PATTON BOGGS LLP

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HOUSE REPUBLICAN FISCAL 2013 BUDGET BLUEPRINT

Tax Policy Client Alert

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On March 20, House Budget Chairman Paul Ryan (R-WI) released the House Republican's proposed blueprint for the fiscal 2013 federal budget. The proposal, which recommends cuts in government spending, includes a template for reforming the tax code. The blueprint contemplates a simpler individual income tax code, with only two tax brackets set at 10 and 25 percent, and would repeal the alternative minimum tax. The budget also proposes lowering the corporate tax rate to 25 percent, and would shift the U.S. from a worldwide system of taxation to a territorial one. The budget also proposes expanding the tax base by enacting unspecified base broadening measures for both individual and corporate taxpayers, with the stated goal of maintaining government revenue in the range of 18 to 19 percent of GDP, which is consistent with the long term historic average.

While the House budget is not expected to become law, with leaders of both parties and the Administration in agreement that some type of tax reform should be finalized in the near-term, the House Republican fiscal 2013 federal budget blueprint can be viewed as another call for tax reform. The blueprint notes the burgeoning consensus that tax reform must be tackled in the immediate future. The following summary provides highlights of what House Republicans believe should be key elements in any tax reform and deficit reduction plans going forward.

Corporate Rate Reduction

Under the Republican blueprint, the corporate income tax rate would be lowered to 25 percent. The proposal would also eliminate various tax subsidies for corporations, but it does not specify which exemptions, deductions and credits it would reform or eliminate. Unlike the President's budget proposal, the Republican blueprint would not increase individual tax rates and therefore does not increase the tax rates of individuals on income earned through pass-through entities.

In addition to the corporate rate reduction, the Republican blueprint would shift the U.S. from a worldwide system of taxation to a territorial tax system. This policy stands in contrast to President Obama's *Framework for Business Tax Reform* proposal, which seeks to establish a minimum tax on U.S.-based multinational corporations' foreign earnings, eroding the use of "deferral" of foreign-source income. The Republican blueprint does not specify a tax rate for foreign earnings returned to the U.S., but previous Republican proposals, such as the international tax reform draft framework released by Ways and Means Committee Chairman Dave Camp (R-MI), have suggested moving to a participation exemption system whereby 95 percent of overseas earnings would be exempt from U.S. tax and subject to certain base erosion protections.

Individual Rate Simplification

The Republican blueprint would consolidate the current six individual tax brackets into two brackets of 10 and 25 percent, while at the same time eliminating or reducing various tax benefits for individuals. Although the blueprint does not offer specifics on what adjusted gross income (AGI) the two respective brackets would apply to, past iterations of similar Republican proposals suggest that the 10 percent rate would apply to AGI up to $100,000 for joint filers and $50,000 for single filers, while the 25 percent rate would apply to incomes above those thresholds[1]. The tax brackets would be amended each year by a cost-of-living adjustment based on the consumer price index. In addition to this individual rate simplification, the Republican blueprint assumes a repeal of the alternative minimum tax (AMT). The Congressional Budget Office has estimated that repealing the AMT would cost $804 billion from 2013 to 2022.

Deficit Reduction and Government Spending

The debt ceiling negotiations resulted in the passing of the Budget Control Act of 2011 (BCA) which paired a $2.1 trillion increase in the debt limit with equivalent deficit reduction over the ensuing 10 years. It included caps on discretionary spending, saving $917 billion in 10 years, with an additional $1.2 trillion in savings garnered from either a deal forged in the Joint Select Committee on Deficit Reduction (Super Committee) or an automatic sequestration that would result in immediate spending reductions, half of which would come from the Department of Defense, beginning in January 2013 and going through 2022. Because the Super Committee was unable to strike an agreement, automatic sequestration is scheduled to go forward next year. The Republican blueprint seeks to replace the discretionary sequester that would disproportionately affect defense spending and focus the cuts on other areas. To accomplish this, the Republican blueprint gives six House committees, including Ways and Means, reconciliation instructions to produce legislation that achieves the same level of savings in alternative ways.

Going Forward

The House Budget committee is expected to debate and vote on the proposal this week, with the expectation that a vote by the full House will occur next week. Yet, as the blueprint was unveiled, Chairman Ryan stated that he did not expect to make law this year with the blueprint, and Senate Majority Leader Harry Reid (D-NV) indicated that the blueprint faces certain defeat in the Democratic controlled Senate[2]. However, it is yet another marker in the debate between the parties in how to best achieve tax reform, which both parties agree should happen sooner rather than later.

Pressure will only increase for an agreement on tax reform as significant deadlines converge at the end of this year. First, analysts expect that the U.S. will hit its $16.4 trillion debt ceiling between November 2012 and January 2013. On January 1, 2013, the Bush tax cuts and the temporary payroll tax cut, just extended last month, will both expire. On January 2, 2013 the automatic cuts to defense and non-defense spending resulting from the failed Super Committee negotiations take effect.

[1] A Roadmap for America's Future Version 2.0. Representative Paul D. Ryan, January 2010, http://www.roadmap.republicans.budget.house.gov/UploadedFiles/Roadmap2Final2.pdf.
[2] Majority Leader Reid has stated that the Senate will not bring a budget to the floor since the Budget Control Act, enacted last August, already sets spending targets for the year.

In advance of these looming deadlines and the growing consensus for tax reform, it is expected that the tax writing committees will continue to engage in detailed policy discussions with the business community. Following on Chairman Camp's international tax draft, it is possible that further drafts and/or white papers on various tax issues including retirement, financial services, manufacturing, high tech, and transportation/infrastructure among others, with the goal of laying the foundation for such tax reform, will be released. This Republican blueprint, along with the President's *Framework for Business Tax Reform* proposal and White House fiscal year 2013 budget unveiled last month, can be viewed as opening statements as to how each side will enter such negotiations on tax reform.