OBAMA RELEASES TAX PROPOSALS FOR 2015

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The proposed U.S. tax changes highlighted in President Obama's State of the Union address on January 20 fall far short of the broad U.S. federal tax reform that members of Congress believe is needed for fundamental fairness and to spur U.S. competitiveness in world markets. His proposal contains a small number of targeted revenue raisers designed to fund other recent proposals made by the president, such as two years of free community college for every student. A spokesman for Rep. Paul Ryan (R-WI), chairman of the House Ways and Means Committee, concisely summed up the Republicans' response: "[t]his is not a serious proposal." "[President Obama] knows we're not likely to pass these kind of measures…" said Senate Majority Leader Mitch McConnell (R-KY). Since the Republicans took control of both the Senate and House following the 2014 elections, calls for tax reform have increased. Both Mr. Ryan and Senator Orrin G. Hatch (R-UT), chairman of the Senate Finance Committee, have emphasized tax reform in 2015. Rhetoric aside, a sweeping overhaul of the U.S. Internal Revenue Code in 2015 is probably unlikely since the philosophical differences between the Republicans and President Obama seem far too great.

The President's Tax Proposals

President Obama's proposal contains the following three primary significant changes to the U.S. federal tax laws.

- The imposition of a seven-basis-point fee on the liabilities of large U.S. financial institutions with assets over $50 billion—the same trigger that qualifies those institutions for enhanced supervision under the 2010 Dodd-Frank Act, according to a fact sheet released by the White House on January 17. This is not the first time such a tax has been proposed. The former chairman of the House Ways and Means Committee, Dave Camp (R-MI), proposed a similar excise tax on large financial institutions in his tax reform plan, the Tax Reform Act of 2014. However, Mr. Camp's excise tax proposal was met with staunch opposition from his Republican colleagues; specifically, 54 Republican lawmakers urged him to erase the measure from his plan.
- An increase in the top capital gains and dividend rate for high-income households (i.e., couples with incomes over approximately $500,000) from the current maximum rate of 20 percent to 28 percent. It is not yet clear if the higher rate would be inclusive or exclusive of the special 3.8 percent "net investment income tax" which high earners also pay on their capital gains and dividends. Taxpayers in

high-tax states such as New York and California will also generally incur significant state income tax on such income. President Obama's proposal would significantly reduce the current federal tax rate preference afforded to those types of income for individuals, considering high-income earners pay a 39.6 percent rate on their ordinary income.

- A closing of what President Obama calls the "trust fund loophole." Currently, when an individual who owns stock or other appreciated capital assets dies, and such assets are transferred to the decedent's beneficiaries, the beneficiaries generally obtain a tax-free "step-up" in the tax basis of the property for income tax purposes equal to the fair market value of the property at date of death. This tax benefit has generally been viewed as an appropriate counter-measure to the fact that the decedent's assets are subject to a U.S. estate tax at date of death. However, since a decedent's estate will generally only incur an actual out-of-pocket U.S. estate tax cost if the value of the estate exceeds the applicable U.S. estate and gift tax exemption amount (currently approximately $5.3 million), the tax-free basis step-up for income tax purposes could be viewed as a windfall for estates with values under $5.3 million. The president would change this rule by treating bequests and gifts (other than those made to charitable organizations) as realization ("deemed-sale") events, subjecting the appreciation to income tax. There are proposed carve-outs and exceptions, including a provision applicable to couples that would defer tax until the death of the second spouse, an exclusion for up to $200,000 in capital gains bequeathed per couple, a $500,000 (per couple) exclusion for personal residences, and a carve-out for the transfer of certain types of tangible personal property. Additionally, no tax would be due on certain inherited small, family-owned and operated businesses until the business was sold, and any closely held business would have an option to pay its tax liability over a 15-year period.

The president's proposal also includes other tax provisions including:

- A new credit of up to $500 for married couples when both spouses work.
- A doubling of the earned income tax credit (EITC) for workers without qualifying children, an increase in the income level at which the credit phases out, and making the credit available for workers age 21 and older.
- Streamlining the child care tax benefits, including tripling (to $3,000) the maximum child care credit for middle class families with young children.
- Consolidating and enhancing education-related tax incentives.
- Expanding access for workers to employer-based retirement options and limiting contributions to and accruals of additional benefits in tax-preferred retirement plans and IRAs when balances reach approximately $3,400,000.

For more information regarding the president's proposals, feel free to contact Daniel Kelly, William Turkovich, or any other member of the Hodgson Russ Tax Practice.