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First Quarter 2012

Matters of Interest

Executive and Director Benefits and COLI

Legislative Proposals

President's 2013 Budget

In President Obama's 2012 State of the Union address, and later in his 2013 Budget, he proposed a number of changes in individual income tax law. The proposals are outlined in the Budget but remain to be fleshed out by legislative language. The proposed changes are summarized here:

Individual Tax Proposals

- Extend the reduced 4.2 percent Social Security payroll tax rate for individuals until end of 2012 (the reduced rate was extended by Congress and the President in February 2012)
- Households making over $1 million/year to pay a minimum effective tax rate of at least 30 percent
- Reduce value of itemized tax deductions for those families making over $250,000/year (married, filing jointly) to 28 percent
- Make permanent a tax credit that provides up to $10,000 for tuition over four years of college
- Extend Bush tax cuts for those families with incomes under $250,000 (married, filing jointly)

Outlook for Proposals/Meaning for 2013 Deferral Elections

Most professional prognosticators see almost no chance for any movement on tax proposals prior to the November Presidential election and many see little chance for any movement during the lame duck session of Congress after the elections. If the prognosticators are correct, this will mean that all Bush tax cuts will end December 31, 2012. If so, the value of deferred compensation for years 2013 and beyond will increase. This could be a significant factor in deferral elections to be made at the end of this year. We will, of course, be keeping close tabs on developments in this area.

The President's Framework for Business Tax Reform

On February 22, 2012, the White House and the Treasury Department jointly released The President's Framework for Business Tax Reform (the "President's Framework"). The President's Framework would reduce the corporate tax rate and eliminate dozens of tax expenditures and reform the business tax base with the intent of reducing distortions that hurt productivity and growth.

Specifically, the President's Framework would:

Reduce the Corporate Tax Rate from 35 Percent to 28 Percent. The reduction in the rate is intended to put the United States in line with other advanced countries and help encourage greater investment in the United States.

Eliminate Dozens of Business Tax Loopholes and Tax Expenditures. The President's Framework starts from a presumption that all tax expenditures for specific industries should be eliminated, with a few exceptions critical to broader growth or fairness. Examples of specific reductions in tax expenditures and loophole closers:

- **Eliminate "Last in First Out" Accounting.** The President's Framework would end LIFO accounting, bringing the Code in line with international standards and simplifying the tax system.
- **Eliminate Oil and Gas Tax Preferences.** The Code currently subsidizes oil and gas production through tax expenditures that provide preferences for these industries over others. The President's Framework would repeal tax preferences available for fossil fuels. This includes, for instance, repealing the expensing of intangible drilling costs and percentage depletion for oil and natural gas wells.
- **Reform Treatment of Insurance Industry and Products.** The President's Framework would not allow company interest deductions allowable to life insurance policies unless the contract is on a person who owns at least 20 percent of the business. Currently, no interest deductions are lost due to ownership of life insurance policies if the insureds are employees, officers, directors, or 20-percent or greater owners. The Framework would also make a number of other reforms to the treatment of insurance companies and products to improve information reporting, simplify tax treatment, and close loopholes.
- **Taxing Carried (Profits) Interests as Ordinary Income.** Currently, many hedge fund managers, private equity partners, and other managers in partnerships are able to pay a 15 percent capital gains rate on their labor income (on income that is known as "carried interest"). The President's Framework finds this loophole inappropriate as it permits these financial managers to pay a lower tax rate on their income than other workers. The President's Framework would eliminate the loophole for managers in investment services partnerships and tax carried interest at ordinary income rates.
- **Eliminate Special Depreciation Rules for Corporate Purchases of Aircraft.** This would eliminate the special depreciation rules that allow owners of non-commercial aircraft to depreciate their aircraft more quickly (over five years) than commercial aircraft (seven years).
- **Depreciation Schedules.** Current depreciation schedules generally overstate the true economic depreciation of assets. In an increasingly global economy, accelerated depreciation may be a less effective way to increase investment and job creation than reducing tax rates.

