

Obama administration proposals for new tax legislation
Selected items affecting Insurance, IRAs, Rental Income, Tax Rates,
HR/Payroll, and other issues
Excerpts from the federal fiscal year 2010 GreenBook issued by Department of the Treasury
(May 11, 2009)
(None of these proposals yet introduced in the current Congress)

PROVIDE THE “MAKING WORK PAY” CREDIT

Proposal

The proposal would make the MWP credit permanent and index the beginning of the phase-out range for inflation. In addition, the phase-out rate would be reduced to 1.6 percent.

The proposal is effective for tax years beginning after December 31, 2010.

EXPAND THE SAVER’S CREDIT AND PROVIDE FOR AUTOMATIC ENROLLMENT IN IRAS

Expand the Saver’s Credit

Proposal

The proposal would make the saver’s credit fully refundable and would provide for the credit to be deposited automatically in the qualified retirement plan account or IRA to which the eligible individual contributed. Making the saver’s credit more like a matching contribution would enhance the likelihood that the credit would be saved and would increase the salience of the incentive by framing it as a match similar to the familiar employer matching contributions to 401(k) plans. The proposal would offer a meaningful saving incentive to tens of millions of additional households while simplifying the current three-tier credit structure and raising the eligibility income threshold to cover millions of additional moderate-income taxpayers.

In place of the current 10-percent/20-percent/50-percent credit for qualified retirement savings contributions up to \$2,000 per individual, the proposal would match 50-percent of such contributions up to \$500 per individual (indexed annually for inflation beginning in taxable year 2011). The eligibility income threshold would be increased to \$65,000 for married couples filing jointly, \$48,750 for heads of households, and \$32,500 for singles and married individuals filing separately, with the amount of savings eligible for the credit phased out at a 5-percent rate for AGI exceeding those levels.

The proposal would be effective December 31, 2010.

Automatic Enrollment in IRAs

Proposal

Employers in business for at least two years that have 10 or more employees would be required to offer an automatic IRA option to employees on a payroll-deduction basis, under which regular payroll-deduction contributions would be made to an IRA. If the employer sponsored a qualified retirement plan or SIMPLE for its employees, it would not be required to provide an automatic IRA option for any employee. Thus, for example, a qualified plan sponsor would not have to offer automatic IRAs to employees it excludes from qualified plan eligibility because they are collectively bargained, under age 18, nonresident aliens, or have not completed the plan’s eligibility waiting period. However, if the qualified plan excluded from eligibility a portion of the employer’s work force or a class of employees such as all employees of a subsidiary or division, the employer would be required to offer the automatic IRA option to those excluded employees.

The employer offering automatic IRAs would give employees a standard notice and election form informing them of the automatic IRA option and allowing them to elect to participate or opt out. Any

employee who did not provide a written participation election would be enrolled at a default rate of three percent of the employee's compensation. Employees could opt for a lower or higher contribution rate up to the IRA dollar limits. For most employees, the payroll deductions would be made by direct deposit similar to the direct deposit of employees' paychecks to their accounts at financial institutions. Payroll-deduction contributions from all participating employees could be transferred, at the employer's option, to a single private-sector IRA trustee or custodian designated by the employer. Alternatively, the employer, if it preferred, could allow each participating employee to designate the IRA provider for that employee's contributions or could designate that all contributions would be forwarded to a savings vehicle specified by statute or regulation.

Employers making payroll deduction IRAs available would not have to choose or arrange default investments. Instead, a low-cost, standard type of default investment and a handful of standard, low-cost investment alternatives would be prescribed by statute or regulation. In addition, this approach would involve no employer contributions, no employer compliance with qualified plan requirements, and no employer liability or responsibility for determining employee eligibility to make tax-favored IRA contributions or for opening IRAs for employees. A national web site would provide information and basic educational material regarding saving and investing for retirement, including IRA eligibility, but, as under current law, individuals (not employers) would bear ultimate responsibility for determining their IRA eligibility.

Employers could claim a temporary tax credit for making automatic payroll-deposit IRAs available to employees. The amount of the credit would be \$25 per enrolled employee up to \$250 each year for two years. The credit would be available both to employers required to offer automatic IRAs and employers not required to do so (for example, because they have fewer than ten employees).

