy Advisor, PricewaterhouseCoopers; John E. Chapoton, Strategic Advisor, Brown Advisory, and Randall D. Weiss, Ph.D, Managing Director, Economic Research, The Conference Board.

December 2, 2010, Senate Finance Committee hearing on “Tax Reform: Historical Trends in Income and Revenue.”

Witnesses: Dr. Douglas Elmendorf, Director, Congressional Budget Office; Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation; and Mark J. Mazur, Deputy Assistant Secretary for Tax Analysis, Department of Treasury.

March 8, 2011: Senate Budget Committee hearing on “Report of the National Commission on Fiscal Responsibility and Reform.”

Witnesses: Former Senator Alan Simpson, Co-Chair, National Commission on Fiscal Responsibility and Reform; and Erskine Bowles, Co-Chair, National Commission on Fiscal Responsibility and Reform.

March 8, 2011: Senate Finance Committee hearing on “Does the Tax System Support Economic Efficiency, Job Creation and Broad-Based Economic Growth?”

Witnesses: Dr. Alan Auerbach, Professor of Economics and Law, University of California Berkeley; Dr. R. Glenn Hubbard, Dean and Professor of Finance and Economics, Columbia University Graduate School of Business; Dr. James K. Galbraith, Chair in Government/Business Relations and Professor of Government, The University of Texas at Austin; and Michael Graetz, Professor of Law, Columbia Law School.

March 9, 2011: Senate Budget Committee hearing on “Distribution and Efficiency of Spending in the Tax Code.”

Witnesses: Robert Greenstein, Executive Director, Center on Budget and Policy Priorities; Robert McIntyre, Director, Citizens for Tax Justice; and Scott Hodge, President, Tax Foundation.

March 15, 2011: Senate Budget Committee hearing on “Report of the Bipartisan Policy Center’s Debt Reduction Task Force.”

Witnesses: Former Senator Pete Domenici, Co-Chair Bipartisan Policy Center’s Debt Reduction Task Force; and Former CBO Director Dr. Alice Rivlin, Co-Chair Bipartisan Policy Center’s Debt Reduction Task Force.

March 30, 2011: Senate Finance Committee hearing on “How Do Complexity, Uncertainty and Other Factors Impact Responses to Tax Incentives?”

Witnesses: Dr. Eric Toder, Institute Fellow and Co-Director, Urban Institute and Brookings Institution Tax Policy Center; Dr. Raj Chetty, Professor, Department of Economics, Harvard University; and Dr. Robert Carroll, Principal, Quantitative Economics and Statistics, Ernst & Young LLP.

March 31, 2011: Ways & Means hearing on “Internal Revenue Service Operations and the 2011 Tax Return Filing Season.”

Witnesses: The Honorable Douglas Shulman, Commissioner, Internal Revenue Service.

April 6, 2011: Joint Committee on Taxation “Roundtable on Tax Reform.”

Witnesses: Former Treasury Secretary James Baker and former Rep. Dick Gephardt.

April 12, 2011: Senate Finance Committee hearing on “Best Practices in Tax Administration: A Look Across the Globe.”

Witnesses: Michael Brostek, Director, Tax Policy and Administration, Strategic Issues, US Government Accountability Office; Brian Erard, B.E. & Associates, Reston, VA; and Michael Gaffney, Tax Partner, PricewaterhouseCoopers.

April 13, 2011: House Ways and Means Committee hearing on “How the Tax Code’s Burdens on Individuals and Families Demonstrates the Need for Comprehensive Tax Reform.”

Witnesses: Alan Viard, Resident Scholar, American Enterprise Institute; Annette Nellen CPA, Director, Masters of Science in Taxation Program, San Jose State University; Mark E. Johannessen CFP, Managing Director, Harris-SBSB; and Neil H. Buchanan Associate Professor of Law, The George Washington University.

May 3, 2011: Senate Finance Committee hearing on “Is the Distribution of Tax Burdens and Tax Benefits Equitable?”

