

# AMERICAN JOBS ACT OF 2011

September 15, 2011

Special Report

## HIGHLIGHTS

- Employee-Side Payroll Tax Cut
- Employer-Side Payroll Tax Cuts
- Tax Credits To Spur Hiring
- 100 Percent Bonus Depreciation
- Limits On Deductions For Higher Income Individuals
- Change In Taxation Of Carried Interest

## President Proposes \$447 Billion Jobs Package; Offsets Target Higher Incomes, Carried Interest

President Obama has challenged Congress to immediately pass the American Jobs Act of 2011 -- a \$447 billion jobs package, including payroll tax cuts and tax credits to encourage hiring, along with extended 100 percent bonus depreciation, which would be paid for by limiting deductions for higher income taxpayers and changing the taxation of carried interest. The offsets, however, would not take effect if the Joint Select Committee on Deficit Reduction achieves additional savings. President Obama described his jobs package during a speech to a Joint Session of Congress on September 8 and unveiled the legislative text on September 12.

The White House wants the American Jobs Act to move quickly through Congress. GOP leaders in the House have told the White House they will schedule hearings on the American Jobs Act as soon as possible. This Jobs Act contains much more than tax changes, although both the administration and its opponents are highlighting the tax aspects. One non-tax provision in particular, however, could hold up passage of the bill: a requirement that infrastructure projects use local prevailing wages (which are customarily union wages).

**COMMENT.** *The elimination of the revenue offsets if the Joint Select Committee on Deficit Reduction exceeds its deficit reduction target is an unusual carrot included to attract reluctant supporters of the proposal.*

**IMPACT.** *President Obama surprised many Washington observers by calling for not only an extension of the calendar year 2011 employee-side payroll tax cut but expanding it. Under the president's proposal, the employee-side payroll tax rate would drop from 4.2 percent for calendar year 2011 (down from 6.2 percent for calendar year 2010) to 3.1 percent for calendar year 2012. Employers that increase their payroll would similarly see their payroll tax rate reduced.*

**IMPACT.** *President Obama's proposal to pay for the payroll tax cuts and other incentives by limiting deductions and other benefits for higher income individuals should not come as a surprise. The president has previously proposed to limit deductions for higher income taxpayers (whom the White House generally defines for many purposes as individuals with incomes over \$200,000 and families with incomes over \$250,000).*

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## PAYROLL TAX CUTS

President Obama has proposed a number of changes to payroll taxes: a substantial employee-side payroll tax cut for calendar year 2012, as well as several generous payroll tax cuts for employers targeted to jobs growth.

### Employee-Side Payroll Tax Cut

For calendar year 2011, the employee-share of Social Security's Old Age, Survivors, and Disability Insurance (OASDI) taxes is 4.2 percent (down from 6.2 percent for calendar year 2010) up to the Social Security taxable wage base of \$106,800 for 2011. Under current law, the employee-share of OASDI taxes will revert to 6.2 percent for calendar

year 2012. Under the president's proposal, the employee-share of OASDI taxes would fall from 6.2 percent to 3.1 percent for calendar year 2012 (known as the "payroll tax holiday period").

The president's proposal includes similar payroll tax relief for self-employed individuals for calendar year 2012.

**IMPACT.** *Individuals in 2012 earning at or above the \$106,800 inflation-adjusted wage base would each receive a \$3,310.80 tax break based on the reduction in OASDI tax to 3.1 percent. The Social Security wage base was unchanged from 2010 to 2011 because of low inflation. Individuals earning at or above the 2011 OASDI cap of \$106,800 receive a \$2,136 tax benefit in 2011 and, therefore, would receive approximately \$1,175 on top of that amount in 2012. The Social Security wage base is expected to rise slightly in 2012, which would extend the full benefit of any employee-side payroll tax cut to more taxpayers.*

The legislative language calls for amounts equal to any reduction in OASDI revenues as the result of the payroll tax cuts to be transferred from the general fund to the Federal OASDI Trust Fund.

**COMMENT.** *There would be no change to Medicare withholding under the president's proposal.*

**COMMENT.** *The president's employee-side payroll tax cut places the GOP-controlled House in a quandary. Many GOP lawmakers have pledged not to raise taxes. Allowing the 2011 employee-side payroll tax rate cut to expire would effectively raise taxes.*

### Employer-Side Payroll Tax Cuts

President Obama has proposed to give businesses a similar payroll tax cut for wages paid up to \$5 million, as well as a full payroll tax holiday to reward any business that experiences growth in its payroll, driven by new hires, increased wages or both.