Contributions by employees to automatic IRAs would qualify for the saver's credit (to the extent the contributor and the contributions otherwise qualified), and the proposed expanded saver's credit would be deposited to the IRA to which the eligible individual contributed.

The proposal would become effective January 1, 2012.

PROVIDE THE AMERICAN OPPORTUNITY TAX CREDIT

Proposal

The proposal would make the AOTC a permanent replacement for the Hope Scholarship credit. To preserve the value of the AOTC, the proposal would index the \$2,000 tuition and expense amounts, as well as the phase-out thresholds, for inflation.

This proposal would be effective for taxable years beginning after December 31, 2010.

ELIMINATE CAPITAL GAINS TAXATION ON INVESTMENTS IN SMALL BUSINESS STOCK

Proposal

Under the proposal the percentage exclusion for qualified small business stock sold by an individual or other non-corporate taxpayer would be increased to 100 percent and the AMT preference item for gain excluded under this provision would be eliminated. The stock would have to be held for at least five years and other provisions applying to the section 1202 exclusion would also apply. The proposal would include additional documentation requirements to assure compliance with the statute.

The proposal would be effective for qualified small business stock issued after February 17, 2009.

(Reasons for Change

Because the taxable portion of gain from the sale of qualified small business stock is subject to tax at a maximum of 28 percent and a percentage of the excluded gain is a preference under the AMT, the current 50-percent provision provides little benefit. Increasing the exclusion would encourage and reward new investment in qualified small business stock.)

CONTINUE CERTAIN EXPIRING PROVISIONS THROUGH CALENDAR YEAR 2010

Current Law

The existing tax code includes a number of provisions that are scheduled to expire before December 31, 2010. These provisions include the optional deduction for State and local general sales taxes, Subpart F “active financing” and “look-through” exceptions, the exclusion from unrelated business income of certain payments to controlling exempt organizations, the new markets tax credit, the modified recovery period for qualified leasehold improvements and qualified restaurant property, incentives for empowerment and community renewal zones, credits for biodiesel and renewable diesel fuels, and several trade agreements, including the Generalized System of Preferences and the Caribbean Basin Initiative.

Proposal

This proposal would extend these provisions through December 31, 2010.

TAX CARRIED (PROFIT) INTERESTS AS ORDINARY INCOME

Current Law

A partnership is not subject to federal income tax. Instead, income and loss of the partnership retains its character and flows through to its partners, who must include such items on their tax returns. Generally, certain partners receive partnership interests in exchange for contributions of cash and/or property, while certain partners (not necessarily other partners) receive partnership interests, typically interests in future profits (“profits interests”) in exchange for services. Accordingly, if and to the extent a partnership recognizes long-term capital gain, the partners, including partners who provide services, will reflect their shares of such gain on their tax returns as long-term capital gain. If the partner is an individual, such gain would be taxed at the reduced rates for long-term capital gains. Gain recognized on the sale of a partnership interest, whether it was received in exchange for property, cash or services, is generally treated as capital gain.

Under current law, income attributable to a profits interest of a general partner is generally subject to self-employment tax, except to the extent the partnership generates types of income that are excluded from self employment taxes, e.g., capital gains, certain interest and dividends.

Reason for Change

Although profits interests are structured as partnership interests, the income allocable to such interests is received in connection with the performance of services. A service provider’s share of the income of a partnership attributable to a carried interest should be taxed as ordinary income and subject to self-employment tax because such income is derived from the performance of services. By allowing service partners to receive capital gains treatment on labor income without limit, the current system creates an unfair and inefficient tax preference. The recent explosion of activity among large private equity firms has increased the breadth and cost of this tax preference, with some of the highest-income Americans benefiting from the preferential treatment.

Proposal

A partner’s share of income on a “services partnership interest” (SPI) would be subject to tax as ordinary income, regardless of the character of the income at the partnership level. Accordingly, such income would not be eligible for the reduced rates that apply to long-term capital gains. In addition, the proposal would require the partner to pay self-employment taxes on such income. Gain recognized on the sale of an SPI would generally be taxed as ordinary income, not as capital gain.