Witnesses: Daniel Shaviro, Wayne Perry Professor of Taxation, New York University School of Law; Scott Hodge, President, Tax Foundation; Aviva Aron-Dine, Ph.D. Candidate, Department of Economics, Massachusetts Institute of Technology (MIT); and Alan Reynolds, Senior Fellow, Cato Institute.

May 4, 2011: Senate Finance Committee hearing on “Budget Enforcement Mechanisms.”

Witnesses: Susan J. Irving, Ph.D., Director for Federal Budget Analysis, Strategic Issues, United States Government Accountability Office; Paul Van de Water, Ph.D., Senior Fellow, Center on Budget and Policy Priorities; and Former Senator Phil Gramm, Vice Chairman, UBS Investment Bank, UBS AG.

May 12, 2011: Senate Finance Committee hearing on “Oil and Gas Tax Incentives and Rising Energy Prices.”

Witnesses: John Watson, Chairman of the Board and Chief Executive Officer, Chevron Corporation; Marvin Odum, US President, Shell Oil Company; James Mulva, Chairman and Chief Executive Officer, ConocoPhillips; H. Lamar McKay, Chairman and President, BP America Inc.; and Rex Tillerson, Chairman and Chief Executive Officer, ExxonMobil Corporation.

May 12, 2011: House Ways and Means Committee hearing on “The Need for Comprehensive Tax Reform to Help American Companies Compete in the Global Market and Create Jobs for American Workers.”

Witnesses: Greg Hayes, Senior Vice President and Chief Financial Officer, United Technologies Corporation; Edward J. Rapp, Group President & Chief Financial Officer, Caterpillar Inc.; James T. Crines, Executive Vice President, Finance, and Chief Financial Officer, Zimmer Holdings, Inc.; Mark A. Buthman, Senior Vice President and Chief Financial Officer, Kimberly-Clark Corporation; James R. Hines, Jr. L., Hart Wright Collegiate Professor of Law, University of Michigan Law School; Dirk J.J. Suringa, Partner, Covington & Burling LLP; and Jane Gravelle, Senior Specialist in Economic Policy, Congressional Research Service.

May 24, 2011: House Ways and Means Committee hearing on “How Other Countries Have Used Tax Reform to Help Their Companies Compete in the Global Market and Create Jobs.”

Witnesses: Gary M. Thomas, White & Case; Frank Schoon, Partner, Dutch Desk, Ernst & Young; Steve Edge, Partner, Slaughter and May; Jorg Menger Partner, Ernst & Young; and Reuven S. Avi Jonah, Professor of Law, University of Michigan Law School.

June 2, 2011: House Ways and Means Committee hearing on “How Business Tax Reform Can Encourage Job Creation.”

Witnesses: Ashby T. Corum, Partner, KPMG LLP; Walter J. Galvin, Vice Chairman of the Board, Emerson Electric Co.; Judy L. Brown, Executive Vice President and CFO, Perrigo Company; James H. Zrust, Vice President, Tax, The Boeing Company; James Mispion, Vice President, Tax, Sears Holdings Management Corporation; and Mark Stutman, National Managing Partner of Tax Services, Grant Thornton.

June 23, 2011: House Ways and Means Subcommittee on Select Revenue Measures hearing on “Tax Reform and Foreign Investment in the United States.”

Witnesses: Nancy L. McLernon, President & Chief Executive Officer, Organization for International Investment; Alexander Spitzer, Senior Vice President-Taxes, Nestle Holdings, Inc.; Claude Draillard, Chief Financial Officer, Dassault Falcon Jet Corporation; Jeffrey DeBoer, President & Chief Executive Officer, The Real Estate Roundtable; Gary Hufbauer, Reginald Jones Senior Fellow, Peterson Institute for International Economics; Robert Stricof, Tax Partner, Deloitte Tax LLP; and Bret Wells, Assistant Professor of Law, University of Houston Law Center.

