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White House recycles familiar tax proposals in U.S. FY 2012 budget package

The Obama administration on 14 February 2011 released an FY 2012 budget proposal that provides USD 392 billion in tax relief and USD 665 billion in revenue raisers over the next 10 years. Given the controversy of the president's previous budget proposals and the scope of recommendations made by the president's fiscal commission late last year, taxpayers were watching closely to see if the FY 2012 budget would signal a directional change in the administration's tax policy agenda. Instead, this year's budget proposal appears to largely stay the course on taxes, renewing with limited modification virtually all of the unenacted components of the president's international, business, industry and high-income tax proposals from prior years.

In total, the budget package provides USD 392 billion in tax relief and USD 665 billion in revenue-raising provisions over the next 10 years relative to the budget's adjusted baseline. Against this adjusted baseline, the budget would reduce cumulative deficits by USD 1.1 trillion over the next decade, with about two-thirds of such savings resulting from spending cuts – mainly due to a five-year freeze in nonsecurity discretionary spending. When including other proposed changes in discretionary spending on war costs, 10-year deficit reduction under the budget rises to USD 2.2 trillion.

International tax reform proposals

As it has in its last two budget plans, the administration has again proposed significant changes to the international tax rules. The controversial check-the-box rule change from the fiscal 2010 budget has not resurfaced, and several foreign account reporting proposals from past budgets are not included because they were enacted into law last year. However, the other international provisions from last year's budget – including changes to deferral, foreign tax credit pooling and intangibles provisions – are repeated with a few changes to raise almost USD 130 billion over 10 years. The budget, however, also proposes extending through 2012 the exception for subpart F (controlled foreign corporation (CFC) regime) active financing income and look-through treatment for payments between related foreign corporations under the foreign personal holding company income rules.

Deferral – The administration again proposes restricting the ability of companies to take current deductions for interest expense that is allocated and apportioned to foreign-source income that is not currently subject to U.S. tax. Foreign-source income earned by a taxpayer through a branch would be considered currently subject to U.S. tax, and this proposal would therefore not reach interest allocated to that income. Deferred interest expenses would be deductible in later tax years when the deferred foreign-source income becomes subject to U.S. tax.

According to the Treasury Department's explanation of the proposal, the allocation and apportionment of interest expense would be determined under existing regulations, but Treasury will revise regulations and propose statutory changes to prevent inappropriate decreases to the amount of interest allocated to foreign-source income. This provision would be effective for taxable years beginning after 31 December 2011 and would raise almost USD 38 billion by 2021.

Foreign tax credits – The administration once again proposes to require taxpayers to determine their deemed-paid foreign tax credits on a consolidated basis. The taxpayer would have to calculate aggregate foreign taxes and earnings and profits of all foreign subsidiaries (including lower-tier ones) for which the taxpayer can claim a deemed foreign tax credit. The deemed foreign tax credit would then be calculated on the basis of the amount of consolidated earnings and profits of the foreign subsidiaries that is repatriated to the taxpayer in the current taxable year. This provision would raise over USD 51 billion by 2021 and would be effective for taxable years beginning after 31 December 2011.

Intangible property transfers – The administration also re-proposed changes to rules affecting intangible property transfers. Under the first proposal, if a U.S. person transfers an intangible from the U.S. to a related CFC that is subject to a low foreign effective tax rate, certain excess income from the transaction would be treated as subpart F income in a separate foreign tax credit limitation basket. For purposes of the proposal, transfers would include sales, leases, licenses and shared risk or development agreements, including cost sharing agreements. This proposal would be effective for transactions in taxable years beginning after 31 December 2011 and would raise USD 20.8 billion by 2021.

In the other proposed change for intangibles, the definition of intangible property would be clarified to include workforce in place, goodwill and going concern value. For transfers of multiple intangibles, the proposal would allow the Internal Revenue Service (IRS) commissioner the option to value the intangible properties on an aggregate basis. The proposal would also allow the commissioner to value intangible property by taking into consideration "the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled transaction undertaken." This proposal would be effective for taxable years beginning after 31 December 2011 and would raise about USD 1.7 billion over 10 years.

Reinsurance – Current law generally allows insurers a deduction for premiums paid for reinsurance. In addition, reinsurance policies issued by foreign insurers covering U.S. risks are generally subject to an excise tax equal to 1% of the premiums paid, unless waived by treaty. The administration believes that these rules provide improper tax advantages and create incentives for foreign-owned domestic insurers to reinsure U.S. risks with foreign affiliates.

The administration has tweaked its proposal from last year and would deny an insurance company a deduction for reinsurance premiums paid to affiliated foreign reinsurers to the extent that the foreign reinsurer or its parent is not subject to U.S. tax on those premiums. The proposal would further exclude from an insurance company's income any ceding commissions received or reinsurance recovered on policies for which a premium deduction is wholly or partially denied.

A foreign company that receives premiums that would be denied a deduction could elect to treat the premiums and associated investment income as effectively connected to the conduct of a U.S. trade or business and attributable to a permanent establishment for tax treaty purposes. According to the Treasury explanation, reinsurance income that is treated as effectively connected income under this provision would be placed in a separate foreign tax credit limitation basket. The proposal would be effective for policies issued in taxable years beginning after 31 December 2011 and would raise approximately USD 2.6 billion over 10 years.

Earnings stripping – The administration proposes to tighten section 163(j) and limit the deductibility of interest paid by "expatriated entities" to related entities. Expatriated entities would be defined by applying section 7874 and its regulations as if they were in effect beginning 10 July 1989, but the definition would not include surrogate foreign corporations that are treated as domestic under section 7874.