An SPI is a carried interest held by a person who provides services to the partnership. To the extent that the partner who holds an SPI contributes “invested capital” and the partnership reasonably allocates its income and loss between such invested capital and the remaining interest, income attributable to the invested capital would not be recharacterized. Similarly, the portion of any gain recognized on the sale of an SPI that is attributable to the invested capital would be treated as capital gain. “Invested capital” is defined as money or other property contributed to the partnership. However, contributed capital that is attributable to the proceeds of any loan or other advance made or guaranteed by any

partner or the partnership is not treated as “invested capital.” Also, any person who performs services for an entity and holds a “disqualified interest” in the entity is subject to ordinary income tax on any income or gain received with respect to the interest. A “disqualified interest” is defined as convertible or contingent debt, an option, or any derivative instrument with respect to the entity (but does not include a partnership interest or stock in certain taxable corporations). This is an anti-abuse rule designed to prevent the avoidance of the proposal through the use of compensatory arrangements other than partnership interests.

The proposal is not intended to adversely impact qualification of a real estate investment trust owning a carried interest in a real estate partnership.

The proposal would be effective for taxable years beginning after December 31, 2010.

REQUIRE INFORMATION REPORTING FOR RENTAL PROPERTY EXPENSE PAYMENTS

Current Law

Generally, a taxpayer making payments in the course of a trade or business to a noncorporate recipient aggregating to \$600 or more for services or determinable gains in a calendar year is required to send an information return to the IRS setting forth the amount, as well as name and address of the recipient of the payment (generally on Form 1099). If the taxpayer making payments is not engaged in a trade or business, such information reporting is not required.

At present, there is limited third-party information reporting related to rental real estate expenses because only taxpayers whose rental real estate activity is considered a trade or business are required to report payments. Additionally, whether a taxpayer’s rental real estate activity should be considered a trade or business requires a case-by-case analysis that depends on the facts and circumstances of each taxpayer.

Reasons for Change

Information reporting requirements generally improve taxpayer compliance. Requiring information reporting by taxpayers receiving rental income and deducting expenses on rental activities would improve the reporting compliance by taxpayers providing services to those rental activities. In addition, increased third-party reporting of major rental expenses is likely to improve reporting compliance on rental real estate income.

Proposal

The proposal would, in general, subject recipients of rental income from real estate would, in general, be subject to the same information reporting requirements as are taxpayers engaging in a trade or business. In particular, rental income recipients making payments of \$600 or more to a service provider (such as a plumber, painter, or accountant) in the course of earning rental income would be required to send an information return, generally a Form 1099-MISC, to the IRS and to the service provider. Exceptions to the reporting requirement would be made for particularly burdensome situations, such as for taxpayers (including members of the military) who rent their principal residence on a temporary basis, or for those who receive only small amounts of rental income.

The proposal would be effective for tax years beginning after December 31, 2009.

ELIMINATE THE ADVANCED EARNED INCOME TAX CREDIT

Current Law

Under current law, low- and moderate-income individuals may be eligible for the refundable EITC. The amount of EITC an eligible individual may claim is a function of income and earnings, the number of children in the household, and filing status. In 2009, families with one child are eligible for a maximum EITC of \$3,043. Eligible individuals with more children receive a larger credit.

Since 1978, most eligible individuals have had the option of requesting advance payments of the EITC from their employers throughout the year. Self-employed and childless individuals are not eligible. Under current law, the advance payment is limited to 60 percent of the maximum credit to which a worker with

one child would be entitled. In 2009, the maximum advance payment is \$1,826.

Employers offset the costs of the advance payments by reducing their payments of withheld income and employment taxes. During the year, employers periodically notify the IRS of the aggregate amount of advance payments withheld from tax payments. After the tax year is over, the employer notifies the IRS of employees' receipts of advance payments. The information is also provided to the employees. Upon filing their tax returns, individuals must reconcile any advance payments received during the year with the amount of EITC for which they actually were eligible. If they received too little, they can obtain the remaining amount; conversely, if they received too much, they must repay the overpayment with their tax return. Individuals who have received an advance payment are required to file a tax return, even if their income is below the filing threshold. In view of the risk of overpayments, the advance payment is limited to 60 percent of the one-child maximum credit.

