

# *Legislative Update*

## **AICPA**

November 1, 2004

### **Overview**

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- Recent Tax Law Changes
- Election Outlook/Tax Policy Implications
- Economic and Budget Outlook
- Emerging Legislative Issues

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2

## **Congressional Timeline**

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- ✓ President Signed Individual & Extenders Bill: October 4
- ✓ Congress Recessed: October 11
- ✓ President Signed ETI Bill: October 22
- Congress Returns for Lame-Duck Session: November 16
- Continuing Resolution Expires: November 20
- Target Adjournment: November 24
- 109<sup>th</sup> Congress Convenes: January 2005

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3

## **Working Families Tax Relief Act of 2004**

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- Extends Expiring Individual Income Tax Cuts to 2010
- Provides Individual AMT Relief Through 2005
- Renew Expired Business Tax Incentives Through 2005
  - Research Tax Credit
  - Work Opportunity Tax Credit/Welfare-to-Work Credit
  - Expensing of “Brownsfield” Environmental Remediation
- Includes “Technical Correction” Provisions

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4

## American Jobs Creation Act of 2004

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Provision	Revenue
Domestic Manufacturing Deduction	(\$76.5 billion)
International Tax Reform	(\$42.6 billion)
State Sales Tax Deduction	(\$5 billion)
Other Relief Provisions	(\$12.8 billion)
<b>Subtotal</b>	<b>(\$137 billion)</b>
ETI Repeal with Transition Relief	\$49 billion
Leasing Reform	\$27 billion
IRS and Customs User Fees	\$19 billion
Fuel Tax Evasion	\$9 billion
Ethanol Excise Tax	\$6 billion
Patent Donations	\$4 billion
Tax Shelter Penalties	\$2 billion
Other Revenue Provisions	\$21 billion
<b>Subtotal</b>	<b>\$137 billion</b>
<b>Net Total</b>	<b>\$0</b>

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5

## ETI Repeal With Transition Relief

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- Repealed for Transactions After 2004
  - Transition Relief:
    - 80% in 2005
    - 60% in 2006
    - 0% in 2007 and thereafter
  - Relief for Binding Contracts before 9/18/03

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## **Domestic Manufacturing Deduction**

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“Domestic Production Gross Receipts”

Less:

- Allocable Cost of Goods Sold
- Directly Allocable Deductions
- Ratable Allocation of Other Deductions Not Directly Allocable to Another Class of Income

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= Qualified Production Activities Income (“QPAI”)

x 3% (6% in 2007-2009, 9% in 2010 and later)

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= Qualified Production Activities Deduction

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7

## **Domestic Production Gross Receipts**

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- Tangible Personal Property
- Computer Software
- Sound Recordings
- Motion Picture or Television Productions
- Electricity, Natural Gas, or Potable Water Production
- Construction
- Engineering or Architectural Services

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8

## **Foreign Repatriation Incentive**

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- 85% DRD for Certain CFC Dividends During One-Year Period (Calendar-Year Taxpayers: 2004 or 2005)
  - Must Be Paid In Cash
  - Must Be Invested in the United States
  - Must Exceed Average Repatriation Level
  - Limited to Greater of \$500 Million or Amount Shown as Permanently Reinvested Overseas

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9

## **Subpart F Reforms**

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- Provide Look-Thru for Sales of Partnership Interests
- Repeal Foreign Personal Holding Company Rules
- Repeal Foreign Investment Company Rules
- Repeal Foreign Base Company Shipping Income
- Modify Exception for Commodities
- Modify Exception for Active Financing Income

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## **Foreign Tax Credit Reforms**

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- Reform Interest Expense Allocation (after 2008)
- Extend Carryforward Period from 5 to 10 Years
- Reduce Baskets from 9 to 2 (after 2006)
- Eliminate 90% AMT Limitation
- Re-Characterize Overall Domestic Loss (after 2006)

