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## The Administration's Tax Reform Targets -- Selected Issues

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**THE ADMINISTRATION'S TAX REFORM TARGETS – SELECTED ISSUES**

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## SELECTED TARGETS FROM THE FISCAL YEAR 2016 REVENUE PROPOSALS

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## LIFO AND LCM INVENTORY METHODS

### **CURRENT LAW**

- **TAXPAYERS GENERALLY MAY ADOPT ANY OF SEVERAL DIFFERENT METHODS OF COMPUTING INVENTORIES TO DETERMINE THE COST OF GOODS SOLD DURING THE TAX YEAR**
  - **THE HIGHER THE COST OF GOODS SOLD, THE LOWER THE AMOUNT OF INCOME FROM THE SALE OF GOODS**
  - **THREE COMMONLY USED METHODS ARE**
    - **FIRST IN, FIRST OUT (“FIFO”)**
    - **LIFO, WHICH IS AUTHORIZED BY IRC § 472**
    - **LCM, WHICH IS AUTHORIZED BY TREAS. REG. §§ 1.471-2 AND 1.471-4**
  - **LCM MAY BE USED IN CONJUNCTION WITH FIFO, BUT NOT WITH LIFO, TO DETERMINE OPENING AND CLOSING INVENTORIES**
- **IN AN INFLATIONARY ENVIRONMENT, THE LIFO METHOD TENDS TO MAXIMIZE THE COST OF GOODS SOLD BECAUSE THE MOST RECENTLY PURCHASED OR**

**PRODUCED (I.E., HIGHEST COST) GOODS ARE TREATED AS BEING SOLD BEFORE PREVIOUSLY PURCHASED OR PRODUCED GOODS**

- **UNDER THE LCM METHOD, THE COST OF GOODS SOLD INCLUDES, IN EFFECT, A DECLINE IN THE VALUE OF GOODS HELD IN INVENTORY AT THE END OF THE TAX YEAR BELOW THE GOODS' COST**

#### **THE ADMINISTRATION'S PROPOSAL**

- **REPEAL USE OF THE LIFO METHOD**
  - **RECAPTURE OF A TAXPAYER'S LIFO RESERVE INTO INCOME WOULD BE SPREAD RATABLY OVER 10 YEARS**
- **PROHIBIT USE OF THE LCM METHOD AND A SIMILAR (SUBNORMAL GOODS) METHOD**
  - **ANY INCREASE TO INCOME RESULTING FROM A REQUIRED CHANGE IN ACCOUNTING WOULD BE SPREAD RATABLY OVER 4 YEARS**

## **SIMPLIFYING TAX ACCOUNTING FOR SMALL BUSINESSES**

### **CURRENT LAW**

- **OVERALL METHOD OF ACCOUNTING – UNDER IRC § 448, C CORPORATIONS (AND PARTNERSHIPS WITH A C CORPORATION PARTNER), OTHER THAN QUALIFIED PERSONAL SERVICE CORPORATIONS AND CERTAIN FARMING BUSINESSES, GENERALLY MUST USE THE ACCRUAL METHOD**
  - **UNDER AN EXCEPTION FOR SMALL BUSINESSES, USE OF THE ACCRUAL METHOD IS NOT REQUIRED FOR A C CORPORATION (OR SUCH A PARTNERSHIP) IF, FOR EACH TAX YEAR BEGINNING AFTER 1985, ITS GROSS RECEIPTS NEVER EXCEEDED \$5,000,000 ON AVERAGE FOR THE THREE PRECEDING TAX YEARS**
    - **RELATED ENTITIES ARE AGGREGATED FOR PURPOSES OF APPLYING THE GROSS RECEIPTS TEST**
    - **THE \$5,000,000 CAP, WHICH HAS EXISTED SINCE 1986, IS NOT INDEXED FOR INFLATION**

