



Budget Reveals Possible Future Tax Scenarios

As you might have expected, President Barack Obama's tax policy objectives have changed. During last year's presidential campaign we heard some promises, but of course, campaign pledges become tempered by reality after an election is won.

For example, the dire state of the economy dictated that President Obama's planned tax increases could not be implemented immediately. But now, in the Administration's proposed budget for the government's 2010 fiscal year, some of Obama's longer-term tax policy goals have been unveiled.

They are listed below. Keep in mind these are only proposals. In order to become reality, they will have to be passed by both the Senate and the House of Representatives -- and some of these plans are already causing heated debates. But they can be useful as a long-term planning mechanism and as a guide to the thinking of the new Administration.

Budget Proposals Affecting Businesses

- **Repeal the LIFO Inventory Method.** In a controversial move, the Obama Administration wants to repeal the last-in-first-out (LIFO) method of calculating inventory costs for federal income tax purposes, starting in 2012.

This time-honored method allows retailers and wholesalers to pay lower current taxes when inventory costs are rising due to inflation. Exactly how the repeal would be structured is not detailed in the budget.

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- **Reduce Tax Breaks for Oil and Gas Companies.** The budget proposes to eliminate a number of tax breaks for oil and natural gas producers including (among others):
 - The ability to immediately deduct intangible drilling costs.
 - The percentage depletion deduction.
 - The Section 199 domestic producers deduction.



- The exception to the passive loss limitation rules for losses from working interests in oil and gas properties.
- Quick write-offs for geological and geophysical costs.

(See the right-hand table to find out how much the U.S. Treasury estimates Uncle Sam will collect from the repeal.) These punitive changes would begin in 2011.

- **Punish Businesses with International Operations.** The budget calls for raising a bundle over 10 years by imposing higher taxes on international operations and transactions by:
 - Increasing IRS enforcement;
 - Reducing tax deferral opportunities; and
 - Introducing other “reforms.”

These changes would kick in starting in 2011.

“The budget calls for raising a bundle over 10 years by imposing higher taxes on international operations and transactions”

- **Reinstate Superfund Taxes.** Beginning in 2011, the budget calls for reinstating the hazardous waste related Superfund Taxes, which expired more than a decade ago.
- **Make the R&D Tax Credit Permanent.** Under the budget, R&D tax credit would be made permanent. Currently, this credit is one of the “extenders” with an expiration date that Congress has repeatedly voted to extend.
- **Liberalize Net Operating Loss Carry-Back Rules.** A change included in the new American Recovery and Reinvestment Act of 2009 allows qualifying small and medium-sized businesses to carry back net operating losses (NOLs) incurred in tax years beginning or ending in 2008 for up to five years to recover federal income taxes paid for those years. Without this change, most losses can only be carried back for two years. The Obama budget calls for liberalized NOL carry-back provisions, but it’s unclear what this proposal would entail. Apparently, it would apply to NOLs incurred in 2009 and 2010 by qualifying businesses.

BUSINESS WISDOM FOR TODAY'S ECONOMY

Can Your Company Win a Stimulus Government Contract?

Pursuing government contracts can be a long, costly and bureaucratic process. But with billions of dollars of stimulus money being awarded in a tough economy, many companies are looking at government contracts as a source of income.

Here are some considerations:

- Find out if any government agencies are buying services or products that your company provides by going to the “Federal Business Opportunities” Web site. By visiting www.fedbizopps.com, you can search government-wide contracting opportunities. The site lists major Federal government solicitations, contract awards, subcontracting opportunities, surplus property sales and foreign business opportunities. FedBizOpps is where Federal government agencies announce proposed contracts.
- If your company hasn’t been involved in government contracting, it can be easier to break in by becoming a subcontractor



- **Eventually Impose Zero Capital Gains Tax on Small Business Stock Sales.** Without providing any specifics, the Obama budget calls for eliminating all federal capital gains taxes on gains from selling stock in certain small and start-up firms when the shares have been held for over five years. This change would kick in starting with 2014.

Budget Proposals Affecting Individuals

- **Reinstate Higher Tax Rates on Higher-Income Individuals.** The proposed budget calls for ending the Bush tax cuts for those in the top two brackets starting in 2011. Specifically, the current 33 percent and 35 percent federal income tax rates would be replaced with the pre-Bush rates of 36 percent and 39.6 percent. According to the budget, this change would affect married joint-filing couples with incomes above \$250,000 and unmarried individuals with incomes above \$200,000.
- **Restore Deduction Phase-Out Rules for Higher-Income Individuals.** In addition to hiking the top two rates, the Obama Administration also wants to fully restore two phase-out rules that can eliminate:
 - All of a higher-income taxpayer's personal exemption deductions and
 - Up to 80 percent of most itemized deductions.

These changes would kick in starting in 2011 and would affect married joint-filing couples with incomes of more than \$250,000 and unmarried individuals with incomes above \$200,000. (Under current law, both of these phase-out rules are scheduled to disappear for 2010 and beyond.)

- **Reduce Itemized Deductions, Including Home Mortgage Interest and Charitable Donations for Higher-Income Individuals.** Starting in 2011, the Obama budget includes a change that would effectively allow only a 28 percent tax benefit for itemized deductions claimed by higher-income individuals who are in the new 35 percent and 39.6 percent tax brackets. So itemized deductions would first be subject to a phase-out rule, and whatever is left after the phase-out would deliver only a reduced tax-saving benefit.