Reason for Change

The advance payment option provides a mechanism for individuals to receive payments on a timely basis, instead of as a single payment during the filing season. Advance payments could help cash-constrained households meet their daily needs. However, advance payments have been extremely unpopular among eligible taxpayers – at most, 3 percent of eligible individuals participate, and IRS' efforts to increase participation have not had a meaningful impact. Furthermore, recent research shows evidence of significant non-compliance by employers and workers. As a consequence, repealing the advance payment option would affect adversely few individuals who are eligible for this benefit.

Proposal

The proposal would repeal the advance payment option of the EITC. Workers would no longer be able to receive an advance against their expected EITC through their employer. (Individuals with positive tax liability would still be able to receive any non-refundable portion of the EITC during the year through adjustments in their withholding.)

The proposal would be effective for taxable years beginning after December 31, 2009.

UPPER-INCOME TAX PROVISIONS DEDICATED TO DEFICIT REDUCTION

REINSTATE THE 39.6-PERCENT RATE

Proposal

The Administration's tax receipts baseline would permanently extend the EGTRRA tax rates. This proposal would permit the EGTRRA reduction in the highest income tax rate to sunset after 2010. Thus, beginning in 2011, the highest income tax rate would be 39.6 percent. The taxable income levels at which this rate begins to apply would vary by filing status and would be indexed annually for inflation.

REINSTATE THE 36-PERCENT RATE FOR TAXPAYERS WITH INCOME OVER \$250,000 (MARRIED FILING A JOINT RETURN) AND \$200,000 (SINGLE)

Proposal

The Administration's tax receipts baseline would permanently extend the EGTRRA tax rates. This proposal would permit the EGTRRA reduction in the second highest income tax rate to sunset after 2010. Thus, beginning in 2011, the second highest tax rate would be 36 percent. The taxable income levels at which that rate begins to apply would vary by filing status and would be indexed annually for inflation. The 36-percent tax rate would apply to taxable income above the following amounts but less than the income levels at which the 39.6-percent rate would apply: \$250,000 less the standard deduction and two personal exemptions, indexed from 2009, for married taxpayers filing jointly; \$200,000 less the standard deduction and one personal exemption, indexed from 2009, for single filers. The 28-percent tax rate bracket would be expanded so that taxpayers earning less than these amounts would not see their taxes rise as a result of the increased tax rate brackets.

IMPOSE A 20-PERCENT RATE ON DIVIDENDS AND CAPITAL GAINS FOR TAXPAYERS WITH INCOME OVER \$250,000 (MARRIED FILING A JOINT RETURN) AND \$200,000 (SINGLE)

Proposal

The Administration's tax receipts baseline would permanently extend the zero- and 15-percent tax rates for dividends and capital gains. The zero- and 15-percent tax rates for capital gains and qualified dividends would be extended permanently for taxpayers with incomes up to \$250,000 for joint returns and \$200,000 for single taxpayers. The 20-percent tax rate on long-term capital gains and qualified dividends would apply for married taxpayers filing jointly with income over \$250,000 less the standard deduction and two personal exemptions (indexed from 2009) and for single taxpayers with income over \$200,000 less the standard deduction and one personal exemption (indexed from 2009). The reduced rates on gains on assets held over 5 years would be repealed.

This proposal is effective on the date of enactment for taxable years beginning after December 31, 2010.

IMPLEMENT UNEMPLOYMENT INSURANCE INTEGRITY LEGISLATION

Proposal

The proposal would increase resources for the recovery of State unemployment benefit overpayments and delinquent employer taxes. The proposal would allow States to redirect up to 5 percent of overpayment recoveries to additional enforcement activity. The proposal would require States to impose a penalty of at least 15 percent on recipients of fraudulent overpayments, and penalty revenue would be used exclusively for additional enforcement activity. The proposal would expand the ability to collect benefit overpayments due to a State from income tax refunds owed to a benefit recipient. The proposal would allow States to deposit up to 5 percent of moneys recovered in the course of an unemployment insurance tax investigation into a special fund dedicated to implementing the State Unemployment Tax Act (SUTA) Dumping Prevention Act of 2004 or enforcing State laws relating to employer fraud or tax evasion. The proposal would require employers to report a "start work date" to the National Directory of New Hires for all new hires.