**First \$5 Million Wages Paid.** Under the president's proposal, the employer-share of OASDI taxes would fall from 6.2 percent to 3.1 percent on the first \$5 million in wages paid during the payroll tax holiday period. The reduced rate would apply to employees performing services in a trade or business and, in the case of a tax-exempt employer, employees performing services related to the exempt purpose or function. The rate cut would apply to qualified wages paid on and after January 1, 2012 and on or before December 31, 2012.

"The White House wants the American Jobs Act to move quickly through Congress. GOP leaders in the House have told the White House they will schedule hearings on the American Jobs Act as soon as possible."

**COMMENT.** *Federal, state and local government employers (other than state colleges and universities) would be ineligible for the reduced payroll tax credit as would wages paid to household employees.*

**Payroll Increase Credit.** President Obama also proposed giving qualified employers a 100 percent payroll tax credit (called a "payroll increase credit") in cases of payroll growth. The credit would be available for up to a designated maximum amount of an employer's payroll increase from the corresponding period of the prior year, whether driven by new hires, increased wages or both. Special rules would apply for new employers that do not have prior year payrolls.

Businesses that experience payroll tax growth in 2012 would be eligible for a full payroll tax holiday on the employer-share

of OASDI taxes up to \$50 million of wages paid above the level for calendar year 2011. This temporary tax credit of 6.2 percent for increased payroll would apply with respect to the period January 1, 2012 through December 31, 2012. Any amount claimed under the 3.1 percent employer's payroll holiday on wages of less than \$5 million would offset the credit.

Payroll growth for the October 1, 2011 through December 31, 2011 period over the same period in 2010, would also be rewarded. The credit of 6.2 percent of wage growth would also be allowed, but limited to \$12.5 million payroll growth rather than \$50 million.

**COMMENT.** *For employers with zero payroll for the corresponding period of either fourth quarter 2010 or the calendar year 2011, the payroll for those periods will be deemed to be 80 percent of the corresponding 2011 or 2012 period.*

**IMPACT.** *The IRS had a challenging time administering an employer-side payroll tax credit in the Hiring Incentives to Restore Employment (HIRE) Act of 2010. The president's proposal would be even more challenging in its administration. Employers will need to certify payroll growth, and the IRS will need to find ways to verify it.*

Federal, state and local government employers (other than state colleges and universities) would be ineligible for full payroll tax relief on account of payroll growth due to hiring, increased wages or both, as would employers of household employees.

**COMMENT.** *The 0.2 percent Federal Unemployment Tax Act (FUTA) surtax expired on June 30, 2011, after being routinely extended for many years. The American Jobs Act does not propose adding this 0.2 percent back to the existing 6.0 percent FUTA rate paid on the first \$7,000 of wages before any state unemployment tax credits are taken into account.*

## OTHER HIRING TAX CREDITS

President Obama has proposed a number of tax credits to encourage businesses to hire long-term unemployed individuals and military veterans. The proposals in the American Jobs Act build on the existing Work Opportunity Tax Credit (WOTC).

**COMMENT.** *The Work Opportunity Tax Credit (WOTC) is designed to encourage private sector businesses to hire individuals from targeted groups. Individuals in these groups have encountered barriers to employment.*

**Long-term unemployed.** Under the president's proposal, employers that hire individuals who are deemed long-term unemployed, defined as those who have been looking for work for more than six months, will be eligible for a tax credit. The president's proposal effectively expands the Work Opportunity Tax Credit (WOTC) to include a new target group: long-term unemployed individuals.

**IMPACT.** *A long-term unemployed individual is, under the president's proposal, an individual who was not a student for at least six months during the one-year period ending on the hiring date and who is certified by the designated local agency as having been unemployed during the one-year period ending on the hiring date for aggregate periods which equal or exceed six months. A student is an individual enrolled at least half-time in a program that leads to a degree, certificate, or other recognized educational credential for at least six months whether or not consecutive during the one-year period ending on the hiring date.*

**IMPACT.** *Generally, the credit for hiring a qualified long-term unemployed individual would reach \$4,000.*

Certain tax-exempt employers would also be eligible for a smaller credit for hiring long-term unemployed individuals. The president's proposal calls for simplified procedures for local agencies to designate individuals as long-term unemployed.

**COMMENT.** *During an online conversation on September 10, a senior White House advisor said that the Obama administration wants the tax credits for hiring to take effect immediately after enactment of the American Jobs Act.*

**Veterans.** The president's proposal would reward employers that hire unemployed veterans with two new tax credits (called the Returning Heroes Tax credits). Employers that hire unemployed veterans with service connected disabilities would be eligible for an enhanced tax credit (called the Wounded Warriors Tax Credit).