For expatriated entities, the current debt-to-equity safe harbor would be eliminated, and the 50% adjusted taxable income threshold for the limitation would be reduced to 25% of adjusted taxable income for disqualified interest. The carryforward for disallowed interest would be limited to 10 years, and the carryforward of excess limitation would be eliminated. This proposal would be effective for taxable years beginning after 31 December 2011 and would raise USD 4.2 billion by 2021.

Dual-capacity taxpayers – Taxpayers that are subject to a foreign levy and also receive a specific economic benefit from the levying country (so-called dual-capacity taxpayers) may not claim a foreign tax credit for the portion of the foreign levy paid for the specific economic benefit. Under Treasury regulations, if a foreign country has a generally imposed income tax, then a dual-capacity taxpayer may credit the portion of the levy in the amount of what the generally imposed income tax would be.

The administration proposes allowing a dual-capacity taxpayer to treat as a creditable tax that portion of a foreign levy that does not exceed the foreign levy the taxpayer would pay if it were not a dual-capacity taxpayer. The administration also proposes replacing the current regulatory provisions, including the safe harbor, on the determination of what amount of a foreign levy paid by a dual-capacity taxpayer qualifies as a creditable tax. Further, the proposal would also convert the special foreign tax credit limitation rules of section 907 into a separate category within section 904 for foreign oil and gas income. The proposal would yield to U.S. treaty obligations that allow a credit for taxes paid or accrued on certain oil and gas income. This proposal would be effective for taxable years beginning after 31 December 2011 and would raise USD 10.8 billion over 10 years.

Carried interests

The budget repeats a proposal from last year to tax carried interests as ordinary income. In addition, the partner receiving a carried interest would be required to pay self-employment taxes on that income, and gain recognized on the sale of such an interest would be taxed as ordinary income.

The proposal would apply to "investment services partnership interests" (ISPIs), which it defines as "a carried interest in an invested partnership held by a person who provides services to the partnership." An investment partnership is defined as one in which the majority of its assets are deemed investment-type assets (certain securities, real estate, interests in partnerships, commodities, cash and cash equivalents, or derivative contracts with respect to those assets) but only if over half of the partnership's contributed capital is from partners in whose hands the interests constitute property held for the production of income. The proposal would not recharacterize gain to the extent that the partner who holds an ISPI contributes "invested capital" and the partnership reasonably allocates its income and loss between such invested capital and the remaining interest. Nor would the proposal recharacterize the portion of any gain recognized on the sale of an ISPI that is attributable to the invested capital. The proposal defines "invested capital" as money or other property contributed to the partnership; it excludes any contributed capital that is attributable to the proceeds of any loan or other advance made or guaranteed by any partner or the partnership.

In addition, the proposal would tax at ordinary rates any income or gain received with respect to a "disqualified interest" by a person who holds that interest in an entity and performs services for it. A disqualified interest is defined as convertible or contingent debt, an option or any derivative instrument with respect to the entity, but it does not include a partnership interest or stock in certain taxable corporations. The proposal would provide relief for real estate investment trusts (REITs), stating that it "is not intended to adversely impact qualification" of a REIT owning a carried interest in a real estate partnership. It would become effective for taxable years beginning after 31 December 2011 and is estimated to raise approximately USD 14.8 billion through 2021.

Tax accounting methods

As it has in previous years, the administration also proposes three changes to tax accounting rules. Specifically, the last-in, first out (LIFO) inventory accounting method would be repealed for federal income tax purposes. Taxpayers that currently use the LIFO method would write up their beginning LIFO inventory to its first-in, first out value in the first taxable year beginning after 31 December 2012 and take this one-time increase in gross income into account ratably over 10 years. The provision would raise nearly USD 52.9 billion over 10 years. The lower-of-cost-or-market and subnormal goods methods also would be repealed, resulting in a change in the method of accounting for inventories. Any resulting 481(a) adjustment would be included in income ratably over the four-year period beginning in the year of the change. The provision would raise USD 8.2 billion over 10 years and would become effective for taxable years beginning after 31 December 2012. Finally, all deductions for punitive damages paid or incurred by a taxpayer on judgment or by settlement of a claim would be disallowed. The rule would also extend to punitive damages covered by insurance. The damages paid or incurred by the insurer would be included in the insured's gross income, and the insurer would be required to report the payment to the insured and the IRS. The proposal would apply to punitive damages paid or incurred after 31 December 2012 and would raise USD 312 million over 10 years.

Dividends received in reorganization exchanges

The administration once again proposes to repeal the boot-within-gain limitation in the case of any reorganization transaction if the exchange has the effect of the distribution of a dividend under section 356(a)(2), effective for taxable years beginning after 2011. The proposal is estimated to raise USD 849 million over 10 years.

Financial services & products

The 2012 budget recycles from the last two budgets several proposals that would affect banks, securities dealers and insurance companies.

Financial crisis responsibility fee – In January 2010, the administration proposed a fee on the covered liabilities of financial firms with assets in excess of USD 50 billion. The FY 2012 budget reaffirms the administration's commitment to the fee with some tweaks, to include a proposed fee of 7.5 basis points (0.075%) instead of last year's proposed 15 basis points. The fee would apply to U.S.-based bank holding companies, thrift holding companies, certain broker-dealers (or the companies that control them) and insured depository institutions. The fee would apply to U.S. companies that owned or controlled these types of entities on 14 January 2010, and it would also apply to the U.S. subsidiaries of foreign firms that are of this type and have assets in excess of USD 50 billion. For purposes of calculating the fee, covered liabilities would be the firm's consolidated risk-weighted assets, less its capital, insured deposits and certain small-business loans. The fee would be deductible for corporate income tax purposes. The proposal would be effective after 31 December 2012 and would raise USD 30 billion by 2021.

Financial institutions and instruments – Three other proposals that would affect financial institutions and products make a return in this budget and would raise about USD 3.2 billion by 2021.