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- **Reducing the Bias Toward Debt Financing.** A lower corporate tax rate reduces but does not eliminate the bias toward debt financing. The President's Framework suggests reducing the deductibility of interest for corporations should be considered as part of any reform plan.
- **Improve Transparency and Reduce Accounting Gimmicks.** Corporate tax reform should increase transparency and reduce the gap between book income, reported to shareholders, and taxable income, reported to the IRS. These reforms could include better disclosure of annual corporate income tax payments.
- **Effectively Reduce the Top Corporate Tax Rate on Manufacturing Income to 25 Percent and to an Even Lower Rate for Income From Advanced Manufacturing Activities by Reforming the Domestic Production Activities Deduction.** The President's Framework would reform the current domestic production activities deduction. It would focus the deduction on manufacturing activity, expand the deduction to 10.7 percent, and increase it further for advanced manufacturing.
- **Expand, Simplify and Make Permanent the Research and Experimentation Tax Credit.** The President's Framework would increase the rate to 17 percent, which would make it more attractive and simplify tax filing for businesses. In addition, the credit would be made permanent to increase certainty and effectiveness.
- **Extend, Consolidate, and Enhance Key Tax Incentives to Encourage Investment in Clean Energy.** The President's Framework would make permanent the tax credit for the production of renewable electricity, in order to provide a strong, consistent incentive to encourage investments in renewable energy technologies like wind and solar.
- **Require Companies to Pay a Minimum Tax on Overseas Profits.** Under the President's Framework, income earned by subsidiaries of U.S. corporations operating abroad would be subject to a minimum rate of tax.
- **Remove Tax Deductions for Moving Productions Overseas and Provide New Incentives for Bringing Production Back to the United States.** The tax code currently allows companies moving operations overseas to deduct their moving expenses—and reduce their taxes in the United States as a result. The President's Framework proposes that companies will no longer be allowed to claim tax deductions for moving their operations abroad. At the same time, to help bring jobs home, the President is proposing to give a 20 percent income tax credit for the expenses of moving operations back into the United States.
- **Other Reforms to Reduce Incentives to Shift Income and Assets Overseas.** The Framework would revise the international tax code and reduce incentives and opportunities to shift income and assets overseas. For example, as noted above, U.S. companies may use accounting rules or aggressive transfer pricing to shift profit offshore. This is particularly true in the case of profits associated with intangible assets (assets like intellectual property). The Framework would strengthen the international tax rules by taxing currently the excess profits associated with shifting intangibles to low tax jurisdictions. In addition, under current law, U.S. businesses that borrow money and invest overseas can claim the interest they pay as a business expense and take an immediate deduction to reduce their U.S. taxes, even if they pay little or no U.S. taxes on their overseas investment. The Framework would eliminate this tax advantage by requiring that the deduction for the interest expense attributable to overseas investment be delayed until the related income is taxed in the United States.

Assessing the Impact of Low Interest Rates on Life Insurance Products

Generally speaking, interest rates have been on the decline for more than 30 years. Events of the financial crisis that began in 2008 contributed to this decline. They include:

1. The Federal Reserve responded to the crisis by suppressing interest rates in order to spur economic growth; and
2. Investor demand for the relative safety of fixed income investments like U.S. Treasury and high-quality corporate bonds has increased, driving prices up and yields down.

Interest rates have a direct impact on life insurers and the products they issue and manage. Companies generally make profits from the spread between what they earn on their general account portfolios and what they credit as interest on insurance policies. Policyowners are impacted as low interest rates result in lower investment returns credited to policies over time.

Historically low interest rates are likely to remain in the near term. On January 25, 2012, the Federal Reserve announced plans to keep short-term rates very low through 2014.

Email info@mben.com, to request the M Due Care Bulletin that examines the impact of a low interest rate environment on insurers, the performance and management of in-force products, and pricing of new products.

M Benefit Solutions®

M Financial Plaza
1125 NW Couch Street, Suite 900
Portland, OR 97209
503.238.1813
fax: 503.238.1815
www.mben.com