**IMPACT.** *Generally, qualified employers that hire veterans who have been unemployed for at least four weeks would be eligible for a credit of \$2,400. The credit would reach \$5,600 in cases of veterans who have been unemployed for at least six months. Employers that hire a disabled veteran unemployed for at least six months would be entitled to up to a \$9,600 credit (up from an existing \$4,800 maximum).*

## BONUS DEPRECIATION

President Obama has proposed to extend 100 percent bonus depreciation for one year, through 2012. Under current law, 100 percent bonus depreciation is scheduled to expire after 2011 (although cer-

tain long-lived property and transportation property under current law is eligible for 100 percent expensing if placed in service before January 1, 2013). Long-lived property would be entitled to 100 percent bonus depreciation through 2013 under the proposal.

**IMPACT.** *Under current law, 100 percent bonus depreciation is scheduled to fall to 50 percent bonus depreciation for 2012 and end after 2012.*

**COMMENT.** *Congress has repeatedly extended bonus depreciation along with enhanced Code Sec. 179 expensing in recent years in an effort to encourage business spending. President Obama did not propose to extend enhanced Code Sec. 179 expensing beyond its current sunset at the end of 2012. Bonus depreciation requires first-use of the property to begin with the taxpayer; while both new and used property qualify for Code Sec. 179 expensing. For 2010 and 2011, Code Sec. 179 expensing has been set at a \$500,000 maximum level with a phase-out starting at \$2 million of qualified property. It is scheduled to drop to a \$125,000/\$500,000 level in 2012 and return to a \$25,000/\$200,000 level (with inflation adjustments) starting in 2013. Special expensing for qualified real property, however, stops at the end of 2011 and is not extended under the American Jobs Act.*

## REVENUE ESTIMATES FOR AMERICAN JOBS ACT OF 2011

Cost of Selected Provisions	
Employee-Side Payroll Tax Cut	\$175 billion
Tax Credits For Hiring Long-Term Unemployed	\$8 billion
100 Percent Bonus Depreciation	\$5 billion
Revenues from Selected Provisions	
Limiting Itemized Deductions to 28 Percent	\$400 billion
Taxing Carried Interest as Ordinary Income	\$18 billion
Repeal of Oil and Gas Preferences	\$40 billion
Closing Corporate Jet Loophole	\$3 billion

**No other extenders.** Although job growth is closely linked with economic growth, the current jobs bill ignores several business/job growth provisions that will expire at the end of 2011 if not extended by Congress. The expiring provisions include: the 100 percent exclusion under Code Sec. 1202 of gain for small business stock acquired before 2012; the reduction in the S corp recognition period for built-in gain under Code Sec. 1374(d)(7); the 20 percent credit for excess qualified research expenses under Code Sec. 41(h)(1)(B); and a variety of energy-related incentives.

## TAX-EXEMPT BONDS

President Obama has proposed to extend the exemption from the alternative minimum tax (AMT) for interest on certain tax-exempt private activity bonds. This treatment was first enacted in 2009.

## GOVERNMENT WITHHOLDING

Three percent government withholding is scheduled to take effect after 2011. The withholding requirement, enacted in the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222), requires federal, state and local governments to withhold three percent of any payment made to government contractors. President Obama has proposed to delay the effective date of three percent government withholding until after 2013.

**COMMENT.** *Witnesses at a September 12, 2011, IRS hearing attacked the withholding provision and called for its repeal. The IRS had issued final and proposed regulations in May 2011 that contain some remedial measures to lessen the law's impact. The final regs pushed the law's effective date back to January 1, 2013, excluded payments under \$10,000 from withholding and exempted agencies from withholding if they made total payments of less than \$100 million for the year.*

## HIGHER INCOME TAXPAYERS

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (2010 Tax Relief Act) extended the full repeal of the limitation on itemized deductions and the personal exemption phaseout for higher income taxpayers through 2012. President Obama has proposed changing course starting in 2013 by effectively limiting the value of itemized deductions and certain other tax expenditures for higher income taxpayers to 28 percent. The president's proposal would apply to taxpayers liable for regular tax or alternative minimum tax (AMT), both for tax years beginning on or after January 1, 2013.

**IMPACT.** *No taxpayer with adjusted gross income (AGI) under \$250,000 in the case of a joint return; \$225,000 in the case of a head of household return; \$125,000 in the case of a married filing separately*

*return, or \$200,000 in all other cases, would be subject to this limitation.*

President Obama made a similar proposal in his FY 2012 budget. The new proposal is expanded to place a cap on a number of above-the-line deductions, such as contributions to a health savings account, tuition for higher education, and certain employee business expenses. In applying the income thresholds, a taxpayer's adjusted gross income would be increased for certain excluded items, such as tax-free interest on municipal bonds, and the foreign earned income exclusion.

The president did not, at this time, call for increasing individual income tax rates for higher income individuals and/or increasing capital gains/dividends tax rates for higher income individuals as he has repeatedly done in the past. Under current law, the reduced individual income tax rates and the reduced capital gains/dividends tax rates are scheduled to expire after 2012. The top two income tax rates, currently 33 percent and 35 percent, will automatically rise to 36 and 39.6 percent, respectively, starting January 1, 2013, if Congress does not act.