- Forward stock sales – Under current law, a company must recognize interest income on the current sale of its own stock for deferred payment, but it does not recognize interest income on the forward sale of its own stock – that is, the future issue of stock in exchange for a future payment. The administration sees no economic difference between the two situations and would align their tax treatment by requiring a corporation that enters into a forward contract to issue its stock to treat a portion of the payment as interest. The proposal would be effective for forward contracts entered into after 31 December 2011.
- Ordinary treatment for dealers – Current law allows commodities dealers, commodities derivatives dealers, dealers in securities and options dealers to treat the income from certain day-to-day dealer activities as capital gain, and treat 60% of this income (or loss) as long-term capital gain and 40% as short-term capital gain. The administration proposes ending this treatment altogether and taxing dealers' income from day-to-day dealing activities at ordinary rates. The proposal would be effective for taxable years beginning after the date of enactment.
- Control – If a company repurchases a debt instrument that is convertible into its stock or into the stock of a corporation it controls or is controlled by, current law may disallow or limit the issuer's deduction for the premium paid to repurchase the instrument. To determine control, section 249 references the test of section 368(c). The administration says this rule applies only to direct relationships, such as a parent and a wholly owned, first-tier subsidiary, and is unnecessarily restrictive. Instead, the administration proposes that the definition of control in section 249(b)(2) be amended to reference section 1563(a)(1), which the administration says would incorporate indirect control relationships, such as a parent and a second-tier subsidiary. The proposal would be effective on the date of enactment.

Insurance companies – The budget re-proposes a handful of items that would affect insurance companies. These proposals would raise just over USD 14 billion by 2021.

- Sales of life insurance contracts – The administration proposes new information reporting with respect to insurance settlement transactions where the insured sells a previously issued policy to investors. The administration also would require anyone who purchases an interest in an existing life insurance contract with a death benefit of USD 500,000 or more to report the purchase price, the buyer's and seller's taxpayer identification numbers (TINs) and the issuer and policy number to the IRS, to the insurance company that issued the contract and to the seller. Further, upon payment of any policy benefits to the buyer, the insurance company would be required to report the benefit payment, the buyer's TIN and the insurer's estimate of the buyer's basis to the IRS and to the payee. The proposal would apply to sales or assignments of interests in life insurance policies and payments of death benefits beginning in 2012.

- DRD for separate accounts – Current law limits the dividends received deduction (DRD) for dividends received from other domestic corporations by life insurance companies to the company's share of the dividends received (versus the share that funds reserves for obligations to policyholders) based on a proration formula. For separate accounts, the company's share and the policyholders' share is calculated separately for each separate account. Concerned that some proration methods may inappropriately inflate a company's share for income earned by its separate account assets, the administration proposes (with more details than last year's budget) repealing the existing proration regime and imposing on the life insurer's general account DRD, tax-exempt interest and increases in certain policy cash values a fixed 15% proration in a manner similar to what currently applies to nonlife insurance companies. Further, the DRD limitations that apply to other corporations would be expanded to apply to life insurance company separate account dividends in the same proportion as the mean of reserves bears to the mean of total assets of the account. This proposal would be effective for taxable years beginning after 31 December 2011.

Energy provisions

The FY 2012 budget proposal provides two significant energy-related incentives and would extend a number of other incentives through 2012.

Credit for advanced energy manufacturing projects – The budget proposal would add USD 5 billion to the USD 2.3 billion that is allocated to the Advanced Energy Investment Credit. This 30% credit was created to encourage investments in facilities that manufacture advanced energy property and is available for projects certified by the Secretary of Treasury, in consultation with the Secretary of Energy, through a competitive bidding process. Advanced energy property includes technology for the production of renewable energy, energy storage, energy conservation, efficient transmission and distribution of electricity and carbon capture and sequestration. In addition to providing more funds, the administration proposes to modify the requirements for the credit so that it can apply to part of a taxpayer's qualified investment in a project. The taxpayer's increased cost sharing and the project's reduced revenue cost to the government are to be taken into account in determining whether to allocate credits to a project, according to the budget proposal.

Credit for energy-efficient commercial buildings – The budget includes a proposal to replace the existing deduction for certain energy-efficient property placed in service on or before 31 December 2013 with a tax credit that would apply for property that is placed in service during calendar year 2012 only. The structure and amount of the proposed credit also would differ from the existing deduction. One of the requirements for the deduction is that the property is certified as being installed as part of a plan designed to reduce the total annual energy and power costs for the interior lighting, heating, cooling, ventilation and hot water systems of the building by 50% or more. The deduction for the building is limited to USD 1.80 per square foot if the 50% energy savings threshold is achieved. However, if the 50% requirement is not met, a partial deduction is allowed for each separate building system that meets certain system-specific targets. The maximum deduction for each system is USD .6 per square foot.

Under the budget proposal, a tax credit would be allowed for lower energy savings. The tax credit would be limited to: USD 0.6 per square foot for property designed to reduce total annual energy and power costs by at least 20% but less than 30%; USD 0.9 per square foot for property designed to reduce total annual energy and power costs by at least 30% but less than 50%; and USD 1.80 per square foot for qualifying property designed to reduce the total annual energy and power costs by 50% or more.

Special rules would be provided that would allow the credit to benefit a REIT or its shareholders.

Extenders – The budget proposal would extend through 2012 a number of temporary energy tax incentives, grants or credits, including those for: biodiesel and renewable diesel; alternative fuel and alternative fuel mixtures; specified energy property; alternative fuel vehicle refueling property; alcohol fuels; electric transmission restructuring; nonbusiness energy property; plug-in hybrid conversion; energy-efficient appliances; and the construction of energy-efficient new homes.