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11

## **Foreign Tax Credit Reforms (cont'd)**

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- Look-Thru for 10/50 Company Dividends
- Indirect Credits Claimed Through Partnerships
- Deemed Payments from Transfers of Intangibles
- Translation of Foreign Taxes
- Treatment of Base Differences

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12

## **Individual and Corporate Expatriation**

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- Tax Treatment of Corporate Inversion Transactions
- Excise Tax on Stock-Based Compensation of Insiders
- Treasury Authority to Address Foreign Reinsurance
- Taxable Merger & Acquisition Reporting
- Treasury Studies and Reports
- Modify Individual Expatriation Tax Rules

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## **Other International Revenue Raisers**

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- Liquidation of Holding Companies
- Transfers of Built-In Loss Transfers
- Overall Foreign Loss Recapture
- Foreign Tax Credit Minimum Holding Period
- Exception from Definition of U.S. Property
- Foreign-Source Effective Connected Income
- Interest, Other Transactions with Related Foreign Persons

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14

## Tax Shelter Penalties

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### Failure to Disclose

- “Listed” Transactions
  - \$100,000 (Individuals)
  - \$200,000 (Non-Individuals)
  - No Waiver
  - SEC Disclosure
- Other Reportable Transactions
  - \$10,000 (Individuals)
  - \$50,000 (Non-Individuals)
  - Limited IRS Waiver Authority

### Accuracy-Related

- “Listed” and “Reportable Avoidance” Transactions
- Adequately Disclosed
  - 20% Penalty
  - Limited Waiver
- Not Adequately Disclosed
  - 30% Penalty
  - No Waiver
  - SEC Disclosure

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15

## Other Tax Shelter Provisions

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- Revised Substantial Understatement Penalty for Transactions Other Than Reportable Transactions
- Expanded Statute of Limitations for Non-Disclosed Listed Transactions
- Denial of Interest on Certain Tax Shelter Deficiencies
- Tax Shelter Exception to Confidentiality Privilege
- Penalty for Failure to Report Foreign Accounts

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16

## Nonqualified Deferred Compensation

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- New Restrictions on Deferral Elections & Distributions and Use of Certain Trusts to Fund Arrangements
- If Requirements Not Met, Participant Subject to:
  - Accelerated Taxation
  - Enhanced Underpayment Interest
  - Additional 20% Tax
- Applies to Amounts Deferred After 2004 (Pre-10/3/04 Plans Grandfathered)

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17

## Nonqualified Deferred Compensation

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- | <u>Deferral Elections</u>   | <u>Distributions</u>   |
|---|--|
| <ul style="list-style-type: none"><li>• Initial Election<ul style="list-style-type: none"><li>– Prior to Year Earned</li><li>– If Performance-Based, 6 Months Before End of Year</li><li>– Distribution Date</li><li>– Form of Payment</li></ul></li><li>• Subsequent Elections<ul style="list-style-type: none"><li>– 12 Months in Advance</li><li>– 5-Year Deferral</li></ul></li></ul> | <ul style="list-style-type: none"><li>• Separation From Service</li><li>• Death</li><li>• Specified Time</li><li>• Fixed Schedule</li><li>• Change in Control</li><li>• Unforeseeable Emergency</li><li>• Participant Disability</li><li>• No Acceleration</li></ul> |

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18

## **Other Compensation Provisions**

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- Employment Tax Exclusion for ISOs and ESPP Stock Options
- Supplemental Wage Withholding for Payments In Excess of \$1 Million
- Personal Use of Company Aircraft and Other Entertainment Expenses
- Minimum Cost Requirement for Transfer of Excess Pension Assets
- Basis Rules in Retirement Plans for Nonresident Aliens

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19

## **Corporate Provisions**

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- Transfers to Creditors and Assumption of Liabilities in Divisive Reorganizations
- Payment of Estimated Tax for Certain Deemed Asset Sales
- Definition of Controlled Group of Corporations
- Consolidated Return Regulatory Authority
- Interest on Convertible Debt
- Modify Straddle Rules
- Expand Definition of Nonqualified Preferred Stock
- Stripped Interests in Bond or Preferred Stock Fund

