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Tax Topics

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The President's FY 2017 tax proposals

Earlier this month, President Obama released his final budget. Soon thereafter, the Treasury Department followed suit with its "General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals," known as the "Greenbook." Although most of these proposals have appeared in prior year budgets, a few are new, and some have been refined. But first, here is a quick recap of some of the familiar faces:

Retirement account proposals include the following:

- Cap the aggregate amount taxpayers can accumulate in various retirement accounts to about $3.4 million
- Mandate a five-year payout for most non-spouse beneficiaries of inherited IRAs and other retirement accounts
- Simplify the "minimum required distribution" rules, which would also apply to Roth IRAs
- Limit Roth IRA conversions to pre-tax dollars

Estate and gift tax proposals include the following:

- Restore the 2009 transfer tax parameters: a $3.5 million estate tax exclusion and generation-skipping transfer tax (GST) exemption, a $1 million gift tax exclusion and a top rate of 45%
- Make grantor retained annuity trusts (GRATs) less attractive by mandating a term of at least 10 years and a significant taxable gift at the trust's creation
- Effectively eliminate sales to "defective grantor trusts" so that the transferred property (and any appreciation thereon) would be includible in the grantor's estate
- Cap the annual exclusion so that donors cannot give more than $50,000 per year in annual exclusion gifts without eroding their (current) $5.45 million applicable exclusion amount (the annual exclusion lets donors give $14,000 per donee ($28,000 if the donor's spouse consents), with no limit on the number of donees)
- Cap a trust's protection from GST to 90 years, after which the tax would again apply

Income tax and capital gains tax proposals include the following:

- Limit the value of various deductions and exclusions to 28%
- Implement the "Buffett Rule" by way of a "fair share tax," so that taxpayers with incomes over $1 million would pay total tax of 30% on that income
- Increase the top rate for "qualified dividends" and capital gains to 24.2% from 20%
- Eliminate the basis "step-up," so that transfers of appreciated property at death would trigger capital gains tax (subject to certain exemptions, including a $100,000 exclusion per individual and a $250,000 exclusion for a principal residence)
- Impose immediate capital gains tax on lifetime gifts of appreciated property

Energy-related proposals include the following:

- Modify and permanently extend the renewable electricity production tax credit
- Modify and permanently extend the deduction for energy-efficient commercial building property
- Provide a tax credit for producing advanced technology vehicles
- Eliminate fossil fuel tax preferences, including expensing intangible drilling costs and percentage depletion for oil and gas wells and hard mineral fossil fuels

Some of the **new proposals** (or refinements) are as follows:

- Modify the so-called "Cadillac tax" on high cost employer-sponsored health coverage

  In December, this 40% excise tax was postponed to 2020 (from 2018). It is part of the Affordable Care Act (also known as "Obamacare"), and applies to health coverage benefits that exceed a statutory threshold (currently $10,200 for individual coverage and $27,500 for family coverage, numbers that will be indexed for inflation). The proposal would "improve" the tax by increasing the statutory thresholds to reflect areas of the country where health care is more expensive.

- Impose a $10.25 per barrel fee on crude oil

  The fee would be collected on domestically produced oil as well as imported (but not exported) petroleum products. The resulting revenue would fund a 21st Century infrastructure package, which would include upgrades to the transportation system, investments in cleaner transportation technologies and relief for households with particularly heavy energy costs.

- Expand the "basis consistency" rule

  Basis reporting is now required for estate executors (see below for the latest filing postponement). "Basis consistency" means that heirs who receive property that increased the decedent's estate tax liability must use the property's finally determined estate tax value when they later dispose of that property. The proposal would expand this consistency requirement so that it also applies to property that is eligible for the marital deduction at the decedent's death (as in, Dad leaves property to Mom) *if* the decedent's estate exceeded the estate tax filing threshold (currently $5.45 million) and therefore required an estate tax return. In addition, the consistency requirement would apply to lifetime gifts of property if the gift had to be reported on a gift tax return.

Comments. It seems unlikely that the revenue proposals in this final budget will have any traction in the current Congress, particularly since the House and Senate Budget Committees are not even inviting the director of the Office of Management and Budget to appear before the Committees to discuss the budget. So what to make of the proposals? They are consistent with what has been put forth in prior years, and reflect Administration priorities, such as limiting tax benefits available to wealthier taxpayers so as to address perceived tax inequities, and providing incentives for favored activities, such as those relating to clean, renewable energy, and disincentives for disfavored activities, such as those relating to fossil fuels.