Revenue offsets – On the revenue side, the budget proposal repeats many of the targeted revenue raisers that were included in prior budgets. These changes would be effective beginning in 2012 and are expected to generate nearly USD 43 billion in revenue over 10 years.

- The 6% domestic production activities deduction would be repealed for oil and gas companies.
- The administration would repeal the current exception to the passive activity loss rules (which limit the ability of taxpayers to deduct certain losses) that is available for working interests in oil or gas property that a taxpayer holds directly or indirectly through an entity that does not limit the taxpayer's liability with respect to the interest.
- Current tax incentives for domestic exploration and drilling would be eliminated. These include: (1) 24-month amortization for geological and geophysical costs for independent oil and gas producers; (2) the enhanced oil recovery credit; (3) the marginal well tax credit; (4) the deduction for tertiary injectant expenses; (5) expensing of intangible drilling costs (IDCs) and 60-month amortization of capitalized IDCs; and (6) percentage depletion for oil and gas wells.
- Incentives for energy production from coal mining activities would be repealed starting in 2012 and would raise more than USD 2 billion in revenue over 10 years. This would eliminate: (1) the "section 199 domestic manufacturing deduction" for the production of coal and other hard mineral fossil fuels; (2) expensing and 60-month amortization of mining exploration and development costs relating to coal and other hard mineral fossil fuels; (3) capital gain treatment of coal and lignite royalties; and (4) percentage depletion with respect to coal and other hard mineral fossil fuels.
- As it did last year, the administration proposes to raise USD 21 billion over 10 years by reinstating taxes that were originally enacted in 1980 to finance the cost of cleaning up toxic waste sites and allowed to expire in 1995. The superfund taxes included: (1) an excise tax of USD .097 per barrel on crude oil received at a U.S. refinery and on each barrel of imported petroleum products; (2) an excise tax of varying amounts on certain hazardous chemicals sold in the U.S. or used in substances imported into the U.S.; and (3) an environmental tax of 0.12% on the amount by which the modified alternative minimum taxable income of a corporation exceeded USD 2 million. These taxes would be reinstated for tax years beginning in 2012 and sunset after 2022.
- The rate of the Oil Spill Liability Trust Fund tax would be increased to USD .09 per barrel (from USD .08) for periods after 31 December 2011, and to USD .1 per barrel for periods after 31 December 2016.

Taxpayer reporting and compliance provisions

This year's budget includes a number of information reporting and other provisions aimed at closing the "tax gap" and improving taxpayer compliance and tax administration.

Worker classification – This year's budget repeats last year's proposals concerning worker classification, with several proposals rolled into one. The Department of the Treasury and the IRS would be permitted to issue generally applicable guidance on the proper classification of workers under common law standards. Industry- or job-specific specific guidance would be also developed that includes safe harbors and/or rebuttable presumptions. The proposal would also permit the IRS to require prospective reclassification of workers who are currently misclassified and whose reclassification has been prohibited under current law. IRS authority would be effective upon enactment, but prospective reclassification would not be effective until the first calendar year beginning at least one year after date of enactment. This provision is expected to raise USD 8.7 billion over 10 years.

Estimated tax payments – The budget includes two proposals related to estimated tax payments by corporations and certain insurance companies.

- Insurance company special loss discount account – This proposal would repeal section 847, and the entire balance of any existing special loss discount account would be included in gross income for the first taxable year beginning after 31 December 2011; the entire amount of existing special estimated tax payments (SETPs) would be applied against additional tax that is due as a result of that inclusion. Any SETPs in excess of the additional tax due would be treated as an estimated tax payment under section 6655. Alternatively, taxpayers would be permitted to elect to include the balance of any existing special loss discount account in gross income ratably over four years, beginning with the first taxable year beginning after 2011. Any additional tax due as a result could be offset by existing SETPs. At the end of the fourth year, any remaining SETPs would be treated as an estimated tax payment under section 6655. The provision would be effective for taxable years beginning after 31 December 2011.
- Corporate estimated tax payments – The administration would repeal all legislative acts that cause the amount and timing of corporate estimated payments to differ from the rules described under section 6655, effective for taxable years beginning after 31 December 2011.

Information reporting – The budget includes proposals that address:

- Information reporting requirement for payments to corporations – The administration would repeal a new reporting requirement enacted in 2010 regarding payments made to a corporation or service provider totaling USD 600 or more in a calendar year. Instead, businesses would be required to file an information return for payments for services or for determinable gains aggregating to USD 600 or more in a calendar year to a corporation; however, an exception would apply for payments to tax-exempt organizations. The requirement for information returns for payments for property would be repealed. The proposal also provides regulatory authority to make certain exceptions for small businesses and other taxpayers for whom reporting could be burdensome. The proposal would be effective for payments made after 31 December 2011.
- Information reporting and withholding for contractors – Contractors receiving USD 600 or more from a business would be required to provide the business with a Form W-9 with a certified TIN. The business would be responsible for verifying the TIN information with the IRS, which would validate the TIN. Should the contractor fail to provide the appropriate information, the business would be directed to withhold a percentage of gross payments. The flat-rate withholding could be at a rate of 15%, 20%, 30% or 35%, to be selected by the contractor. The proposal would raise more than USD 1 billion over 10 years, effective for payments to contractors after 31 December 2011.