- **UNIFORM CAPITALIZATION (“UNICAP”) RULES – UNDER IRC § 263A, TAXPAYERS GENERALLY MUST CAPITALIZE TO THE COST OF INVENTORY, OR TO THE COST OF REAL OR TANGIBLE PERSONAL PROPERTY PRODUCED BY OR FOR THE TAXPAYER, DIRECT COSTS AND ALLOCABLE INDIRECT COSTS OF THE PROPERTY**
  - **UNDER AN EXCEPTION FOR SMALL BUSINESSES, THE UNICAP RULES FOR PROPERTY ACQUIRED FOR RESALE DO NOT APPLY TO A TAXPAYER FOR A TAX YEAR IF ITS ANNUAL AVERAGE GROSS RECEIPTS DID NOT EXCEED \$10,000,000 FOR THE THREE IMMEDIATELY PRECEDING TAX YEARS**
    - **RELATED ENTITIES ARE AGGREGATED FOR PURPOSES OF APPLYING THE GROSS RECEIPTS TEST**
    - **THE \$10,000,000 CAP, WHICH HAS EXISTED SINCE 1986, IS NOT INDEXED FOR INFLATION**



- **ACCOUNTING FOR INVENTORIES – UNDER TREAS. REG. §§ 1.471-1 AND 1.446-1(c)(2)(i), TAXPAYERS GENERALLY MUST ACCOUNT FOR INVENTORIES WHENEVER THE PRODUCTION, PURCHASE, OR SALE OF MERCHANDISE IS AN INCOME PRODUCING FACTOR IN THE TAXPAYER’S BUSINESS, AND MUST USE THE ACCRUAL METHOD TO ACCOUNT FOR PURCHASES AND SALES OF INVENTORY**
  - **UNDER AN ADMINISTRATIVE EXCEPTION FOR SMALL BUSINESSES CURRENTLY PROVIDED IN REV. PROC. 2001-10, A TAXPAYER IS NOT REQUIRED TO ACCOUNT FOR INVENTORIES AND USE THE ACCRUAL METHOD IF, FOR EACH TAX YEAR ENDING AFTER DECEMBER 16, 1997, ITS GROSS RECEIPTS NEVER EXCEEDED \$1,000,000 ON AVERAGE FOR THE THREE PRECEDING TAX YEARS**
    - **RELATED ENTITIES ARE AGGREGATED FOR PURPOSES OF APPLYING THE GROSS RECEIPTS TEST**
    - **THE \$1,000,000 CAP, WHICH HAS EXISTED SINCE 2000, IS NOT INDEXED FOR INFLATION**

## **THE ADMINISTRATION'S PROPOSAL**

- **FOR ALL THE SMALL BUSINESS EXCEPTIONS DESCRIBED ABOVE, MAKE THE GROSS RECEIPTS CAP \$25,000,000, USING THE AVERAGE ANNUAL GROSS RECEIPTS FOR THE THREE PRECEDING YEARS**
  - **THE EXCEPTION FROM UNICAP WOULD BE EXTENDED TO ALL OF UNICAP (NOT JUST REALES)**
  - **QUALIFYING TAXPAYERS COULD CHOOSE TO USE AN INVENTORY METHOD THAT CONFORMS TO THE METHOD USED FOR FINANCIAL ACCOUNTING PURPOSES OR OTHERWISE PROPERLY REFLECTS INCOME, INCLUDING SIMPLY DEDUCTING THE COST OF AN ITEM WHEN IT IS SOLD**
  - **AS UNDER CURRENT LAW, RELATED ENTITIES WOULD BE AGGREGATED FOR PURPOSES OF APPLYING THE GROSS RECEIPTS TEST**
  - **UNLIKE CURRENT LAW, THE CAP WOULD BE INDEXED FOR INFLATION AFTER 2016**
  - **ALSO UNLIKE CURRENT LAW, A TAXPAYER THAT FAILED THE GROSS RECEIPTS TEST FOR A YEAR COULD AGAIN BECOME ELIGIBLE TO QUALIFY FOR THE SMALL BUSINESS EXCEPTIONS BEGINNING FIVE YEARS LATER**