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20

## **Pass-Through Entities**

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- Disallow Certain Partnership Loss Transfers
- Prohibit Partnerships Basis Reduction of Stock in Corporate Partner
- Require Recognition of COD Income on Satisfaction of Debt with Partnership Interest
- Reform S Corporation Rules
- Modify REIT Rules
- Repeal of FASIT Rules

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21

## **Other Business Provisions**

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- Leasing Arrangements Involving Tax-Exempt Entities
- Charitable Contributions of Intellectual Property
- Donor Reporting for Non-Cash Contributions
- Amortization of Start-Up & Organizational Costs
- Deposits to Avoid Interest on Deficiencies

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22

## **Selected Small Business Provisions**

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- Increased Small Business Expensing Limit
- S Corporation Reforms
- Depreciation of Sport Utility Vehicles
- Mandatory Partnership Basis Adjustment

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## **Dropped Small Business Provisions**

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- Reduced Corporate Income Tax Rate for Small Corporations
- Expansion of AMT Exemption for Small Corporations

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24

## Individuals

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- Election to Deduct State & Local Sales Taxes
- Deduction for Attorney's Fees in Discrimination Lawsuits
- Limit Deduction for Charitable Donations of Vehicles
- U.S. Possession Residency
- Gain Recognition on Sale of Principal Residence Acquired in Like-Kind Exchange Within 5 Years of Sale

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25

## Key Dropped Provisions

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### Tax Relief

- Look-Thru for Payments Between Related CFCs
- Extension of 5-Year NOL Carryback Period to 2003

### Revenue Raisers

- Codification of Economic Substance Doctrine
- CEO Return Declaration Signature
- Denial of Deduction for Fines & Penalties
- Guaranteed Rewards for IRS "Whistleblowers"
- Earnings-Stripping

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26

## Unfinished Business

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Issue	Status
Netherlands Tax Treaty	Hearing Held by Senate Foreign Relations
Internet Tax Moratorium	Passed by House and Senate
Highway Reauthorization	Passed by House and Senate
Charitable Giving Incentives	Passed by House and Senate
Taxpayer Bill of Rights	Passed by House and Senate
Pension Reform	Approved by W&M and SFC
Energy Incentives	Conf. Report Passed House, Not Senate

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27

## Pending Reports & Studies

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Issue	Author	Due Date
Research Credit	Treasury Department	--
APA Process	Senate Finance Committee	--
Puerto Rico*	GAO/JCT	--
Nonprofits*	Independent Sector	February/Spring 2005
Earnings Stripping	Treasury Department	June 30, 2005
Tax Treaties	Treasury Department	June 30, 2005
Transfer Pricing	Treasury Department	June 30, 2005
Corporate Inversions	Treasury Department	December 31, 2006

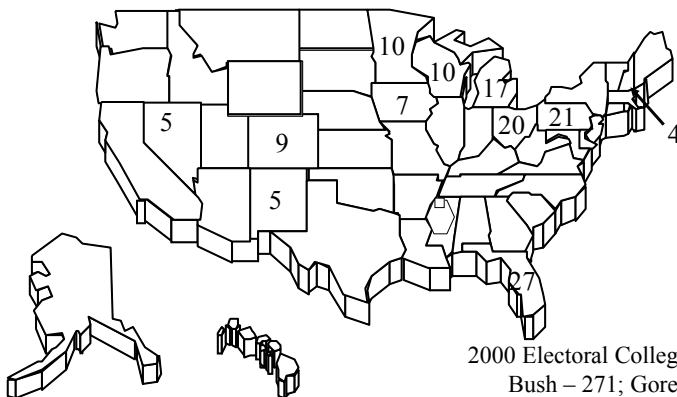
\* Requested by the Senate Finance Committee

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## 2004 Presidential Election Battleground States?