June 28, 2011: Senate Finance Committee hearing on “Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What’s Due.”

Witnesses: Michael Brostek, Director, Tax Policy and Administration, Strategic Issues, United States Government Accountability Office; Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service; David Kirkham, President, Kirkham Motor Sports; and Kris Carpenter, Founder/CEO, Sanctuary Spa and Salon.

July 13, 2011: House Ways and Means Committee/Senate Finance Committee joint hearing on “Tax Reform and the Tax Treatment of Debt and Equity.”

Witnesses: Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation; Dr. Mihir A. Desai, Mizuho Financial Group Professor of Finance, Harvard Business School; Pamela F. Olson, Former Assistant Secretary of the Treasury for Tax Policy, Partner, Skadden, Arps, Slate, Meagher & Flom; Victor Fleischer, Associate Professor of Law, University of Colorado Law School; Dr. Simon Johnson, and Ronald A. Kurtz Professor of Entrepreneurship, Massachusetts Institute of Technology Sloan School of Management.

July 26, 2011: House Ways and Means Committee hearing on “Tax Reform and Consumption-Based Tax Systems.”

Witnesses: Panel 1 on Fair Tax-Mike Huckabee, former Governor of Arkansas; Dr. Laurence Kotlikoff, Professor of Economics, Boston University; Bruce Bartlett, columnist, Tax Notes, the Fiscal Times, and The New York Times. Panel 2 on Value Added Tax-Michael Graetz, Professor of Law, Columbia University; Dr. Rosanne Altshuler, Professor and Chair, Economics Department, Rutgers University; Dr. Robert Carroll, Ernst & Young; Jim White, US Government Accountability Office; Dr. Daniel Mitchell, Senior Fellow, Cato Institute; and Dr. Simon Johnson, Professor, Sloan School of Management, Massachusetts Institute of Technology.

July 26, 2011: Senate Finance Committee hearing on “Perspectives on Deficit Reduction: A Review of Key Issues.”

Witnesses: Robert Greenstein, President, Center on Budget and Policy Priorities; Dr. Lawrence B. Lindsey, Former Director of the National Economic Council, President and Chief Executive Officer, The Lindsey Group; Michael Ettliger, Vice President for Economic Policy, Center for American Progress; and Chris Edwards, Director, Tax Policy Studies, Cato Institute.

July 27, 2011: Senate Finance Committee hearing on “CEO Perspectives on How the Tax Code Affects Hiring, Businesses and Economic Growth.”

Witnesses: Michael Duke, President and CEO, Wal-Mart Stores, Inc.; Thomas Falk, Chairman and CEO, Kimberly-Clark Corporation; Gregory Lang, President and CEO, PMC-Sierra, Inc.; and Larry Merlo, President and CEO, CVS Caremark Corporation.

September 8, 2011: Senate Finance Committee hearing on “Tax Reform Options: International Issues.”

Witnesses: Phillip R. West, Partner, Steptoe & Johnson LLP; Dr. James R. Hines, Jr, L. Hart Wright Collegiate Professor of Law, University of Michigan Law School; Scott Naatjes, Vice President and General Tax Counsel, Cargill, Incorporated; Dr. Reuven S. Avi-Yonah, Irwin I. Cohn Professor of Law, University of Michigan Law School.

September 13, 2011: Senate Finance Subcommittee on Fiscal Responsibility and Economic Growth hearing on “Examining whether there is a Role for Tax Reform in Comprehensive Deficit Reduction and US Fiscal Policy.”

Witnesses: Dr. Alan C. Greenspan, President, Greenspan Associates LLC; Dr. John B. Taylor, Mary and Robert Raymond Professor of Economics and George P. Shultz Senior Fellow in Economics, Stanford University, Hoover Institution; Dr. Martin S. Feldstein, George F. Baker Professor of Economics, Harvard University; Former Governor of Michigan John M. Engler, President, Business Roundtable; Edward D. Kleinbard, Professor of Law, USC Gould School of Law.