## LIKE-KIND EXCHANGES

### **CURRENT LAW**

- **UNDER IRC § 1031, A TAXPAYER GENERALLY DOES NOT RECOGNIZE GAIN (EXCEPT TO THE EXTENT THE TAXPAYER RECEIVES “BOOT”) OR LOSS ON AN EXCHANGE OF PROPERTY FOR PROPERTY OF “LIKE KIND”, IF BOTH THE PROPERTY TRANSFERRED AND THE PROPERTY RECEIVED IN EXCHANGE ARE HELD EITHER FOR PRODUCTIVE USE IN A BUSINESS OR FOR INVESTMENT**
- **THE NONRECOGNITION RULE DOES NOT APPLY TO EXCHANGES OF PROPERTY HELD PRIMARILY FOR SALE AND VARIOUS TYPES OF INTANGIBLE PROPERTY (E.G., STOCKS, BONDS, OTHER EVIDENCES OF INDEBTEDNESS, AND PARTNERSHIP INTERESTS)**
- **REAL PROPERTY IS GENERALLY CONSIDERED TO BE OF LIKE KIND TO OTHER REAL PROPERTY, WHETHER IMPROVED OR UNIMPROVED, AND A LEASEHOLD INTEREST OF REAL PROPERTY WITH AT LEAST 30 YEARS TO RUN IS CONSIDERED OF LIKE KIND TO A FEE SIMPLE OWNERSHIP INTEREST IN REAL PROPERTY – TREAS. REG. § 1.1031-1(b) & (c)**

- BUT REAL PROPERTY LOCATED IN THE U.S. IS NOT OF LIKE KIND TO REAL PROPERTY NOT LOCATED IN THE U.S. – IRC § 1031(h)
- THERE IS NO ANNUAL OR LIFETIME LIMIT ON THE AMOUNT OF GAIN THAT MAY BE DEFERRED UNDER §1031

#### THE ADMINISTRATION'S PROPOSAL

- LIMIT THE AMOUNT OF GAIN THAT MAY BE DEFERRED ON THE EXCHANGE OF REAL PROPERTY TO \$1 MILLION (INDEXED FOR INFLATION) PER TAXPAYER PER YEAR
  - REGULATORY AUTHORITY WOULD PERMIT AGGREGATING EXCHANGES BY RELATED PERSONS
- MAKE § 1031 INAPPLICABLE TO EXCHANGES OF “ART AND COLLECTIBLES”

**DEDUCTIONS AND INCOME EXCLUSIONS FOR INDIVIDUALS**  
**WITH MARGINAL RATES ABOVE 28%**

**CURRENT LAW**

- **THE HIGHEST FEDERAL INCOME TAX RATE FOR INDIVIDUALS WAS 28% UNDER THE TAX REFORM ACT OF 1986**
- **TODAY, RATES GO UP TO 39.6%. WITH THREE RATES ABOVE 28% (33%, 35%, AND 39.6%), NOT COUNTING THE 3.8% TAX ON NET INVESTMENT INCOME OF “HIGH INCOME” TAXPAYERS**
- **EXCLUSIONS FROM INCOME (FOR EXAMPLE, TAX-EXEMPT INTEREST ON STATE AND LOCAL GOVERNMENT BONDS) AND ALLOWABLE DEDUCTIONS REDUCE, IN EFFECT, INCOME SUBJECT TO A TAXPAYER’S HIGHEST MARGINAL RATE BEFORE REDUCING INCOME TAXABLE AT A LOWER RATE**
- **UNDER IRC §67, AN INDIVIDUAL’S “MISCELLANEOUS ITEMIZED DEDUCTIONS” ARE DEDUCTIBLE ONLY TO THE EXTENT THEIR TOTAL AMOUNT EXCEEDS 2% OF THE TAXPAYER’S ADJUSTED GROSS INCOME (“AGI”)**

- **UNDER IRC § 68, THE TOTAL AMOUNT OF OTHERWISE ALLOWABLE ITEMIZED DEDUCTIONS FOR A “HIGH INCOME” INDIVIDUAL IS REDUCED BY 3% OF THE TAXPAYER’S AGI IN EXCESS OF THE HIGH INCOME THRESHOLD, BUT CANNOT BE REDUCED BY MORE THAN 80%**