This proposal is facing steep criticism from not-for-profit organizations and the real estate industry, which argue it will hurt charitable giving and home buying.

or teaming up with another company that is familiar with the bidding process.

- Keep in mind there is a great deal of paperwork involved in pursuing federal government business. It generally begins with filing a 7- page form with the Central Contractor Registry (CCR). The registration form asks for detailed information about your company, identification numbers (such as a taxpayer ID number and a DUNS number from Dun & Bradstreet) as well as classification codes for your products or services.
- Contact your accounting or law firm to see if it provides services to help companies navigate the federal (as well as state and local) government contracting world.

“ This proposal is facing steep criticism from not-for profit organizations and the real estate industry, which argue it will hurt charitable giving . . . ”

TIPS



Apparently, this change would impact married jointfiling couples with incomes above \$250,000 and unmarried individuals with incomes above \$200,000.

- **Increase Tax Rates on Capital Gains and Dividends.** The Obama budget would leave the current taxpayer-friendly federal income tax rate structure on long-term capital gains and dividends in place for everyone except individuals who are in the highest two tax brackets. For them, the tax rate would be increased to 20 percent, up from the current 15 percent. This change would kick in starting in 2011 and would impact married joint-filing couples with incomes above \$250,000 and unmarried individuals with incomes above \$200,000.
- **Keep Applying the Alternative Minimum Tax “Patch.”** The budget proposes to continue the current policy of increasing the alternative minimum tax (AMT) exemption amounts each year to account for inflation.

“Any refundable credits left over after a taxpayer’s liability has been fully offset are sent in cash.”

- **Keep the Current Estate Tax Rules.** The budget calls for continuing the 2009 federal estate tax exemption amount of \$3.5 million per person and the current maximum estate tax rate of 45 percent. (Republicans are pushing for a higher exemption and a lower tax rate.)
- **Give More Tax Credit Cash to Some Taxpayers.** As you may know, most nonrefundable personal federal income tax credits (such as the child credit and the higher education credits) can currently be used to offset up to 100 percent of your federal income tax bill, including any AMT. But that’s it.

In contrast, “refundable” credits have that description because the government pays them out in cash to eligible individuals after their federal income tax liabilities (if any) have been reduced to zero. In other words, any refundable credits left over after a taxpayer’s liability has been fully offset are sent in cash.

Under the Proposed Budget: Where Will the Money Come From — and Go

<i>Proposal</i>	<i>Approximate Projected Revenue ↑ or Cost ↓ to the U.S. Treasury</i>
LIFO repeal	↑ \$60 billion in 2012 through 2019
Reduce tax breaks for oil and gas companies	↑ \$30 billion in 2011 through 2019
Penalize businesses with international operations	↑ \$210 billion in 2011 through 2019
Superfund reinstatement	↑ \$15 billion in 2011 through 2019
R&D Credit Permanent	↓ \$75 billion in 2011 through 2019
Reinstate 36 and 39.6 percent tax rates	↑ \$340 billion in 2011 through 2019
Restore phase-out rules for higher income taxpayers	↑ \$180 billion in 2011 through 2019
Reduce itemized deductions for higher income taxpayers	↑ \$320 billion in 2011 through 2019
Increase capital gains taxes on top two tax rates	↑ \$120 billion in 2011 through 2019



The Obama budget document includes the following proposals for refundable personal tax credits:

- **Continue the “Making Work Pay” Credit.** The current refundable credit of up to \$400 for working singles and up to \$800 for working couples would be continued. This credit was put in place for 2009 and 2010 by the American Recovery and Reinvestment Act of 2009 (also called the Stimulus Law).
- **Keep the American Opportunity Credit in Place.** The current partially refundable credit of up to \$2,500 to cover qualified higher education expenses during the first four years of college would be continued through 2019. This credit was created for 2009 and 2010 by the Stimulus Law.
- **Liberalize the Earned Income Credit.** The Obama budget calls for continuing the Stimulus Law’s liberalizations of the refundable earned income tax credit. These changes provide increased credits to qualifying married joint-filing couples and to qualifying families with three or more children.
- **Modify the Retirement Savers Credit.** Under current law, this credit is for taxpayers with modest incomes who make eligible contributions to an employersponsored retirement plan or to an IRA. Under the proposed budget, the credit would be expanded to include more taxpayers, although the maximum amount of the credit would be apparently less. Also, the credit would be made refundable.
- **Liberalize the Child Credit.** The budget plan would continue the Stimulus Law’s liberalizations of the child credit, which make it a wholly or partially refundable tax credit for more taxpayers.

Based on all the tax proposals being discussed right now, it’s a good idea to work with your tax adviser to plan for the financial impact future legislation could have on you and your business.

Continue the “Making Work Pay” Credit ↓ \$540 billion in 2012 through 2019

Continue the “American Opportunity” Credit for higher education ↓ \$75 billion in 2011 through 2019

Increase the Earned Income Tax Credit for qualifying taxpayers ↓ \$30 billion in 2011 through 2019

Expand the “Retirement Savers” Credit ↓ \$30 billion in 2011 through 2019

Liberalize the Child Tax Credit by making more Americans able to collect more cash ↓ \$70 billion in 2011 through 2019

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