PUBLICATION

The Budget Control Act of 2011 – Tax Considerations

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As many of you well know, tax planning over the past decade has become a rather uncertain undertaking due to the myriad of sunset provisions and extensions that have permeated the tax code. Even more uncertainty came earlier this week when President Obama signed the Budget Control Act of 2011 (the Act) into law as part of a compromise to increase the federal debt ceiling.

The Committee

Perhaps the most important of the Act's many provisions is that which calls for the establishment of a new deficit reduction committee (the Committee) consisting of twelve members, six being from the House and six from the Senate, with both groups equally divided among Republicans and Democrats. The Committee will be tasked with producing legislation by late November of this year that would trim the deficit by $1.2 trillion over the next ten years. Should Congress fail to enact this legislation by the end of the year, the Act calls for automatic cuts to various government programs in 2013.

Though the Act provides for establishment of the Committee, it provides no guidance whatsoever as to what may be considered to reduce the deficit. Based on statements made by major party leaders, we have little doubt that the elimination of some tax provisions will be brought into the deficit reduction discussions. Whether or not this will be in the broader context of overall tax reform remains to be seen, though Senator Max Baucus, chairman of the Senate Finance Committee, has indicated interest in presenting a tax reform proposal to the Committee. Tax reform to some may mean the mere simplification of the tax code, i.e., a lower overall rate in exchange for more income being subject to taxation, though some have indicated their desire to see a tax reform proposal that would result in a net increase of revenue to the federal government, while still others prefer a "revenue neutral" proposal.

What this Means for You

Individuals: Individuals face a wide range of possible changes to their current tax structure, whether it is through broad tax reform or a piecemeal elimination of credits and deductions. Some will likely propose the elimination of the mortgage interest deduction for second homes, and possibly a cap on the amount of interest that may be deducted for a primary residence. Other items that may be part of the deficit reduction discussion could include limits or "means testing" for the current exclusion from income of amounts contributed by employers toward health care and insurance premiums, and possible changes to the tax treatment of 401(k)s and other tax favored retirement plans. Some in Congress have also indicated their desire to limit or eliminate the Bush era tax cuts, which include favorable capital gains and dividend tax rates. The tax rate on carried interests, a popular way of compensating asset managers (also known as "the hedge-fund loophole"), would likely also see a large increase under any revenue raising legislation. While we certainly will have to wait until an actual proposal is before Congress regarding the Bush tax cuts, you may find yourself next year considering the possibility of accelerating income into the 2012 calendar year (currently the last for the Bush tax cuts), and postponing discretionary expenses for tax deductions until the 2013 tax year.

Changes to the tax code as it currently applies to estates are also likely due to the sunsetting of many current provisions at the end of 2012. This could include elimination of the current exemption portability, an increase in

estate tax rates, or even a decrease in exemption amounts. It is therefore important to keep in mind that any changes could result in the most unintended of consequence absent revisions to current plans.

Businesses: Business entities may also face the elimination or limitation of many deductions that have grown unpopular with many in Congress despite being legitimate business expenses. High on the list are deductions associated with the operation of a corporate jet, as well as unique tax code provisions related to the oil and gas industry. Any actual changes to these provisions would affect not only the business as a taxable entity, but could very well have tax consequences to the owners as well.

Republicans and Democrats alike have indicated a desire to reform the tax code as it applies to U.S. taxation of foreign operations, and this could very well include a shift to a territorial tax regime. Short of a comprehensive overhaul of the foreign tax system as it exists today, other proposals could include a repatriation holiday similar to the one enacted in 2004, or possibly even an elimination of the active foreign income deferral.

Summary

All of the talk and suggestions thus far are simply proposals, which in the end must be approved by Congress and signed into law by the President. However, as is always the case, you should be prepared to take steps (where appropriate for you) so as to reduce your exposure to additional taxes, should these proposals eventually evolve through the Committee process into recommendations that are enacted into law.

Despite the fact that all these proposed changes are just that, it is nevertheless important to focus on what they could mean to you. A second home, for instance, could get a lot more expensive when you're no longer able to deduct the interest, as well could an aircraft for your business should you no longer be able to deduct the operating expenses associated with it. Whether any of these proposals create a real risk or opportunity for you will depend on the facts and circumstances of your particular situation. Should you wish to discuss possible planning opportunities, please do not hesitate to contact an attorney in the Firm's Tax Department.

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