#### **THE ADMINISTRATION’S PROPOSAL**

- **LIMIT THE VALUE OF MOST EXCLUSIONS AND DEDUCTIONS APPLIED TO COMPUTE AGI AND ALL ITEMIZED DEDUCTIONS TO 28%**
  - **FOR EXAMPLE, APPLICABLE DEDUCTIONS AND EXCLUSIONS OF \$1 MILLION FOR AN INDIVIDUAL WHO WOULD HAVE \$1 MILLION OF TAXABLE INCOME SUBJECT TO THE 39.6% RATE (BEFORE TAKING THE EXCLUSIONS AND DEDUCTIONS INTO ACCOUNT) WOULD REDUCE THE TAXPAYER’S FEDERAL INCOME TAX BY \$280,000 INSTEAD OF \$396,000**
  - **THE PROPOSAL WOULD APPLY AFTER APPLYING §§ 67 AND 68**

## THE BUFFET RULE

### CURRENT LAW

- THE MAXIMUM FEDERAL INCOME TAX RATE ON LONG-TERM CAPITAL GAIN AND QUALIFIED DIVIDENDS OF INDIVIDUALS IS 20%
  - IN ADDITION, CAPITAL GAINS AND DIVIDENDS SUBJECT TO THE 20% RATE USUALLY ARE SUBJECT TO THE 3.8% TAX ON NET INVESTMENT INCOME (“NII TAX”)
- UNDER IRC § 55, THE ALTERNATIVE MINIMUM TAX (“AMT”) GENERALLY IMPOSES A RATE OF 28% ON A HIGH-INCOME INDIVIDUAL’S AMT INCOME, WHICH DISALLOWS MANY ITEMIZED DEDUCTIONS
- BUT THE TOP AMT RATE ON LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS IS 20%
- FOR HIGH-INCOME TAXPAYERS WHO DERIVE A LARGE PERCENTAGE OF INCOME FROM LONG-TERM CAPITAL GAINS AND DIVIDENDS AND/OR HAVE A LARGE AMOUNT OF ALLOWABLE ITEMIZED DEDUCTIONS, THE EFFECTIVE FEDERAL INCOME TAX RATE CAN BE SIGNIFICANTLY LOWER THAN FOR TAXPAYERS FOR

**WHOM A LARGE PERCENTAGE OF INCOME IS FROM WAGES AND OTHER TYPES OF ORDINARY INCOME (ESPECIALLY IF ONE HAS A SMALL AMOUNT OF ALLOWABLE ITEMIZED DEDUCTIONS)**

#### **THE ADMINISTRATION'S PROPOSAL**

- **IMPOSE A NEW MINIMUM TAX CALLED THE "FAIR SHARE TAX" OR FST ON AGI OF AT LEAST \$1 MILLION AND INCREASE THE TOP RATE ON LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS OF INDIVIDUALS TO 24.2% (RESULTING IN 28% WHEN COMBINED WITH THE 3.8% NII TAX)**
- **THE FST WOULD BE A TAX OF 30% OF AGI MINUS A CREDIT OF 28% OF ALLOWABLE CHARITABLE CONTRIBUTIONS**
  - **THE FST WOULD BE PAYABLE IF AND TO THE EXTENT IT EXCEEDED THE SUM OF AN INDIVIDUAL'S REGULAR INCOME TAX (INCLUDING NII TAX), AMT, AND EMPLOYEE PORTION OF PAYROLL TAXES**
  - **THE FST WOULD BE PHASED IN ON AGI OF \$1 MILLION UP TO \$2 MILLION AND WOULD BE PAYABLE IN FULL ON AGI OF AT LEAST \$2 MILLION**



## CARRIED INTERESTS

### CURRENT LAW

- **THE RECEIPT OF AN INTEREST IN A PARTNERSHIP'S FUTURE PROFITS IN EXCHANGE FOR SERVICES USUALLY DOES NOT RESULT IN THE REALIZATION OF INCOME, BECAUSE SUCH A PROFITS (OR "CARRIED") INTEREST HAS NO CURRENT FAIR MARKET VALUE AND THE HOLDER OF THE PROFITS INTEREST (HAVING NO INTEREST IN PARTNERSHIP CAPITAL) WOULD BE ENTITLED TO NOTHING IF THE PARTNERSHIP WERE IMMEDIATELY LIQUIDATED – SEE REV. PROC. 93-27 AND REV. PROC. 2001-43; BUT SEE PROP. TREAS. REG. § 1.707-2 (REG-115452-14, JULY 23, 2015)**
- **WHEN FUTURE PROFITS ARE SUBSEQUENTLY RECOGNIZED AS LONG-TERM CAPITAL GAIN (OR QUALIFIED DIVIDENDS) BY THE PARTNERSHIP, THE TAX CHARACTER OF THE PROFITS AS DETERMINED AT THE PARTNERSHIP LEVEL FLOWS THROUGH TO THE PARTNERS, INCLUDING THE HOLDER OF A PROFITS INTEREST – IRC § 702(b)**