Tax administration – Notable proposals related to tax administration include the following:

- Corporations and partnerships that file a Schedule M-3 would be required to file returns electronically. For other large taxpayers that are not required to file a Schedule M-3 (such as exempt organizations), regulatory authority would be granted to allow the current threshold of filing 250 or more returns in a calendar year to be reduced. The e-filing requirement may also be waived if a taxpayer is unable to comply due to technological constraints or if compliance would financially burdensome. The proposal would be effective for tax years ending after 31 December 2011 and is estimated to have no revenue impact.
- The IRS would be authorized to require additional information in the electronically filed annual reports by sponsors of funded deferred compensation plans. The proposal would be effective for plan years ending after 31 December 2011 and is estimated to have no revenue impact.
- Standards would be set for holding employee leasing companies jointly and severally liable with their clients for federal employment taxes. The proposal would raise USD 64 million over 10 years, effective for wages paid after 31 December 2011.
- Both the per return and annual maximum information return penalties for failure to disclose certain information to the IRS would be significantly increased. The proposal would raise USD 376 million over 10 years, effective for information returns required to be filed after 31 December 2011.
- Estimated to raise USD 9 million over 10 years, a penalty of USD 25,000 for a corporation and USD 5,000 for a tax exempt organization would apply for a failure to comply with electronic filing requirements for returns required to be electronically filed after 31 December 2011.
- Repeated willful failure to file a tax return would become a felony, effective for returns required to be filed after 31 December 2011.
- The statute of limitations would be extended where state adjustment affects federal tax liability, effective for returns required to be filed after 31 December 2011.
- Inflation-adjustment provisions would be modified to prevent deflationary adjustments.
- It would be clarified that the IRS can levy 100% of any payment due to a federal vendor with unpaid tax liabilities, effective for payments made after the date of enactment.

Unemployment insurance provisions

The administration would raise nearly USD 61 billion over 10 years through several proposed changes to the unemployment tax (UI) rules. The Federal Unemployment Tax Act (FUTA) imposes a 6.2% payroll tax on employers for the first USD 7,000 paid annually to each employee. This rate includes a 0.2% surtax that currently applies through 30 June 2011. The budget proposal would: (1) make the surtax permanent; (2) expand the FUTA wage base (including that of states) to USD 15,000 per worker paid annually in 2014, index the wage base to wage growth for subsequent years and reduce the net federal unemployment insurance tax from 0.8% to 0.38%; and (3) for 2011 and 2012, suspend interest payments on state unemployment insurance debt (arising when state unemployment insurance funds are exhausted and states borrows from the federal trust fund) and suspend the FUTA credit reduction for employers in borrowing states. These proposals would be effective upon enactment.

Permanent research credit

The budget proposal would permanently extend the research and experimentation credit and increase the alternative simplified research credit from 14% to 17%, effective after 31 December 2011, at a cost of about USD 106.3 billion over 10 years.

Extension of expiring business provisions

Extend and increase New Markets Tax Credit – The proposal would extend the New Markets Tax Credit (NMTC) for one year (through 2012) with an allocation amount of USD 5 billion. Further, the proposal would allow NMTC amounts resulting from qualified equity investments made after 31 December 2010 to offset AMT liability. Under current law, the NMTC is only allowed to be offset against federal income tax liability. The proposal would cost USD 1.9 billion over 10 years.

Other extenders – The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended many of the annual "tax extenders" through 2011. The administration proposes to extend dozens of other expired or expiring business tax provisions through 2012, including: the Work Opportunity Tax Credit, the 15-year straight-line cost recovery for qualified leasehold, restaurant and retail improvements and enhanced charitable deductions for contributions of food inventory, book inventory to public schools and computer inventory for educational purposes.

Permanent small-business capital gains exclusion

The administration would permanently permit taxpayers other than corporations to exclude 100% of the gain from the sale of small business stock acquired at original issue and eliminate the alternative minimum tax preference item for gain excluded under this provision. A five-year holding period and other provisions applying to the section 1202 exclusion would also apply, and the proposal would impose additional documentation requirements to assure compliance. The relief is currently allowed for eligible stock acquired before 1 January 2012. The proposal would be effective for qualified small business stock acquired after 31 December 2011 and is estimated to cost almost USD 5.4 billion over the 2012-2021 budget windows.

Provisions affecting high-income individuals

Like his prior budget proposals, President Obama's FY 2012 budget package calls for a shift in the tax burden toward high-income individuals – those defined as having adjusted gross income (AGI) above USD 200,000 for single filers and USD 250,000 for married filers. If all of these proposals are enacted, high-income taxpayers could see substantial increases in their effective tax rates beginning in 2013 (or in 2012 in the case of the 28% itemized deduction value limitation).

Tax increases, deduction limitations for high-income earners – The tax relief for high-income taxpayers enacted during the George W. Bush administration was extended through 2012 at the end of 2010. This tax relief would not be extended further. Specifically, the White House calls for:

- Reinstating the top two individual income tax rates, currently 33% and 35%, at their pre-2001 levels – 36% and 39.6% – after their expiration in 2012 for taxpayers with AGI above USD 200,000 for single filers and USD 250,000 for married filers (in 2009 dollars, indexed for inflation thereafter). The 28% tax rate bracket would be expanded to reflect modifications to the upper limit of that bracket (i.e., where the 36% bracket would begin).
- Increasing the capital gains and dividends rate to 20% for taxpayers falling into the 36% and 39.6% tax brackets. The reduced rate on gains on assets held over five years would be repealed. In both cases, the increased rates would apply beginning in 2013. All other individual taxpayers would continue to be taxed at the zero and 15% tax rates for long-term capital gains and qualified dividend income.
- Reinstating in 2013 the personal exemption phase-out (PEP) and itemized deduction limitation (Pease) for taxpayers with AGI above USD 200,000 for single filers and USD 250,000 for married filers (in 2009 dollars, indexed for inflation thereafter).

Limit tax rate at which itemized deductions can reduce tax liability – The administration also proposes once again to limit the tax rate at which itemized deductions reduce tax liability for high-income taxpayers. Under this proposal, taxpayers in the highest two brackets could deduct itemized expenses, but at the 28% rate. For example, assuming the top two brackets revert to pre-2001 levels in 2013, a taxpayer in the 39.6% bracket could receive a benefit of USD 396 for a USD 1,000 charitable contribution. If the administration's curb on the savings provided by itemized deductions were enacted, the benefit for the same contribution would be limited to USD 280. A similar limitation would apply under the AMT. This limitation would apply to itemized deductions after any reduction under the Pease limitation discussed above and would be effective beginning in 2012.