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2000 Electoral College Results:  
Bush – 271; Gore – 266  
2000 Results with New Census  
Bush – 278; Gore – 260

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29

## Presidential Election: Bush v. Kerry

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### Bush Tax Plan

- Permanent 2001 & 2003 Tax Cuts
- Savings Tax Incentives (LSA/RSA)
- Tax Reform

### Kerry Tax Plan

- Partial Repeal of 2001 and 2003 Tax Cuts
- Education & Health Care Tax Incentives
- Business Tax Reform

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30

## **Kerry Tax Plan – Individuals**

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- Repeal 2001 and 2003 Tax Cuts for Families with Income over \$200,000
- Replace Estate Tax Repeal with Increased Exemption
- Make Other 2001 and 2003 Tax Cuts Permanent
- Provide New Tax Credits for Higher Education and Health Insurance Coverage

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31

## **Kerry Tax Plan – Business**

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- Eliminate Deferral of U.S. Tax on Foreign Earnings
- Close “Abusive” International Tax “Loopholes”
- Lower Top Corporate Income Tax Rate to 33.25%
- (Provide One-Year Foreign Repatriation Incentive)
- Establish Employer Payroll Credit for New Hires

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32

## Bush Tax Plan – Tax Reform

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- President Reagan (1984):
  - “Let us go forward with an historic reform for fairness, simplicity and incentives for growth.”
- George Bush (2004):
  - “a simpler, fairer, pro-growth” tax system
- President Bush to appoint bipartisan commission to make recommendations on revenue-neutral reform

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33

## Control of 108<sup>th</sup> Congress

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### U.S. Senate\*

<b>51 Republicans</b>	<b>48 Democrats</b>	
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\* 1 Independent

### U.S. House of Representatives\*

<b>227 Republicans</b>	<b>205 Democrats</b>	
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\* 1 Independent; 2 Vacancies

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34

## Selected Congressional Retirements

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### Senate

- John Breaux (D-LA)
- Ben Nighthorse Campbell (R-CO)
- John Edwards (D-NC)
- Peter Fitzgerald (R-IL)
- Bob Graham (D-FL)
- Fritz Hollings (D-SC)
- Zell Miller (D-GA)
- Don Nickles (R-OK)

### Ways & Means

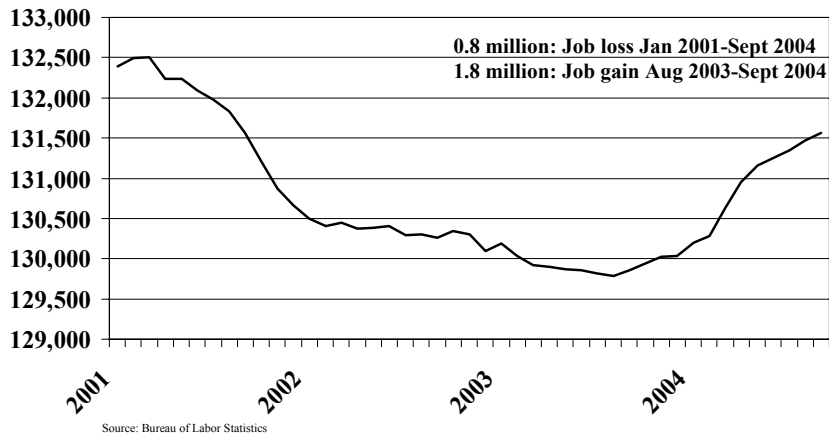
- Mac Collins (R-GA)
- Jennifer Dunn (R-WA)
- Amo Houghton (R-NY)
- Jerry Kleczka (D-WI)
- Scott McInnis (R-CO)