- AN INDIVIDUAL REALIZING A SHARE OF SUCH PARTNERSHIP PROFITS MAY BENEFIT FROM THE PREFERENTIAL TAX RATES ON LONG-TERM CAPITAL GAIN
- GAIN RECOGNIZED ON THE SALE OR OTHER TAXABLE DISPOSITION OF A PARTNERSHIP INTEREST GENERALLY IS TREATED AS CAPITAL GAIN, ESPECIALLY IF THE PARTNERSHIP HAS LITTLE OR NO ORDINARY INCOME PROPERTY – IRC §§ 741 & 751
- IN ADDITION, A PARTNER'S SHARE OF A PARTNERSHIP'S LONG-TERM CAPITAL GAIN (PLUS MOST REAL ESTATE RENT, DIVIDENDS AND INTEREST), AS WELL AS A "LIMITED PARTNER'S" SHARE OF PARTNERSHIP INCOME, IS NOT SUBJECT TO SECA TAXES – IRC § 1402(a)(1)-(3) & (13)

#### **THE ADMINISTRATION'S PROPOSAL**

- TREAT PARTNERSHIP INCOME ALLOCATED TO AN "INVESTMENT SERVICES PARTNERSHIP INTEREST," WHICH IS A CARRIED INTEREST OF A SERVICE PROVIDER IN AN "INVESTMENT PARTNERSHIP," AS ORDINARY INCOME SUBJECT TO ORDINARY INCOME TAX RATES AND SECA TAXES

- IN ADDITION, GAIN FROM THE TAXABLE DISPOSITION OF SUCH A PARTNERSHIP INTEREST GENERALLY WOULD BE CHARACTERIZED AS ORDINARY INCOME INSTEAD OF CAPITAL GAIN
- A PARTNERSHIP IS AN INVESTMENT PARTNERSHIP ONLY IF, AMONG OTHER THINGS, SUBSTANTIALLY ALL OF ITS ASSETS ARE INVESTMENT-TYPE ASSETS
- IF A SERVICE PROVIDER HOLDING A CARRIED INTEREST IN AN INVESTMENT PARTNERSHIP CONTRIBUTES “INVESTED CAPITAL” AND OBTAINS A “QUALIFIED CAPITAL INTEREST,” THE PRECEDING CHARACTERIZATION RULES WOULD NOT APPLY TO PARTNERSHIP INCOME ALLOCATED TO THE QUALIFIED CAPITAL INTEREST OR TO GAIN ON THE DISPOSITION OF THE QUALIFIED CAPITAL INTEREST

## **IDENTIFYING SHARES OF STOCK SOLD**

### **CURRENT LAW**

- **IF A TAXPAYER HOLDS MULTIPLE SHARES OF THE SAME STOCK WITH DIFFERENT BASES AND/OR HOLDING PERIODS, THE TAXPAYER USUALLY MAY IDENTIFY THE SHARES SOLD IF LESS THAN ALL THE SHARES ARE SOLD – TREAS. REG. § 1.1012-1(c)**
- **IF NO IDENTIFICATION IS MADE, USUALLY THE SHARES HELD THE LONGEST ARE DEEMED TO HAVE BEEN SOLD – TREAS. REG. § 1.1012-1(c)(1)(i)**

### **THE ADMINISTRATION'S PROPOSAL**

- **REQUIRE THE USE OF AN AVERAGE-COST BASIS FOR ALL IDENTICAL SHARES OF "PORTFOLIO STOCK" HAVING A LONG-TERM HOLDING PERIOD**