The proposal would be effective upon the date of enactment.

REDUCE THE TAX GAP AND MAKE REFORMS

Expand Information Reporting

REQUIRE INFORMATION REPORTING FOR PRIVATE SEPARATE ACCOUNTS OF LIFE INSURANCE COMPANIES

Current Law

Earnings from direct investment in securities generally result in taxable income to the holder. In contrast, investments in comparable assets through a separate account of a life insurance company generally give rise to tax-free or tax-deferred income. This favorable tax treatment for investing through a life insurance company is not available if the policyholder has so much control over the investments in the separate account that the policyholder, rather than the insurance company, is treated as the owner of those investments.

Reasons for Change

In some cases, private separate accounts are being used to avoid tax that would be due if the assets were held directly. Better reporting of investments in private separate accounts will help the IRS to ensure that income is properly reported. Moreover, such reporting will enable the IRS to identify more easily which variable insurance contracts qualify as insurance contracts under current law and which contracts should be disregarded under the investor control doctrine.

Proposal

The proposal would require life insurance companies to report to the IRS, for each contract whose cash

value is partially or wholly invested in a private separate account for any portion of the taxable year, the policyholder's taxpayer identification number, the policy number, the amount of accumulated untaxed income, the total contract account value, and the portion of that value that was invested in one or more private separate accounts. For this purpose, a private separate account would be defined as any account with respect to which a related group of persons owned policies whose cash values, in the aggregate, represented at least 10 percent of the value of the separate account.

The proposal would be effective for taxable years beginning after December 31, 2010.

IMPLEMENT STANDARDS CLARIFYING WHEN EMPLOYEE LEASING COMPANIES CAN BE HELD LIABLE FOR THEIR CLIENTS' FEDERAL EMPLOYMENT TAXES

Current Law

Employers are required to withhold and pay Federal Insurance Contribution Act (FICA) and income taxes, and are required to pay Federal Unemployment Tax Act (FUTA) taxes (collectively "Federal employment taxes") with respect to wages paid to their employees. Liability for Federal employment taxes generally lies with the taxpayer that is determined to be the employer under a multi-factor common law test or under specific statutory provisions. For example, a third party that is not the common law employer can be a statutory employer if the third party has control over the payment of wages. In addition, certain designated agents are jointly and severally liable with their principals for employment taxes with respect to wages paid to the principals' employees. These designated agents prepare and file employment tax returns using their own name and employer identification number. In contrast, reporting agents (often referred to as payroll service providers) are generally not liable for the employment taxes reported on their clients' returns. Reporting agents prepare and file employment tax returns for their clients using the client's name and employer identification number.

Employee leasing is the practice of contracting with an outside business to handle certain administrative, personnel, and payroll matters for a taxpayer's employees. Employee leasing companies (often referred to as professional employer organizations) typically prepare and file employment tax returns for their clients using the leasing company's name and employer identification number, often taking the position that the leasing company is the statutory or common law employer of their clients' workers.

Reasons for Change

Under present law, there is often uncertainty as to whether the employee leasing company or its client is liable for unpaid Federal employment taxes arising with respect to wages paid to the client's workers. Thus, when an employee leasing company files employment tax returns using its own name and employer identification number, but fails to pay some or all of the taxes due, or when no returns are filed with respect to wages paid by a taxpayer that uses an employee leasing company, there can be uncertainty as to how the Federal employment taxes are assessed and collected.

Providing standards for when an employee leasing company and its clients will be held liable for Federal employment taxes will facilitate the assessment, payment and collection of those taxes and will preclude taxpayers who have control over withholding and payment of those taxes from denying liability when the taxes are not paid.

Proposal

The proposal would set forth standards for holding employee leasing companies jointly and severally liable with their clients for Federal employment taxes. The proposal would also provide standards for holding employee leasing companies solely liable for such taxes if they meet specified requirements. The provision would be effective for employment tax returns required to be filed with respect to wages paid after December 31, 2009.

