

January 31, 2012

*Practice Group(s):*  
*Public Policy and*  
*Law*

## Tax Policy Outlook for 2012: Expiring Provisions, Tax Reform Dominate Agenda

*By: Patrick G. Heck, Michael W. Evans, Mary Burke Baker, John B. Godfrey, Karishma Shah Page, Ryan J. Severson*

While it is conventional thinking that significant tax legislation does not pass in a presidential election year, in fact, since 1988, Congress has enacted an average of roughly 12 pieces of tax legislation in each presidential election year.

This year, there are a number of pending tax issues that are expected to garner attention. In addition to the continuing dialogue on tax reform, an ongoing focus will be the issue of expiring tax provisions, with the payroll tax package and possibly tax extenders being considered at the beginning of the year and the 2001/2003 Bush-era tax cuts being considered at the end of the year. There may also be attempts to advance issue-specific legislation, such as items related to economic growth, transportation, and energy. While this tax policy environment presents risks, it may also present opportunities.

### Expiring Tax Provisions

One of the first issues facing lawmakers will be extension of the payroll tax package, which is scheduled to expire on February 29. By way of background, in December, legislation was passed extending for two months a 2% reduction in the payroll tax, an extension of unemployment benefits, and a physician payment increase (the so-called “doc fix”). Legislation to provide an extension through December 2012 is now in a House-Senate conference committee.

As the conference committee begins formal meetings, the two key issues for debate will be whether and how the package should be offset and whether the package should also be expanded to include extension of temporary tax provisions that expired on December 31, 2011, known as the “tax extenders.” These provisions, which are extended regularly and have a cost of approximately \$30 billion, include business tax provisions, such as the active financing exception under subpart F, controlled-foreign corporation look-through treatment, the R&D tax credit, 15-year depreciation for leasehold, restaurant, and retail property, and individual provisions, such as the mortgage insurance deduction, the IRA charitable rollover, and the deduction for donations of conservation easements. Additionally, the “patch” for the Alternative Minimum Tax also expired at the end of 2011; the cost of extension is approximately \$92 billion.

With political gridlock and the significant cost of the tax extenders and AMT, it is possible that extension of these provisions slips to year-end when Congress is likely to turn to the issue of the 2001/2003 Bush-era tax cuts. The 2001/2003 cuts, which, among other provisions, reduce individual income tax rates, reduce rates on capital gains and dividends, and reduce estate tax rates, were extended for two years at the end of 2010 and cost approximately \$3.8 trillion over 10 years to make permanent. In a partisan election year environment, how to address these policies, given their cost and the size of the budget deficit, will be controversial and may be deferred until after the election.

## Tax Policy Outlook for 2012: Expiring Provisions, Tax Reform Dominate Agenda

Taken together, the single largest task Congress will face in 2012 will be determining the fate of expired or expiring tax provisions. This task also could include other expired or expiring tax and tax-related policies such as: reauthorization of the Federal Aviation Administration; reauthorization of the federal surface transportation programs (“SAFETEA”); and small business expensing and bonus depreciation. Collectively, all of these provisions cost approximately \$4.7 trillion (if made permanent) or about 17 percent of all federal receipts outside of social insurance taxes.

Expiring Provision/Legislation	Date of Expiration	Approximate Cost
Tax Extenders (R&D, 15-year Depreciation, AFE, CFC Look-through, etc...)	Dec. 31, 2011	\$30B for 1 year
Alternative Minimum Tax Patch	Dec. 31, 2011	\$92B for 1 year
Payroll Tax Reduction	Feb. 29, 2012	\$100B for 1 year
Federal Aviation Administration	Jan. 31, 2012	
SAFETEA	Mar. 31, 2012	
Provisions of 2001/2003 Tax Acts, including: <ul style="list-style-type: none"> <li>• Reduced individual income tax rates;</li> <li>• Reduced rates on capital gains and dividends; and</li> <li>• Increased deductions for married couples.</li> </ul>	Dec. 31, 2012	\$3.7T to make permanent
Estate Tax Rates (35%, with \$5 million exemption)	Dec. 31, 2012	\$238B to make permanent

### Tax Reform

Congressional tax-writing committees are expected to continue work on tax reform. They will explore different tax reform issues in the form of hearings and meetings with stakeholders. They also will likely continue to develop legislative text. In October 2011, House Ways and Means Chairman Dave Camp (R-MI) released draft international tax reform legislation and solicited public comment on the proposal. There have been indications that draft tax reform proposals on other issues may be forthcoming. Stakeholders have been using these various opportunities to actively and strategically advocate on issues of interest. At end, although it is unlikely that comprehensive reform legislation will be enacted in 2012, these efforts will be foundational as Congress moves ahead with tax reform.

Notably, the Joint Select Committee on Deficit Reduction’s deliberations during the end of 2011 could serve to accelerate the tax reform debate. There was some concern that the inability of the Joint Select Committee to reach agreement represented a possible setback as it could have served as a vehicle to put tax reform on a fast track for consideration in 2012. However, the Joint Select Committee’s work may have helped increase consensus around the idea of reforming the tax code by reducing or eliminating a number of tax preferences, incentives, credits and deductions to offset the cost of a general reduction in marginal tax rates for both individuals and businesses.

### President’s Budget

President Barack Obama outlined a number of tax proposals in his January 24 State of the Union Address. The White House is expected to expand on these proposals in the coming weeks both as part

## Tax Policy Outlook for 2012: Expiring Provisions, Tax Reform Dominate Agenda

of his Budget for Fiscal Year 2013—expected on February 13—and as part of a corporate tax reform framework.