## **APPLICABILITY OF SECA TAXES**

### **CURRENT LAW**

- **SECA TAXES, INSTEAD OF FICA TAXES, APPLY TO SELF-EMPLOYMENT INCOME OF PARTNERS (OTHER THAN LIMITED PARTNERS) DERIVED FROM A PARTNERSHIP'S TRADE OR BUSINESS – IRC §1402(a)**
- **SECA TAXES DO NOT APPLY TO A LIMITED PARTNER'S DISTRIBUTIVE SHARE OF PARTNERSHIP INCOME, EXCEPT FOR GUARANTEED PAYMENTS FOR THE PARTNER'S SERVICES – CODE § 1402(a)(13)**
  - **SOME TAXPAYERS TAKE THE POSITION THAT ALL MEMBERS IN A LIMITED LIABILITY COMPANY("LLC") AND ARGUABLY ALL PARTNERS IN A LIMITED LIABILITY PARTNERSHIP ("LLP") ARE "LIMITED PARTNERS" FOR SECA TAX PURPOSES**
- **SECA TAXES DO NOT APPLY TO AN S CORPORATION SHAREHOLDER'S PRO RATA SHARE OF S CORPORATION INCOME**
  - **BUT FICA TAXES DO APPLY TO COMPENSATION PAID BY THE S CORPORATION TO AN EMPLOYEE-SHAREHOLDER FOR SERVICES**

## **THE ADMINISTRATION'S PROPOSAL**

- **TREAT ALL INDIVIDUAL, DIRECT AND INDIRECT OWNERS OF PASS-THROUGH “PROFESSIONAL SERVICE” BUSINESSES THE SAME FOR PURPOSES OF APPLYING SECA TAXES, REGARDLESS OF THE TYPE OF PASS-THROUGH LEGAL ENTITY THEY OWN**
  - **A PASS-THROUGH ENTITY WOULD BE A “PROFESSIONAL SERVICE BUSINESS” IF SUBSTANTIALLY ALL OF ITS ACTIVITIES INVOLVE THE PERFORMANCE OF SERVICES IN THE FIELDS OF HEALTH, LAW, ENGINEERING, ARCHITECTURE, ACCOUNTING, ACTUARIAL SCIENCE, PERFORMING ARTS, CONSULTING, ATHLETICS, INVESTMENT ADVICE OR MANAGEMENT, BROKERAGE SERVICES, AND LOBBYING**
  - **AN OWNER WHO DOES NOT “MATERIALLY PARTICIPATE “ (USING IRC § 469 STANDARDS, EXCLUDING THE EXCEPTION FOR LIMITED PARTNERS) WOULD BE SUBJECT TO SECA TAXES ONLY ON COMPENSATION PAID BY THE ENTITY FOR THE OWNER’S SERVICES**
  - **FICA TAXES WOULD NO LONGER APPLY TO COMPENSATION PAID BY AN S CORPORATION TO AN EMPLOYEE-SHAREHOLDER, BUT THE COMPENSATION WOULD BE INCLUDED IN THE INCOME SUBJECT TO SECA TAXES**

## TRANSFERS OF PROPERTY BY GIFT OR DEATH

### CURRENT LAW

- FOR INCOME TAX PURPOSES, NO GAIN OR LOSS IS RECOGNIZED (OR REALIZED, FOR THAT MATTER) ON THE TRANSFER OF PROPERTY BY GIFT OR DEATH
- THE TRANSFEREE'S BASIS IN PROPERTY TRANSFERRED BY GIFT GENERALLY IS THE SAME AS THE TRANSFEROR'S BASIS OR, IF THE PROPERTY OTHERWISE WOULD BE TREATED AS DISPOSED OF AT A LOSS BY THE TRANSFEREE, THE PROPERTY'S FAIR MARKET VALUE ("FMV") ON THE GIFT DATE – IRC § 1015
  - CONSEQUENTLY, BUILT-IN GAIN REMAINS TO BE TAXED UPON THE TRANSFEREE'S SALE OR TAXABLE EXCHANGE OF THE PROPERTY
- THE TRANSFEREE'S BASIS IN PROPERTY TRANSFERRED BY REASON OF THE DECEDENT'S DEATH GENERALLY IS THE FMV OF THE PROPERTY ON THE DATE OF DEATH (OR, AT THE DECEDENT'S ESTATE'S ELECTION, AN ALTERNATE VALUATION DATE OF UP TO SIX MONTHS LATER) -- IRC § 1014
  - CONSEQUENTLY, BUILT-IN GAIN AS OF THE DATE OF DEATH (OR ALTERNATE VALUATION DATE) IS ELIMINATED