September 14, 2011: Senate Finance Committee hearing on “Tax Reform Options: Marginal Rates on High-Income Taxpayers, Capital Gains and Dividends.”

Witnesses: Dennis Mehiel, Chairman of the Board, US Corrugated, Inc.; Stephen Entin, President and Executive Director, Institute for Research on the Economics of Taxation; Bill Rys, Tax Counsel, National Federation of Independent Business; and Dr. Leonard E. Burman, Daniel Patrick Moynihan Professor of Public Affairs, Maxwell School, University of Syracuse.

September 15, 2011: Senate Finance Committee hearing on “Tax Reform Options: Promoting Retirement Security.”

Witnesses: Dr. Jack VanDerhei, Research Director, Employee Benefit Research Institute; Dr. William G. Gale, Senior Fellow, Brookings Institution; Judy A. Miller, Chief of Actuarial Issues/Director of Retirement Policy, American Society of Pension Professionals and Actuaries; and Karen Friedman, Executive Vice President and Policy Director, Pension Rights Center.

September 20, 2011: Senate Finance Committee hearing on “Tax Reform Options: Incentives for Innovation”

Witnesses: Dr. Scott Wallsten, Vice President for Research & Senior Fellow, Technology Policy Institute and Senior Policy Fellow, Georgetown Center for Business and Public Policy; Michael D. Rashkin, Author, Practical Guide to Research and Development Tax Incentives: Federal, State, and Foreign; Annette Nellen, Professor, Department of Accounting & Finance, College of Business at San Jose State University; and Dr. Dirk Pilat, Head, Structural Policy Division, Organisation for Economic Co-operation and Development Directorate for Science, Technology and Industry.

September 21, 2011: House Ways and Means Committee hearing on “Economic Models Available to the Joint Committee on Taxation for Analyzing Tax Reform Proposals.”

Witnesses: Thomas Barthold, Chief of Staff, Joint Committee on Taxation; Douglas Holtz-Eakin President, American Action Forum; John Buckley, Visiting Professor, Georgetown University Law Center; and William Beach, Director, Center for Data Analysis, the Heritage Foundation.

October 6, 2011: Senate Finance Committee hearing on “Tax Reform Options: Incentives for Homeownership.”

Witnesses: Former Senator John B. Breaux, Senior Counsel, Patton Boggs LLP; Dr. Karl “Chip” Case, Professor of Economics Emeritus, Wellesley College and Senior Fellow, Joint Center for Housing Studies, Harvard University; Dr. Robert D. Dietz, Assistant Vice President for Tax and Policy Issues, National Association Home of Builders; Dr. Richard Green, Director, Lusk Center for Real Estate, University of Southern California; and Gregory M. Nelson, Vice President and Assistant Secretary, PulteGroup, Inc.

October 18, 2011: Senate Finance Committee hearing on “Tax Reform Options: Incentives for Charitable Giving.”

Witnesses: Frank Sammartino, Assistant Director For Tax Analysis, Congressional Budget Office; Elder Dallin H. Oaks, The Quorum of the Twelve Apostles, The Church of Jesus Christ of Latter-day Saints; Dr. Eugene Steuerle, Richard B. Fisher Chair and Institute Fellow, The Urban Institute; Brian A. Gallagher, President and CEO, United Way Worldwide; and Roger Colinvaux, Associate Professor, The Catholic University of America, Columbus School of Law.

December 6, 2011: House Ways and Means Committee/Senate Finance Committee joint hearing on “Tax Reform and the Tax Treatment of Financial Products.”

Witnesses: Thomas Barthold, Chief of Staff, Joint Committee on Taxation; Alex Raskolnikov, Charles Evans Gerber Professor of Law and Co-chair of the Charles E. Gerber Transactional Studies Program, Columbia Law School; Andrea S. Kramer, Partner, McDermott Will & Emery LLP; and David S. Miller, Partner, Cadwalader, Wickersham & Taft LLP.

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