Specifically, the President proposed limiting deductions related to business expenses related to moving employment and production jobs overseas and providing a 20 percent tax credit for expenses related to closing production overseas and bringing employment back to United States. Modifications to the domestic production activities deduction would focus it on manufacturing and high-tech manufacturing in particular. And a new Manufacturing Tax Credit would encourage investment in areas where a major employer had shut down or a military base had closed. The President also proposed extending the Advanced Energy Manufacturing Credit and 100 percent bonus depreciation.

Administration officials have also said a broader corporate tax reform framework will be released around the same time as the Budget for Fiscal Year 2013. This framework would impose a minimum corporate tax on overseas profits, provide a permanent R&D credit, and repeal unspecified “special deductions, credits, and other tax expenditures.”

On the matter of individual income taxes, the President used the State of the Union Address to flesh out some of the details of the Buffett Rule he announced last year. Under the proposal, individuals making more than \$1 million a year would be required to pay an effective tax rate of at least 30 percent. The provision would be drafted so as not to “disadvantage” those making large charitable contributions. Conversely, they would receive no benefit from deductions and credits related to housing, health care, retirement, or child care.

### Congressional Tax Initiatives

Members and stakeholders will also continue to work to advance their tax priorities. For example, Senate Finance Committee member Jeff Bingaman (D-NM) has expressed interest in advancing energy tax legislation, and transportation-related tax provisions may be attached to the SAFETEA reauthorization.

Likewise, with the ongoing weakness of the economy and in light of the upcoming election, there may be efforts to advance “jobs” legislation. One possible iteration is another repatriation holiday, which has had some Congressional support previously.

### Offsets

Despite the \$2 trillion in spending cuts enacted as part of the Budget Control Act of 2011, the nation’s fiscal challenges continue. According to the Congressional Budget Office, if all expiring income tax provisions are made permanent, then annual budget deficits over the next decade will average \$1 trillion. However, under the Pay-As-You-Go Act of 2010 (“Paygo”), Congress must offset the cost of new tax policy and the cost of extending expiring tax policy. If Congress does not waive Paygo and does not provide such offsets, then across-the-board spending cuts will be triggered.

As a result, there is the risk in the context of tax reform, extending expiring tax provisions, or issue specific tax legislation, that revenue-raising provisions may be identified and included as offsets. These revenue raising-provisions may be ones discussed in the past or wholly new proposals. Examples include carried interest, LIFO, and taxes on financial institutions or transactions.

# Tax Policy Outlook for 2012: Expiring Provisions, Tax Reform Dominate Agenda

## Calendar

The amount of time lawmakers will spend in Washington in 2012, particularly time when the House and Senate are in session together, will be limited; there will only be 45 days in the first eight months of the year in which the House and Senate will both be in session and voting (or at least with votes planned to occur before 6:30 p.m.) The Senate has not yet set its schedule for the last four months of the year.

Additionally, Congress may spend a substantial amount of its limited time trying to prevent the mandatory spending cuts triggered by the Joint Select Committee's inability to reach an agreement. These cuts, totaling roughly \$110 billion for Fiscal Year 2013, would cut across all but a few programs, and lawmakers have already said there will be significant efforts to either avoid them, or at least redirect them. Sequestration could also affect tax policy, if lawmakers decide to use new revenue to offset deficit savings lost due to reducing sequestration's size or scope.

## Unforeseen Risks

While it is possible to list known factors likely affect tax policy in 2012, there is always the unknown. From natural disasters to changes in the economic outlook, unforeseen events could alter the discussion and debate.

There is also growing risk within the legislative process. With increasing frequency, major pieces of legislation are advancing directly to the House and Senate floor without having been considered by the tax writing committees under regulator process. Absent such a process, it is critical to remain vigilant to defend against risks and identify opportunities.

# Tax Policy Outlook for 2012: Expiring Provisions, Tax Reform Dominate Agenda

---

## Authors:

**Patrick G. Heck**  
**Partner**

patrick.heck@klgates.com  
+1.202.778.9450

**Michael W. Evans**  
**Partner**

michael.evans@klgates.com  
+1.202.661.3807

**Mary Burke Baker**  
**Government Affairs Advisor**

mary.baker@klgates.com  
+1.202.778.9223

**John B. Godfrey**  
**Government Affairs Analyst**

john.godfrey@klgates.com  
+1.202.661.3807

**Karishma Shah Page**  
**Associate**

karishma.page@klgates.com  
+1.202.778.9128

**Ryan J. Severson**  
**Associate**

ryan.severson@klgates.com  
+1.202.778.9251

## K&L GATES

Anchorage Austin Beijing Berlin Boston Brussels Charleston Charlotte Chicago Dallas Doha Dubai Fort Worth Frankfurt Harrisburg  
Hong Kong London Los Angeles Miami Moscow Newark New York Orange County Palo Alto Paris Pittsburgh Portland Raleigh  
Research Triangle Park San Diego San Francisco São Paulo Seattle Shanghai Singapore Spokane Taipei Tokyo Warsaw Washington, D.C.

K&L Gates includes lawyers practicing out of 40 offices located in North America, Europe, Asia, South America, and the Middle East, and represents numerous GLOBAL 500, FORTUNE 100, and FTSE 100 corporations, in addition to growth and middle market companies, entrepreneurs, capital market participants and public sector entities. For more information about K&L Gates or its locations and registrations, visit [www.klgates.com](http://www.klgates.com).

This publication is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

©2011 K&L Gates LLP. All Rights Reserved.