## **THE ADMINISTRATION'S PROPOSAL**

- **IN ADDITION TO INCREASING THE HIGHEST INCOME TAX RATE ON LONG-TERM CAPITAL GAINS TO 24.2% FROM 20%, TREAT TRANSFERS OF APPRECIATED PROPERTY BY GIFT OR DEATH AS SALES FOR FMV (SUBJECT TO CERTAIN EXCLUSIONS)**
  - **GIFTS AND DEATH WOULD BECOME REALIZATION/RECOGNITION EVENTS FOR INCOME TAX PURPOSES**
  - **ANY RESULTING INCOME TAX LIABILITY OF A DECEDENT WOULD BE DEDUCTIBLE FOR ESTATE TAX PURPOSES**
  - **OTHERWISE UNUSED CAPITAL LOSSES OF THE DECEDENT WOULD BE DEDUCTIBLE AGAINST ORDINARY INCOME ON THE DECEDENT'S FINAL INCOME TAX RETURN**
- **GIFTS AND BEQUESTS OF APPRECIATED PROPERTY TO A SPOUSE OR TO CHARITY WOULD NOT BE TREATED AS SALES, AND THE TRANSFEREE WOULD SUCCEED TO THE TRANSFEROR'S BASIS**
- **OTHER EXCLUSIONS FROM TAXABLE SALE TREATMENT WOULD INCLUDE:**
  - **GIFTS AND BEQUESTS OF TANGIBLE PERSONAL PROPERTY, EXCEPT FOR "COLLECTIBLES"**



- **\$100,000 OF OTHERWISE TAXABLE GAIN, WITH PORTABILITY FOR A SURVIVING SPOUSE**
- **THE § 125 EXCLUSION OF \$250,000 FOR THE QUALIFIED SALE OF A PRINCIPAL RESIDENCE ( \$500,000 PER MARRIED COUPLE)**
- **THE § 1202 EXCLUSION FOR GAIN ON THE SALE OR TAXABLE EXCHANGE OF QUALIFIED SMALL BUSINESS STOCK**

## **SCOPE OF ESTATE, GIFT, AND GENERATION SKIPPING TAXES**

### **CURRENT LAW**

- **AS A RESULT OF POST-2009 LEGISLATION, THERE GENERALLY IS A LIFETIME EXCLUSION OF \$5 MILLION (INDEXED FOR POST-2010 INFLATION) FROM FEDERAL ESTATE, GIFT, AND GENERATION SKIPPING TAXES, AND THE TOP TAX RATE FOR EACH SUCH TAX IS 40% -- IRC §§ 2001(c), 2010(c), 2502(a), 2505(a), 2631(c), 2641**
  - **FOR 2015, THE INDEXED AMOUNT IS \$5,430,000 – REV. PROC. 2014-61, § 3.33**
  - **ANY UNUSED EXCLUSION AMOUNT OF ONE SPOUSE CAN BE TRANSFERRED TO THE SURVIVING SPOUSE, PROVIDING AN EFFECTIVE EXCLUSION OF MORE THAN \$10 MILLION FOR A MARRIED COUPLE**

### **THE ADMINISTRATION'S PROPOSAL**

- **REVERT TO THE EXCLUSION AMOUNTS AND TAX RATES IN EFFECT IN 2009**
- **THE EXCLUSION AMOUNT FOR ESTATE AND GENERATION SKIPPING TAXES WOULD BE \$3.5 MILLION**
- **THE EXCLUSION AMOUNT FOR GIFT TAXES WOULD BE \$1 MILLION**

- **THE TOP RATE FOR ALL THREE TAXES WOULD BE 45%**
- **THERE WOULD BE NO INDEXING FOR INFLATION**
- **PORTABILITY BETWEEN SPOUSES WOULD BE PERMITTED**