**IMPACT.** *The administration now estimates that this proposal would raise \$400 billion over 10 years. The FY 2012 budget proposal was estimated to raise \$321 billion over 10 years. Either way, a 28 percent cap on the level of itemized deductions would increase taxes significantly on higher income taxpayers.*

## SPECIAL OFFSET RULE

Under the president's proposal, the offsets in the American Jobs Act of 2011 would not take effect if the Joint Select Committee on Deficit Reduction exceeds its deficit reduction goal. Specifically, if the Joint Select Committee achieves an amount greater than \$1.65 trillion in deficit reduction, the revenue raisers in the American Jobs Act would not go into effect for any tax year.

The Joint Select Committee is charged with producing a deficit reduction bill for expedited passage by Congress before 2012. The 12-member committee is equally divided between Democrats and Republicans.

## CARRIED INTEREST

The president's proposal includes special rules for partners providing investment management services to partnerships. Under current law, these service partners treat their distributions from the partnership as capital gain, taxed at a rate of 15 percent. Under the president's proposal, this so-called carried interest would be taxed as ordinary income if it were paid for services, regardless of the character of

the income at the partnership level. Furthermore, the income would be subject to self-employment tax. However, income attributable to invested capital would not be recharacterized as ordinary income.

The administration estimates that this proposal would raise \$18 billion over 10 years.

**IMPACT.** *The president's proposal to change the taxation of carried interest is expected to face an uphill struggle. Previous attempts to change the taxation of carried interest have failed in Congress. Opponents claim that, as a result, fund operations will be moved offshore and this will further decrease U.S. tax revenues. To soften immediate resistance to the proposal, the changes would not be effective until tax years beginning after December 31, 2012.*

**COMMENT.** *In 2010, the House passed the American Jobs and Closing Tax Loopholes Act (H.R. 4213) which would have taxed carried interest at capital gain tax rates to the extent it reflects a return on invested capital. However, to the extent that carried interest did not reflect a return on invested capital, the measure would have required investment fund managers to treat 75 percent of the remaining carried interest as ordinary income (50 percent for tax years beginning before January 1, 2013). The Senate rejected the House's taxation of carried interest, and the 2010 Jobs Act ultimately passed Congress without any change in the taxation of carried interest.*

## OIL/GAS TAX INCENTIVES

President Obama has proposed a repeal of a number of tax incentives for oil and gas producers. These tax incentives include, but are not limited to, the deduction for tertiary injectants, percentage depletion for oil and gas wells, the Code Sec. 199 deduction with respect to oil, natural gas or primary products thereof, and the enhanced oil recovery credit.

**IMPACT.** *The American Jobs Act characterizes these provisions as subsidies. All oil and gas provisions carry effective dates beginning in 2013.*

## CORPORATE JETS

The president's proposal would require businesses to depreciate corporate jets over the same number of years as other aircraft. This treatment, according to the White House, is intended to close a loophole favoring corporate jets. The president's proposal accomplishes this objective first by raising the recovery period for general aviation aircraft to 12 years from 7 years, and then by redefining "general aviation aircraft" to include any airplane or helicopter not used in commercial or contract carrying of passengers or freight, but which primarily engages in the carrying of passengers.

**IMPACT.** *This provision would apply to tax years beginning after December 31, 2012. The provision is estimated to raise \$3 billion over 10 years.*

**COMMENT.** *Rather than being treated as aircraft that must be depreciated at the same rate as commercial airlines carrying passengers, corporate jets have been allowed more accelerated depreciation. Under current law the entire basis of a noncommercial airplane may qualify for bonus depreciation at the applicable 100 percent rate.*

## FOREIGN TAX CREDIT SAFEGUARDS

The president's proposal would seek to modify the foreign tax credit rules applicable to "dual capacity taxpayers." In situations in which a single payment is made to a foreign jurisdiction to serve as payment of a foreign tax and as a payment in return for an economic benefit, the proposal would treat as a creditable tax only that portion of a foreign levy that would be paid if the taxpayer were not a dual-capacity taxpayer.

**IMPACT.** *The administration notes that dual capacity taxpayer status may arise, for example, when a foreign country imposes a levy only on oil and gas income, or imposes a higher levy on oil and gas income as compared to other income.*

Aimed at foreign oil and gas operations, the proposal also would move the foreign tax credit limitation rules of Code Sec. 907 over into a separate category within Code Sec. 904 for foreign oil and gas income. This provision would yield to U.S. treaty obligations only when they explicitly allow for a credit for taxes paid or accrued on specific oil and gas income.