Estate and gift tax changes

The White House continues to push for the closing of perceived loopholes in the area of estate and gift taxation. These proposals would make permanent the portability of unused exemption amounts between spouses, require consistent treatment of asset basis for transfer and income tax purposes, place limits on valuation discounts, require a minimum term for grantor retained annuity trusts and limit the duration of the generation-skipping transfer tax exemption.

Tax incentives for families & individuals

The administration has proposed a number of individual tax incentives targeted largely at the middle class. Many of these are recycled from prior budget packages. The budget proposes to eliminate barriers to working or pursuing higher education by expanding the child and dependent care tax credit and excluding certain student loan forgiveness from income, and to promote retirement savings by requiring employers to provide automatic enrollment in IRAs. The budget also would make permanent or expand several of the middle-class tax cut initiatives in the American Recovery and Reinvestment Act of 2009. Finally, the administration also would renew several individual extenders provisions through 2012.

Economic development incentives

Under proposed incentives, the Build America Bond program would be made permanent and the list of eligible uses for Build America Bonds would be expanded. The Low-Income Housing Tax Credit would be reformed and expanded, and various tax incentives to promote rebuilding of the New York Liberty Zone and the Gulf Opportunity Zone would be temporarily extended.

Tax code simplification

The budget includes the following targeted proposals aimed at simplifying the tax code, including:

- Eliminating the minimum required distribution rules for individual retirement accounts or annuity/plan balances of USD 50,000 or less;
- Allowing all inherited plan and individual retirement account or annuity balances to be rolled over within 60 days;
- Clarifying the exception to recapture of unrecognized gain on sale of stock to an Employee Stock Ownership Plan;
- Repealing the nonqualified preferred stock (NQPS) designation that currently results in NQPS being treated as taxable "boot";
- Repealing the preferential dividend rule for publicly traded REITs by which REITs are not allowed a deduction for dividends paid to their shareholders to the extent dividends are deemed preferential;
- Reforming the excise tax based on investment income of private foundations; and
- For tax-exempt bonds:
    - Simplifying arbitrage investment restrictions;
    - Simplifying single-family housing mortgage bond targeting requirements; and
    - Streamlining private business limits on governmental bonds.

Next steps

While many of these proposals are the same or are refreshed versions of provisions in last year's budget, there are nonetheless some important takeaways here for taxpayers. First, the focus in the near term will be more on spending policy than taxes. The looming expiration of the current government funding resolution on 4 March 2011 will provide a forum for the first real debate on spending between the president and congressional Republicans. Second, the president reaffirmed his goal of reinstating the pre-2001 tax rates for upper-income individuals by calling for rates to increase for those taxpayers when they expire beginning in 2013. Finally, given that most of the revenue raisers in the current budget package received little congressional attention last year in a Democratically controlled Congress, they are unlikely to move now that Republicans are in charge of the House and have expanded their presence in the Senate.

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Portugal:
Budget Law for 2011 in effect

Portugal's Budget Law for 2011, which became effective on 1 January 2011 with the exception of some provisions of the new social security contributions code, includes changes to the corporate and personal tax laws, investment incentives and other taxes of interest to nonresident investors. The Budget Law also includes a new tax on banking institutions.

Corporate tax

Participation exemption – The participation exemption available for entities that hold less than 10% of the shares of a dividend paying company has been abolished. Previously, the exemption applied if the acquisition value of the shares for such shareholdings was EUR 20 million or more. Additionally, the partial participation exemption under which 50% of dividends were exempt if the recipient did not qualify for the full exemption has been eliminated, so that dividends from shareholdings of less than 10% of the share capital are now fully taxable at the general corporate tax rate (generally between 25% and 29%). Application of the participation exemption is conditioned on the effective taxation of the underlying corporate profits, even if earned by a regulated holding company (SGPS).

The special participation exemption regime applicable to dividends received by an SGPS, venture capital company and venture capital investors also is abolished, with the result that these entities are only eligible for the normal participation exemption (provided they meet the requirements).

Dividends paid to EU/EEA resident entities – The withholding exemption for dividends paid by a Portuguese resident company to a parent company resident in an EU/EEA Member State that satisfy the conditions in article 2 of the EU Parent-Subsidiary Directive applies only where the recipient company holds at least 10% of the share capital of the payer company (i.e. the acquisition cost of the participation is no longer relevant for purposes of this exemption).

Separately, tax withheld on dividends paid by a Portugal resident company (that is subject to, and not exempt from, corporate income tax) to a company resident in an EU/EEA Member State (with the condition for EEA countries that an administrative and tax cooperation obligation apply) may be refunded if the amount of tax withheld and paid to the Portuguese Treasury exceeds the tax that would have been incurred by a Portuguese resident corporate recipient. The refund request must be submitted to the Portuguese tax authorities within two years following the end of the year the taxable event took place.

Intercompany dividends – The automatic exclusion of dividends received from the taxable profits of group companies under the special group taxation regime is abolished.

Losses on shares – Capital losses and other losses associated with shareholdings are no longer tax deductible when determining taxable profits to the extent dividends derived from the holding benefited from the participation exemption in the previous four years.

Carryforward of tax losses – The carryforward of tax losses is conditioned on certification by a statutory auditor (with conditions still to be defined) for all companies that have used loss carryforwards in the previous two years. Additionally, resident companies that do not carry on an agricultural, commercial or industrial activity are subject to the general four-year limitation on the tax loss carryforwards.