In other words, the revenue proposals represent a Democratic wish list and offer a potential blueprint for tax law changes if the upcoming elections produce a Democratic "trifecta," namely, a Democrat in the White House and Democratic control of the House and the Senate. Although this election season continues to confound, a Democratic trifecta would be a steep climb, and would require, for example, a large turnover in the House: Republicans currently hold 246 of the House's 435 seats, while Democrats hold 188 (there is one vacancy). The 100-seat Senate currently has 54 Republicans, 44 Democrats and 2 Independents who caucus with the Democrats. Of the 1/3 of the Senate that is up for election this year, 24 are Republicans and 10 are Democrats, some of whom are not running for re-election (e.g., Marco Rubio, R-FL, and Barbara Boxer, D-CA). What will happen in November, of course, is anyone's guess.

Still, bi-partisan support for the occasional revenue raiser is possible, as evidenced by the basis reporting and consistency rules mentioned above. Nevertheless, it would be surprising to see much tax legislation this year, given how far apart the parties are, philosophically, and that neither party seems especially interested in helping provide what could be viewed as a "victory" for the other side. Continuing gridlock would not be surprising.

Basis reporting postponed again – this time until March 31st

Legislation last summer imposed new basis reporting requirements on estate executors: within 30 days of filing an estate tax return, an executor is required to file a statement with both the IRS and beneficiaries that details estate property and its value. This new law took effect immediately and applied to estate tax returns filed after July 31, 2015 – meaning that the first statements would have been due by the end of August (generally relating to people who died in the fall of 2014). The IRS issued a reprieve on August 21, 2015 with Notice 2015-57, and instructed executors to wait until February 29, 2016 to file any statements that would otherwise be due, so as to give the IRS time to develop forms and guidance.

In mid-December, draft Form 8971, "Information Regarding Beneficiaries Acquiring Property from a Decedent," was issued; in early January, draft instructions for the form followed, and left many questions unanswered, including whether reporting is required of executors who are merely filing a "portability" return (this means, for example, that even though deceased Dad's estate is under the current $5.45 million estate tax filing threshold, Dad's executor files a return anyway, so that Dad's unused exclusion amount carries over to now-widowed Mom). The form and instructions, with scarcely any changes, were made final in late January – although the promised guidance is still pending.

In recognition of the looming February 29th deadline and that more time was needed to produce the guidance, the IRS issued another filing extension on February 11th. Notice 2016-19 says that the Form 8971 need not be filed before March 31, 2016, which will allow "executors…the opportunity to review the proposed regulations to be issued." In other words, the guidance presumably will be out soon.

Taxpayers beware!

The 2015 tax season is now underway and tax scammers are busy. Their fraudulent schemes include aggressive and threatening phone calls demanding payment for a purported tax liability. Once again, the IRS is warning taxpayers to be careful. Here's part of what the IRS said in IR-2016-14, issued on February 2, 2016:

IRS will never:

- Call to demand immediate payment, nor will the agency call about taxes owed without first having mailed you a bill.
- Demand that you pay taxes without giving you the opportunity to question or appeal the amount they say you owe.
- Require you to use a specific payment method for your taxes, such as a prepaid debit card.
- Ask for credit or debit card numbers over the phone.
- Threaten to bring in local police or other law-enforcement groups to have you arrested for not paying.

If you get a phone call from someone claiming to be from the IRS and asking for money, here's what you should do:

- Do not give out any information. Hang up immediately.
- Contact TIGTA [Treasury Inspector General for Tax Administration] to report the call. Use their "IRS Impersonation Scam Reporting" web page. You can also call 800-366-4484.
- Report it to the Federal Trade Commission. Use the "FTC Complaint Assistant" on FTC.gov. Please add "IRS Telephone Scam" in the notes.

As IRS Commissioner John Koskinen put it, "Taxpayers across the nation face a deluge of these aggressive phone scams….We continue to say if you are surprised to be hearing from us, then you're not hearing from us."

March 7520 rate

The IRS has issued the March 2016 applicable federal rates: the March 7520 rate dropped 0.40% (40 basis points!) to 1.8%, from the February (and January) 7520 rate of 2.2%. The March mid-term rates are also down: 1.48% (annual), and 1.47% (semiannual, quarterly and monthly). The February mid-term rates were: 1.82% (annual), 1.81% (semiannual and quarterly) and 1.80% (monthly).

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