From the Desk of David Lang, Director of Tax Services…

On April 10th of this year the President presented his current year budget. Rep. Dave Camp (R-MI), Chairman of the House Ways & Means Committee, has been holding hearings and issuing a number of legislative proposals designed to elicit comments and push tax reform. Sen. Max Baucus (D-MT), Chairman of the Senate Finance Committee, has also been pursuing tax reform, so ultimate bipartisan legislation is obviously highly uncertain.

This article focuses on various tax provisions of the President's plan and discusses the author's opinion whether such provisions are likely to be included in any ultimate legislation.

Such provisions include:

- Limitation on value of certain tax benefits – this provision would allow certain tax benefits to only shelter income taxed at the 28% or less marginal income tax rates, thus eliminating the benefits for these items taxed at the 33%, 35% or 39.6% rates. These would include :
    1. All itemized deductions (including: mortgage interest,charitable contributions, & state and local income taxes),
    2. Tax-exempt income from municipal bonds,
    3. Employer and employee contributions to retirement plans such as 401(k)'s,
    4. Contributions to HSA's & Archer MSA's,
    5. Interest on education loans & certain higher education accounts.
        - There would be a basis adjustment for any pre-tax retirement account contributions taxed under this provision by increasing account basis.

- Implementation of a new "Fair Share Tax" (FST) under the "Buffett rule" – this provision is intended to limit the advantage that high income taxpayers derive from preferential low rates on dividends & LTCG's. The FST would be designed so that taxpayers would pay at least 30% tax on their AGI, with a credit allowed for charitable contributions. The upshot is that if regular tax, reduced by certain credits, but including the AMT, the new 3.8% surtax on net investment income and payroll taxes didn't equal or exceed 30%, the FST would kick in and make up the difference. This is one of the "anti-Romney" provisions of the budget proposal.

- 2009 transfer tax parameters would be restored – starting in 2018, the top transfer tax rate would increase from 40% to 45% and the estate exclusion & GST exemption would be $3.5 million and the gift tax exclusion would be $1 million and none of these figures would be indexed for inflation. No "clawback" would occur and "portability" would continue. I predict this provision is very unlikely to gain much traction.

- A minimum term would be required for GRAT's.

- The duration of the GST exemption would be limited.

- Rules coordinating income and transfer tax rules for grantor trusts would be adopted.

- "Carried" (profits) interests would be taxed as ordinary income – another of the budget proposal's anti-Romney rules.

- Protracted payouts for non-spouse beneficiaries of IRA's and retirement plans would be limited.

- The size of retirement benefits would be limited – under this provision the size of a taxpayer's various retirement accounts would be limited to that amount, which would provide a $205,000 annual annuity, which for a hypothetical 62 year old and spouse would equal approximately $3.4 million. Additional increases could occur from investment growth, but not new contributions, unless the maximum permitted annuity increased. I personally expect that Congress will not adopt such a provision that penalizes successful savers.

- Replace the Consumer Price Index (CPI) with chained CPI – the big savings here, as I'm sure we've all read, comes from reducing COLA increases to Social Security recpients. However, this proposal, which would take effect in 2015 if adopted, seems to be presently disliked by enough members of both parties, but for different reasons.

There are many other provisions that I have left off. My expectation is that very few of these provisions will wind up surviving in their present form, but at least this gives some insight into the executive branch's thinking and priorities. Many of us would like to believe that Congress will be more ambitious and substantially reform the code, akin to what occurred with the 1986 Tax Reform Act. However, given the current difficulties we are seeing with gun control legislation and immigration reform, skepticism of success in this area is quite understandable.

We hope that this gives you some insight and information into the selected provisions of President Obama's fiscal year 2014 budget. If you have any questions regarding this article or need to contact us with any questions, please don't hesitate.

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