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35

## Economic & Budget Outlook: Total Employment, 2001-2004 (in thousands)

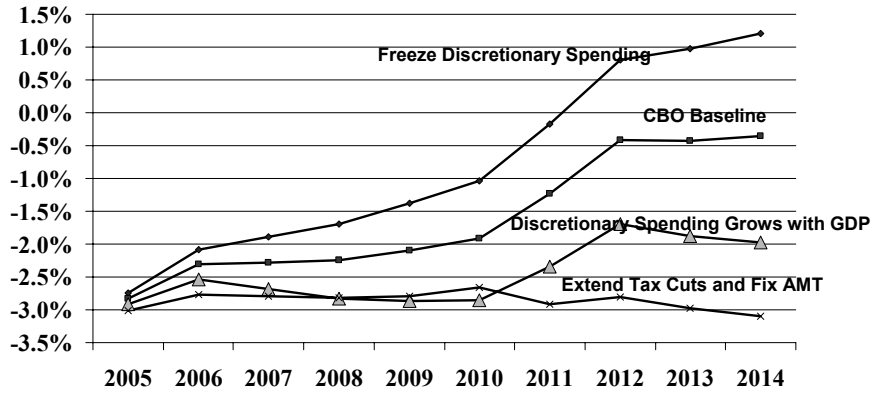
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36

## CBO Deficit Projections under Alternative Policies, 2005-2014 (as share of GDP)



Source: Congressional Budget Office and PricewaterhouseCoopers calculations.

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37

## Emerging Issues: Expiring Tax Provisions

2005	2008	2010
Research Tax Credit	Capital Gains Relief	Individual Income Tax Rates
Work Opportunity Tax Credit	Dividend Tax Relief	Estate Tax Repeal
Welfare-to-Work Tax Credit		Increased Retirement Plan Limits
Individual AMT Relief		Pease & PEP Repeal
Brownfield Expensing		Increased Child Tax Credit
Other Traditional Extenders		Marriage Penalty Relief

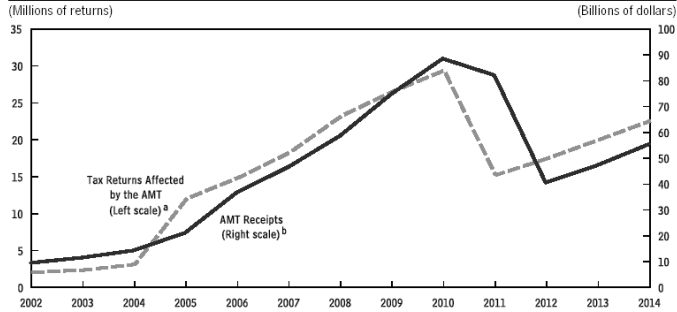
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38

# Emerging Issues: Individual AMT

**Figure 1.**

## Projected Effects of the Individual Alternative Minimum Tax

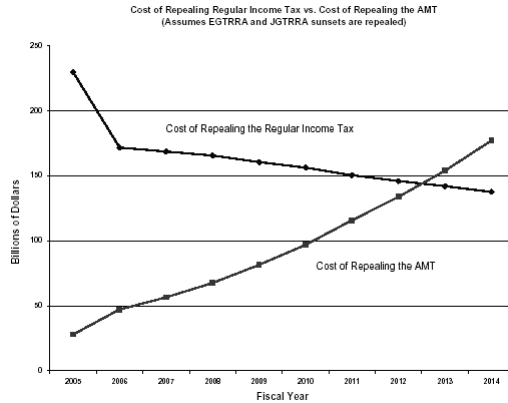


Source: Congressional Budget Office.

- a. Calendar year basis.
- b. Fiscal year basis.