EXPAND IRS ACCESS TO INFORMATION IN THE NATIONAL DIRECTORY OF NEW HIRES FOR TAX ADMINISTRATION PURPOSES

Current Law

The Office of Child Support Enforcement of the Department of Health and Human Services (HHS)

maintains the National Directory of New Hires (NDNH), which is a database that contains newly-hired employee data from Form W-4, quarterly wage data from State and Federal employment security agencies, and unemployment benefit data from State unemployment insurance agencies. The NDNH was created to help State child support enforcement agencies enforce obligations of parents across State lines. Under current provisions of the Social Security Act, the IRS may obtain data from the NDNH, but only for the purpose of administering the EITC and verifying employment reported on a tax return. Generally, the IRS obtains employment and unemployment data less frequently than quarterly, and there are significant internal costs of preparing these data for use. Under various State laws, the IRS may negotiate for access to employment and unemployment data directly from State agencies that maintain these data.

Reasons for Change

Employment data are useful to the IRS in administering a wide range of tax provisions beyond the EITC, including verifying taxpayer claims and identifying levy sources. Currently, the IRS may obtain employment and unemployment data on a State-by-State basis, which is a costly and time-consuming process. NDNH data are timely, uniformly compiled, and electronically accessible. Access to the NDNH would increase the productivity of the IRS by reducing the amount of IRS resources dedicated to obtaining and processing data without reducing the current levels of taxpayer privacy.

Proposal

The Social Security Act would be amended to expand IRS access to NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions.

The proposal would be effective upon enactment.

FACILITATE TAX COMPLIANCE WITH LOCAL JURISDICTIONS

Current Law

Although Federal tax returns and return information (FTI) generally are confidential, the IRS and Treasury Department may share FTI with States as well as certain local government entities that are treated as States for this purpose. Generally, the purpose of information sharing is to facilitate tax administration. Where sharing of FTI is authorized, reciprocal provisions generally authorize disclosure of information to the IRS by State and local governments. State and local governments that receive FTI must safeguard it according to prescribed protocols that require secure storage, restricted access, reports to IRS, and shredding or other proper disposal. See, e.g., IRS Publication 1075. Criminal and civil sanctions apply to unauthorized disclosure or inspection of FTI. Indian Tribal Governments (ITGs) are treated as States by the tax law for several purposes, such as certain charitable contributions, excise tax credits, and local tax deductions, but not for purposes of information sharing.

Reasons for Change

IRS and Treasury compliance activity, especially with respect to alcohol, tobacco and fuel excise taxes, may necessitate information sharing with ITGs. For example, the IRS may wish to confirm if a fuel supplier's claim to have delivered particular amounts to adjacent jurisdictions is consistent with that reported to the IRS. If not, the IRS in conjunction with the ITG, which would have responsibility for administering taxes imposed by the ITG, can take steps to ensure compliance with both Federal and ITG tax laws. Where the local government is treated as a State for information sharing purposes, IRS, Treasury, and local officials can support each other's efforts. Where the local government is not so treated, there is an impediment to compliance activity.

Proposal

ITGs that impose alcohol, tobacco, or fuel excise or income or wage taxes would be treated as States for purposes of information sharing to the extent necessary for ITG tax administration. An ITG that receives FTI would be required to safeguard it according to prescribed protocols. The criminal and civil sanctions would apply.

The proposal would be effective for disclosures made after enactment.

EXTENSION OF STATUTE OF LIMITATIONS WHERE STATE TAX ADJUSTMENT AFFECTS FEDERAL TAX LIABILITY

Current Law

In general, additional Federal tax liabilities in the form of tax, interest, penalties and additions to tax must be assessed by the IRS within three years after the date a return is filed. If an assessment is not made within the required time period, the additional liabilities generally cannot be assessed or collected at any future time. The Code contains exceptions to the general statute of limitations. In general, the statute of limitations with respect to claims for refund expires three years from the time the return was filed or two years from the time the tax was paid, whichever is later.

State and local authorities employ a variety of statutes of limitations for State and local tax assessments. Pursuant to agreement, the IRS and State and local revenue agencies exchange reports of adjustments made through examination so that corresponding adjustments can be made by each taxing authority. In addition, States provide the IRS with reports of potential discrepancies between State returns and Federal returns.