Reinvestment regime – Capital gains derived from the sale of shares may benefit from reinvestment relief only if the shareholding was at least 10% of the share capital and was held for at least one year. Thus, the regime (which provides relief of 50% of the excess of capital gains over capital losses) no longer applies to shareholdings of less than 10% where the acquisition of the shares was at least EUR 20 million.

Merged or demerged companies – The tax neutrality regime for shareholders of companies that have been merged or demerged is extended to all transactions covered by the EU Merger Directive.

Tax rates – The corporate tax rate applicable to entities that have their registered office or place of effective management in Portugal but that do not carry on a commercial, industrial or agricultural business as their main activity is increased from 20% to 21.5%.

Withholding tax obligations – Investment income from accounts in the name of one or more companies where the beneficial owners are not identified is subject to a final withholding tax of 30%. Income arising from debt instruments and other investment income of entities without a headquarters or permanent establishment (PE) in Portugal to which the income can be attributed is subject to a 21.5% withholding tax, unless a different rate specifically applies.

Withholding tax responsibility on income paid or made available to a custodian entity by a wealth management company resident in the Portuguese territory now falls on the wealth management company.

Tax incentives

Limitation on tax incentives – The amount of tax due where reduced by tax incentives may not be less than 90% (previously 75%) of the tax that would have been due had the incentives not been claimed. In determining whether the 90% limitation is exceeded, all tax incentives available are taken into account, except the following: those of a contractual nature; R&D incentives; those related to free trade areas/zones; those that operate through a reduction of the tax rate; job creation benefits; those affecting SGPSs, venture capital companies and venture capital investors; and those relating to the elimination of double taxation on dividends arising from companies resident in the African Portuguese-speaking countries and East Timor.

Capital gains derived by nonresidents – The corporate and personal tax exemptions applicable to capital gains derived by a nonresident without a PE in Portugal no longer apply if the recipient is resident in a jurisdiction that does not have a tax treaty or an information exchange agreement with Portugal.

R&D tax credit – The corporate R&D incentives regime is extended to the period 2011 to 2015, maintaining the general rules in relation to eligibility and conditions for tax deductions and corresponding accounting obligations. A new eligible expense is introduced for the conduct of R&D projects necessary for complying with public contractual obligations and eligible expenses are no longer limited to 55% of the cost of staff directly involved in R&D processes.

Tax regime applicable to investment – This regime remains in effect in 2011 under the same rules that have applied since 2009. Briefly, the regime, which is conditioned on job creation, provides for a tax credit of up to 25% of the tax liability for 20% or 10% of the eligible investment in the case of regional incentives, as well as certain indirect tax exemptions.

Tax incentives on foreign loans – Portuguese-source interest on foreign-source funding (e.g. specific bilateral loan agreements with certificates of indebtedness) obtained by Portugal's National Treasury and Public Debt Management Institute are exempt from corporate and personal income tax provided the creditor is not resident in, and does not have a PE in, Portugal to which the income is attributable.

Debt securities issued by nonresident entities – Income from private or public debt securities issued by nonresident entities is exempt from corporate or personal income tax if paid by the Portuguese state as a guarantee of compliance with obligations assumed by the Portuguese state, along with other EU Member States.

Debt instruments – The tax regime applicable to Portuguese debt instruments/securities providing nonresident individuals and corporates with an exemption from tax on certain interest and gains has been broadened to cover other public debt instruments, namely, treasury bonds or other public debt instruments designed to meet random financing needs.

Repo transactions – Gains derived by a nonresident financial institution from a repo transaction relating to securities with a resident financial institution are exempt from corporate income tax provided the gains are not attributable to a PE of the nonresident in Portugal.

Personal tax

Tax rates and brackets – Overall, the personal income tax brackets have been broadened by 2.2%. The lowest marginal tax rate is 11.5% and the highest is 46.5%, as detailed below:

2011 progressive rates		
Taxable income (EUR)	Marginal rate on bracket	Amount to deduct (EUR)
Up to 4,898	11.5%	-
From 4,898 up to 7,410	14%	122.45
From 7,410 up to 18,375	24.5%	900.45
From 18,375 up to 42,259	35.5%	2,921.81
From 42,259 up to 61,244	38%	3,978.26
From 61,244 up to 66,024	41.5%	6,121.95
From 66,024 up to 153,300	43.5%	7,442.61
153,300 and above	46.5%	12,041.71

Final tax rates – Investment income received by a Portuguese resident from a nonresident without a Portuguese-resident paying intermediary is liable to autonomous taxation at a rate of 21.5%, correcting an inconsistency created in July 2010 when other withholding tax rates on investment income were increased. A final withholding tax of 21.5% is introduced for interest and all other payments regarding shareholder loans, premiums and capital advances related to deferred payment of dividends/salaries (this income previously was reportable as taxable income liable at the progressive rates).

Tax deductions – Limits are included on most deductions, including deductions for pension funds and retirement saving plans; costs of reconstruction of real estate; investment in venture capital entities; and renewable energy equipment. Life insurance premiums are no longer deductible.

Nondiscrimination between resident and nonresident individuals – To eliminate potential discrimination between residents of Portugal and those in another EU/EEA Member State, part or all of the Portuguese tax withheld may be refunded if it exceeds the tax that would be due if the progressive tax rates applicable to resident individuals were applied. This refund opportunity applies to salaries; fees paid to board members; income from employment on board ships and aircraft; and intellectual and industrial property rights.

Anti-avoidance measures – Income subject to a final withholding tax that is paid or made available in an account in the name of one or more individuals where the beneficial owners are not identified is subject to a final 30% withholding tax.