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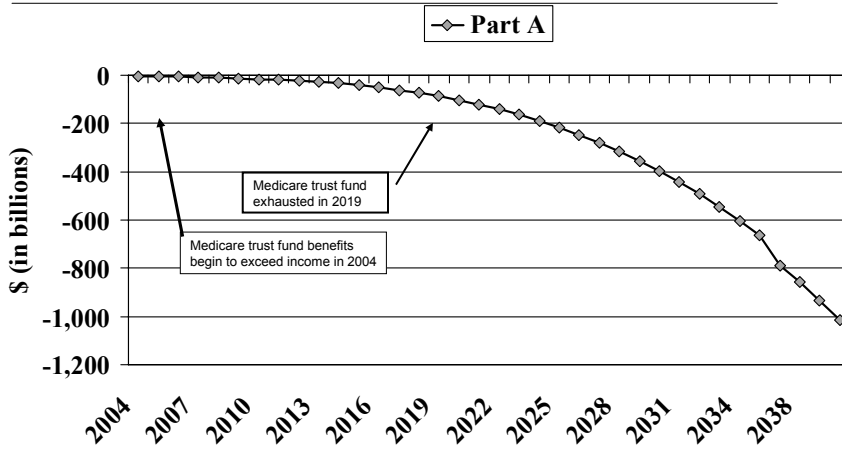
# Cost of Repealing Regular Tax Versus AMT



Source: US Treasury Department.

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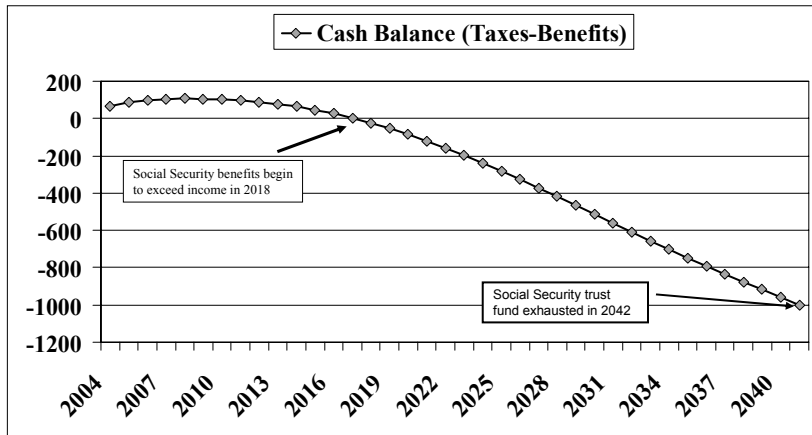
## Required General Fund Transfers to Medicare



Source: Office of Chief Actuary, SSA (2004) and PricewaterhouseCoopers Calculations

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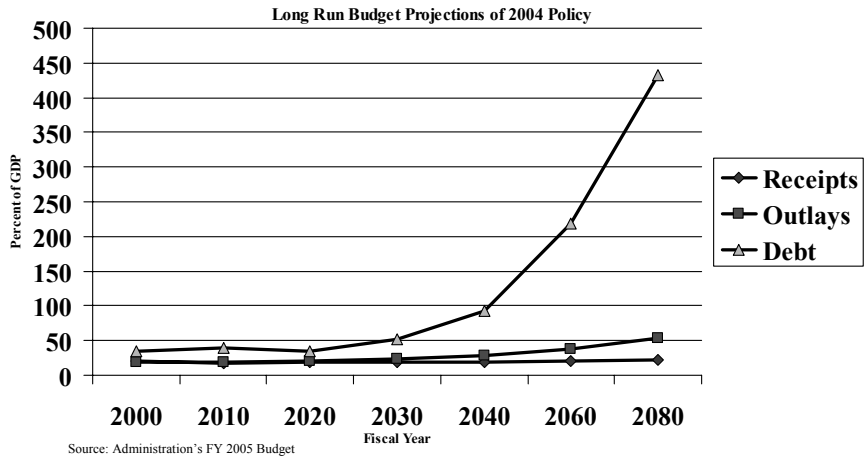
## Social Security Financing (in billions)



Source: Office of Chief Actuary, SSA (2004)

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# Long Run Budget Projections



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