## LIABILITY OF SHAREHOLDERS WHO SELL STOCK OF C CORPORATIONS

### CURRENT LAW

- NOTICE 2001-16, MODIFIED BY NOTICE 2008-111, IDENTIFIED THE “INTERMEDIARY TRANSACTION TAX SHELTER” AS A LISTED TRANSACTION SUBJECT TO VARIOUS REGISTRATION AND DISCLOSURE REQUIREMENTS AND POTENTIAL PENALTIES FOR PARTICIPANTS AND PROMOTERS
- IN SUCH A TRANSACTION:
  - THE STOCK OF A CLOSELY-HELD C CORPORATION OWNING APPRECIATED ASSETS IS SOLD FOR AN AMOUNT GREATER THAN THE SHAREHOLDER(S) WOULD RECEIVE FROM THE CORPORATION IF THE CORPORATION SOLD ITS ASSETS, PAID ITS INCOME TAX(ES), AND DISTRIBUTED THE AFTER-TAX PROCEEDS TO THE SHAREHOLDER(S)
  - THE PURCHASER OF THE STOCK (OFTEN A FOREIGN ENTITY) THEN CAUSES THE CORPORATION TO SELL OR OTHERWISE DISPOSE OF THE ASSETS AND TO DISTRIBUTE THE PROCEEDS TO THE NEW SHAREHOLDER WITHOUT PAYING THE CORPORATION’S RESULTING TAX LIABILITY

- THE PURCHASER, ITS PRINCIPALS, AND THE PROCEEDS THEN USUALLY DISAPPEAR, LEAVE THE COUNTRY, OR OTHERWISE MAKE IT PRACTICALLY IMPOSSIBLE FOR THE IRS TO COLLECT THE UNPAID TAX LIABILITY RESULTING FROM THE DISPOSITION OF THE CORPORATION'S ASSETS
- THE IRS HAS TRIED TO COLLECT THE CORPORATE TAX DEFICIENCY FROM THE SELLING SHAREHOLDER(S) BY INVOKING THE TRANSFEREE LIABILITY RULE OF IRC § 6901, BUT WITH LIMITED SUCCESS
  - § 6901 HAS BEEN INTERPRETED TO REQUIRE THAT THE PERSON FROM WHOM THE IRS IS TRYING TO COLLECT HAVE TRANSFEREE LIABILITY UNDER APPLICABLE STATE LAW – SEE *COMMISSIONER V. STERN*, 357 U.S. 30 (1958)
  - WHERE THE SELLING SHAREHOLDER(S) DID NOT KNOW WHAT THE PURCHASER OF THE STOCK WAS GOING TO DO, THE IRS HAS UNSUCCESSFULLY TRIED TO ESTABLISH SUCH LIABILITY BY RECHARACTERIZING THE ACTUAL TRANSACTION AS INCLUDING A DISTRIBUTION OF PROCEEDS FROM THE CORPORATION TO THE SELLING SHAREHOLDER(S) FOR PURPOSES OF APPLYING STATE TRANSFEREE LIABILITY LAW -- SEE, E.G., *STARNES V. COMMISSIONER*, 680 F. 3D 417 (4TH CIR. 2012)

## **THE ADMINISTRATION'S PROPOSAL**

- **MAKE THE SELLING SHAREHOLDER(S) SECONDARILY LIABLE FOR THE CORPORATION'S FEDERAL INCOME TAX LIABILITY (INCLUDING INTEREST, ADDITIONS TO TAX, AND PENALTIES) TO THE EXTENT OF SALES PROCEEDS RECEIVED BY THE SHAREHOLDER(S), IF**
  - **THE SHAREHOLDER(S) SELL AT LEAST 50% OF THE CORPORATION'S STOCK ("CONTROL") WITHIN A TWELVE-MONTH PERIOD AND**
  - **THE CORPORATION IS AN "APPLICABLE C CORPORATION"**
    - **ITS STOCK IS NOT PUBLICLY TRADED AND AT LEAST 2/3 OF ITS ASSETS CONSIST OF CASH, PASSIVE INVESTMENT ASSETS, AND/OR ASSETS SOLD PURSUANT TO A SALE SUBSTANTIALLY NEGOTIATED WHEN THE SALE OF CONTROL OF THE CORPORATION OCCURS**
- **THE PROPOSAL WOULD BE RETROACTIVE, APPLYING TO SALES OF CONTROL OCCURRING ON OR AFTER APRIL 10, 2013**