Reasons for Change

The general statute of limitations serves as a barrier to the effective use by the IRS of State and local tax adjustment reports when the reports are provided by the State or local revenue agency to the IRS with little time remaining for assessments to be made at the Federal level. Under the current statute of limitations framework, taxpayers may seek to extend the State statute of limitations or postpone agreement to State proposed adjustments until such time as the Federal statute of limitations expires in order to preclude assessment at the Federal level. In addition, it is not always the case that a taxpayer that files an amended State or local return reporting additional liabilities at the State or local level that also affect Federal tax liability will file an amended return at the Federal level.

Proposal

The proposal would create an additional exception to the general three-year statute of limitations for assessment of Federal tax liability resulting from adjustments to State or local tax liability. The statute of limitations would be extended the greater of: (1) one year from the date the taxpayer first files an amended tax return with the IRS reflecting adjustments to the State or local tax return; or (2) two years from the date the IRS first receives information from the State or local revenue agency under an information sharing agreement in place between the IRS and a State or local revenue agency. The statute of limitations would be extended only with respect to the increase in Federal tax attributable to the State or local tax adjustment. The statute of limitations would not be further extended if the taxpayer files additional amended returns for the same tax periods as the initial amended return or if the IRS receives additional information from the State or local revenue agency under an information sharing agreement. The statute of limitations on claims for refund would be extended correspondingly so that any overall increase

in tax assessed by the IRS as a result of the State or local examination report would take into account agreed-upon tax decreases or reductions attributable to a refund or credit.

The proposal would be effective for returns required to be filed after December 31, 2009.

Insurance Companies and Products

MODIFY RULES THAT APPLY TO SALES OF LIFE INSURANCE CONTRACTS

Current Law

The seller of a life insurance contract generally must report as taxable income the difference between the amount received from the buyer and the adjusted basis in the contract, unless the buyer is a viatical settlement provider and the insured person is terminally or chronically ill.

Under a transfer-for-value rule, the buyer of a previously-issued life insurance contract who subsequently

receives a death benefit generally is subject to tax on the difference between the death benefit received and the sum of the amount paid for the contract and premiums subsequently paid by the buyer. This rule does not apply if the buyer's basis is determined in whole or in part by reference to the seller's basis, nor does the rule apply if the buyer is the insured, a partner of the insured, a partnership in which the insured is a partner, or a corporation in which the insured is a shareholder or officer.

Persons engaged in a trade or business that make payments of premiums, compensations, remunerations, other fixed or determinable gains, profits and income, or certain other types of payments in the course of that trade or business to another person generally are required to report such payments of \$600 or more to the IRS. However, reporting may not be required in some circumstances involving the purchase of a life insurance contract.

Reasons for Change

Recent years have seen a significant increase in the number and size of life settlement transactions, wherein individuals sell previously-issued life insurance contracts to investors. Compliance is sometimes hampered by a lack of information reporting. In addition, the current law exceptions to the transfer-for-value rule may give investors the ability to structure a transaction to avoid paying tax on the profit when the insured person dies.

Proposal

The proposal would require a person or entity who purchases an interest in an existing life insurance contract with a death benefit equal to or exceeding \$1 million to report the purchase price, the buyer's and seller's taxpayer identification numbers (TINs), and the issuer and policy number to the IRS, to the insurance company that issued the policy, and to the seller.

The proposal also would modify the transfer-for-value rule to ensure that exceptions to that rule would not apply to buyers of policies. Upon the payment of any policy benefits to the buyer, the insurance company would be required to report the gross benefit payment, the buyer's TIN, and the insurance company's estimate of the buyer's basis to the IRS and to the payee.

The proposal would apply to sales or assignment of interests in life insurance policies and payments of death benefits for taxable years beginning after December 31, 2010.

APPENDIX: EXTENDING CURRENT POLICIES

Continue the 2001 and 2003 tax cuts. Most of the tax reductions enacted in 2001 and 2003 expire on December 31, 2010. The Administration's baseline projection of current policy continues all of these expiring provisions except for repeal of estate and generation-skipping transfer taxes. Estate and gift taxes are assumed to be extended at parameters in effect for calendar year 2009 (a top rate of 45 percent and an exemption amount of \$3.5 million).