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Lane Gorman Trubitt, L.L.P.
Accountants & Advisors

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President Obama's Fiscal Year 2011 Budget Proposal

President Obama recently introduced his 2011 budget which includes many potential tax changes. The proposals include provisions unchanged from the current budget and several new provisions related to international taxes, job creation and energy incentives. Many of the provisions are likely to increase taxes and raise revenue. The tax proposals likely to affect most individuals and businesses include:

Business Tax Incentives

- A credit of \$5,000 for each new job created in 2010 and a 6.2% credit of aggregate wage increases in excess of inflation. Total benefits would be capped at \$500,000 per employer.
- Make the research credit permanent.
- The budget extends the special 15 year recovery period for qualified leasehold improvements and restaurant property.
- Extends the bonus depreciation rules for property placed in service in 2010.
- Extend through 2010 the \$250,000 limit for Section 179, small business expensing, and the phase out threshold of \$800,000.
- Extend AMT and Research credits acceleration in lieu of bonus depreciation will also be extended.
- Extend the New Markets Tax Credits and incentives for Empowerment Zones.
- Remove the substantiation requirements for employers who provide cell phones to employees.
- Doubles the \$500 tax credit for small employers who adopt a new qualified retirement, SEP or SIMPLE plan.
- Establish automatic IRAs for employees whose employers do not offer a retirement plan.
- Make the Build America Bond Program permanent.

Business Revenue Raisers

- Repeal LIFO method of accounting.
- Repeal the lower-of-cost-or- market inventory accounting method.
- Prohibit the use of lower of cost or market accounting for subnormal goods.
- Enhance rules for classifying workers as employees or independent contractors. The IRS will issue new guidance on worker classification.
- Making the federal .2 percent unemployment surtax (FUTA) permanent.
- Reinstate the superfund taxes and related excise taxes.
- Change the taxation of carried interest. (Carried interest is most commonly defined as a share of any profits that the general partners of a private equity fund receive as compensation, despite not contributing any initial funds.) Income and gain attributable to such an interest in a services partnership would be taxed as ordinary income and subject to self employment tax.
- The administration will continue its efforts to support codifying the economic substance doctrine. Economic substance is a doctrine in the tax law requiring a transaction to have an economic purpose aside from reduction of tax liability in order to be considered valid. This doctrine is used to determine whether tax shelters, or strategies used to reduce tax liability, are considered abusive by the Internal Revenue Service.

Individual Tax Proposals

- During 2001 and 2003, The Bush Administration enacted tax cuts for individuals making less than \$200,000 per year and families earning under \$250,000. This budget continues the rates currently in effect for taxpayers under the \$200,000 (single) and \$250,000 (joint) income thresholds. Tax bracket above these limits -- higher than \$200,000 for individuals and \$250,000 for families -- will see a tax increase as the tax cuts for expire at the end of this year. The tax rates will rise for these individuals, from 33 percent to 36 percent and for couples, from 35 percent to 39.6 percent.
- The budget includes a 20% rate on capital gains and dividends for individuals with income over \$200,000 and \$250,000. The 15% capital gain rate remains in effect for those with lower income levels.
- The budget provides tax cuts for individuals and families earning below \$200,000 and the expansion of the 10% and 28% brackets.
- Doubling the child tax credit for families earning less than \$85,000 per year and increase the amounts available for families earning up to \$115,000 per year.
- Extending the optional deduction for state and local general sales taxes.
- Expand the saver's tax credit to more taxpayers (the current cap for married taxpayers is \$55,000) and make it refundable; the trade off is that the corresponding credit would be smaller (\$500 maximum).
- Personal exemptions will continue to be phased out.
- The proposal limits the extent to which itemized deductions may reduce tax liability by reducing itemized deductions by 3% of the amount by which adjusted gross income exceeds \$250,000 (for married couples

filing jointly) or \$200,000 (for individual filers) but not by more than 80%, and (2) limiting the amount of tax liability that is reduced by itemized deductions to 28% of the value of the itemized deductions, even where the taxpayer has income that is subject to a tax rate that is higher than 28%.

- Higher Earned Income Tax Credit (EITC) would be made permanent while advanced EITC would be repealed.
- The American Opportunity Tax Credit, for qualified tuition payments would be made permanent.
- The Making Work Pay credit of \$400 for singles and \$800 for joint filers would be extended to 2011. This was the signature provision of the President's initial tax proposal of 2009. This credit, as in the previous law, is subject to income limitations.
- Extend the \$250 Economic Recovery Payment for Social Security recipients and retirees to 2010.
- The 65% 15 month Cobra subsidy for employees terminated would be extended to provide assistance for up to 12 months for those terminated during the remainder of 2010.
- Expand the Saver's Credit which is a refundable credit that provides a 50% match on the first \$1,000 of savings for families (\$500 for singles). The credit phases out with AGI between \$65,000 and \$85,000 (joint) and \$32,500 and \$42,500 (single).
- The budget proposes to permanently patch (NOT REPEAL) the individual AMT by indexing the brackets, exemptions and triggers for inflation.

IRS Administration

- The budget seeks new revenue through administration changes such as expanding the IRS's reach on the agency's ability to levy and to collect damages.
- Form 1099 will now be required for payments to corporations over \$600.
- Requires taxpayers with rental income to report payments of \$600 or more made to a service provider to the IRS on a Form 1099.
- Contractors would need to furnish valid TINs to any business from which they receive at least \$600 or face withholding.
- Information return penalties will be doubled.
- Bad check penalty will be expanded.
- All business returns requiring Form M-3 would be required to file electronically. A new \$25,000 penalty applies to entities that do not file electronically.

Estate Tax Changes

- The budget assumes a permanent extension of the estate, gift and generation skipping tax rules including the top 45% rate and the \$3.5 million exemption for estates.
- A provision is to be implemented curbing valuation discounts for transfer tax purposes.
- A proposed new minimum term requirements for GRATs.
- Estate tax returns would require consistency in valuations related to inherited property.

International Revenue Raisers

- Companies would be limited to deducting interest expense to the extent of foreign source income. This provision could force U.S. companies to repatriate income in order to use interest deductions.
- The foreign tax credit rules would be modified by requiring that U.S. taxpayers determine foreign tax paid on a consolidated basis, aggregating earnings and profits of all foreign subsidiaries.
- Separate foreign tax credit rules will be imposed on U.S. persons who transfer an intangible to a related foreign corporation subject to a low foreign effective tax rate where there is evidence of income shifting.
- Revising the earnings stripping provisions and further limiting deductibility of interest paid to related persons.

Financial Industry Provisions

- The proposal imposes a .15% tax on the liabilities of financial institutions with over \$50 billion in assets. This is known as the Financial Crisis Responsibility Fee and will be implemented to cover TARP expenses. The fee would be effective as of July 1, 2010 and would be reported on the annual income tax return.
- Require day to day dealers to report activity in a Section 1256 contract as ordinary, not capital.
- Energy Provisions
- The budget proposes to allocate \$5 billion for the Advance Energy Product Credit pertaining to energy manufacturing projects.
- The Domestic Production Activity Deduction (Section 199) will exclude revenue from the sale of oil, coal, shale, hard minerals, fossil fuels and natural gas.
- The Enhanced Oil Recovery Credit and the Marginal Well Tax Credit will be repealed.
- Require intangible drilling costs and exploration and development costs to be capitalized.
- Eliminates tax preferences, such as intangible drilling costs and percentage depletion, for oil, gas and coal companies.

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