Wealth management companies – Portuguese wealth management companies having an account with a custodian entity are now obliged to comply with obligations regarding withholding tax, payments and reporting obligations that, until 31 December, applied only to custodian entities. Consequently, withholding tax responsibility on income paid or made available to a custodian entity by a wealth management company resident in the Portuguese territory will fall on the wealth management company.

Miscellaneous provisions

VAT rate – The standard rate of VAT increased from 21% to 23% in mainland Portugal and from 15% to 16% in the Autonomous Regions (Madeira and the Azores). Also, certain goods are now subject to the standard rate of 23% (previously liable to the reduced 6% or intermediate 13% rates).

Social security contributions code – The new social security contributions code is in effect, which broadens the contribution base and increases the rates.

Repo transactions – Repo transactions in securities or similar rights carried out on a stock exchange, as well as repos and fiduciary guarantee disposals made by credit and finance institutions through central counterparties, are now exempt from stamp tax.

Banking tax – A new charge applies to Portuguese credit institutions, subsidiaries in Portugal of nonresident credit institutions and branches in Portugal of credit institutions resident outside the EU. The levy is computed on the liabilities in the balance sheet reduced by Tier 1 and 2 funds and certain guaranteed deposits (at rates between 0.01% and 0.05%), as well as on certain off-balance sheet derivative instruments (at rates between 0.0001% and 0.0002%). The banking tax is not deductible for corporate tax purposes and specific rules and procedures relating to the levy will defined in a future Ministerial Order. The charge is due on 30 June following the end of the applicable tax year.

Access to bank documents and information – The Portuguese tax authorities will now have access to all bank documents and information, regardless of the owner's consent, whenever the taxpayer has an overdue tax debt.

Annual municipal property tax – The rates applicable to real estate held by entities domiciled or with their place of effective management in a country with a more favorable tax regime blacklisted (as set out in a list approved by the Minister of Finance) were increased from 1% or 2% to 5%.

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In brief

Greece – The European Commission announced on 16 February 2010 that it has sent Greece a reasoned opinion (the second stage of the infringement procedure under article 258 of the Treaty on the Functioning of the EU) requesting that tax amnesty rules relating to undisclosed funds be amended. Taxpayers that voluntarily disclose funds held abroad can benefit from a temporary tax amnesty, and if the funds are transferred to a Greek bank account for at least one year, a 5% tax is levied on the value of the funds when the funds are transferred to Greece. The tax rate is 8% if the funds remain abroad. According to the Commission, the Greek tax amnesty rules dissuade Greek taxpayers from maintaining disclosed funds in other EU/EEA Member States and, therefore, violate the freedom to provide services and the free movement of capital principles. Greece has two months to comply with the request; otherwise, the Commission can refer the issue to the European Court of Justice.

Jersey – Following a review by the EU, Jersey's Chief Minister announced on 15 February 2011 that, while Jersey would maintain its zero-ten tax regime, the regime's deemed distribution and attribution rules will be removed with effect from 1 January 2012. Under the rules, Jersey resident individuals are assessable on a proportion of taxable profits reported by Jersey resident companies in which they own, directly or indirectly, more than 2% of the ordinary share capital. While Jersey considers the provisions to be personal tax measures outside the EU Code of Conduct, the EU Council's High Level Working Party on Tax Issues decided in January 2011 that the measures were a way of taxing domestic business profits and were within the scope of the Code. Jersey must still enact legislation to effect the change, which must then receive the assent of the British Crown.

Spain – The Supreme Court has ruled that taxpayers can claim damages and interest where Spanish law has been held to be in breach of EU law, even where the domestic statute of limitations has expired. This opens up the possibility of claims relating to unlawfully levied taxes even where that claim may be time expired under the statute of limitations; instead, claims must be filed within a year of the European Court of Justice (ECJ) decision declaring Spanish law to contravene the EU treaty. There are a number of cases pending before the ECJ in respect of Spanish law, so companies should be ready to file refund claims.

United Kingdom – The Chancellor has announced an increase in the rate of the bank levy to be charged in 2011. The government initially announced that a reduced rate of 0.05% would apply in 2011, but now decided that, as from 1 March 2011, the rate of the levy will be 0.1% for two months, to offset the lower rate of 0.05% charged in January and February, before moving to 0.075%. It is estimated that this will raise an additional GBP 800 million.

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Kuwait
Executive Rules amended and clarified
The tax authorities have amended their Executive Rules, which contain procedures for implementation of the Income Tax Law and Decree. The new Rules address notification requirements, the treatment of consultancy expenses, withholding tax issues and reporting requirements for foreign entities.
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/ce6389413f33e210VgnVCM3000001c56f00aRCRD.htm?id=us_email_Tax_WTA_021811
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_Kuwait_170211.pdf?id=us_email_Tax_WTA_021811
Issued: 17 February 2011

Peru
Capital gains tax rules on indirect transfer tightened
A new law significantly expands the scope of income that qualifies as Peruvian-source income in order to bring capital gains derived from an indirect transfer of shares within the scope of the Peruvian tax net.
URL: http://www.deloitte.com/view/en_GX/global/services/tax/international-tax/7211e7ebf443e210VgnVCM3000001c56f00aRCRD.htm?id=us_email_Tax_WTA_021811
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_Peru_170211.pdf?id=us_email_Tax_WTA_021811
Issued: 17 February 2011

United States
Treasury Department releases descriptions of international tax proposals in Greenbook
The FY 2012 Budget and its General Explanations have been released, with the included international tax proposals substantially similar to those in last year's budget and expected to raise USD 130 billion over 10 years.
URL: http://www.deloitte.com/view/en_GX/global/services/tax/e339878a73a2e210VgnVCM1000001a56f00aRCRD.htm?id=us_email_Tax_WTA_021811
URL: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Alerts/dtt_tax_alert_United_States_150211.pdf?id=us_email_Tax_WTA_021811
Issued: 15 February 2011

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