



PRESIDENT-ELECT OBAMA'S TAX PROPOSALS: A FORECAST

Special Report

HIGHLIGHTS:

- ✓ Higher Tax Rates at \$200,000/\$250,000-Plus Level
- ✓ Permanent AMT Patches
- ✓ Emergency Retirement Savings Relief
- ✓ Permanent Research Credit
- ✓ Corporate Loophole Closers
- ✓ Estate Tax \$3.5 Million Exemption
- ✓ More Incentives to "Go Green"

Inside

- Individuals 1
- Capital gains/dividends 2
- Retirement 2
- Business 3
- Energy 3
- Estate Tax 3
- Revenue Raisers 4

President-Elect Brings Ambitious Tax Policy Agenda To Washington

The campaigning is over and governing will begin under a new Administration and Congress in January. On January 20, 2009, Barack Obama will take the oath of office as the 44th president of the United States. For the first time in three years, the same party will control the White House and both Houses of Congress. During the campaign, President-elect Obama pledged to cut taxes for the middle class, raise taxes on higher-income individuals and protect retirement savings. The president-elect also appears to support a lower corporate rate so long as business tax "loopholes" are closed.

lawmakers have been lukewarm to the idea, preferring instead to invest in infrastructure to spur economic growth.

INDIVIDUALS

During the campaign, Obama promised a "middle class tax cut." "No family making less than \$250,000 will see their taxes increase," the president-elect frequently said. Conversely, families making more than \$250,000 and individuals making more than \$200,000 can expect a tax increase.

The president-elect's middle class tax cut appears to be two-prong. First, Obama will renew the 10, 15, 25, and 28 percent individual tax rates created by EGTRRA but set to sunset after 2010. However, the top two rates under EGTRRA (currently 33 percent and 35 percent, respectively) would revert to 36 percent and 39.6 percent respectively. Second, Obama has proposed a new refundable "Making Work Pay" tax credit to offset the first \$8,100 in payroll taxes for lower and middle-income taxpayers. This credit would apparently be capped at \$500 per wage earner.

The president-elect also proposed restoring the personal exemption phase-out (PEP) and itemized deduction limitation (Pease limitation) for individuals making over \$200,000 and families with incomes above \$250,000.

Impact. *Tax cuts cost money. The federal government's fiscal year (FY) 2008 budget deficit is \$454 billion and could approach \$1 trillion for FY 2009 without any of Obama's tax cuts. Lawmakers have two choices: increase taxes and user fees elsewhere to pay for new tax cuts or make significant spending reductions. Their decision is certain to spark furious debate in the new Congress as Obama and his Democratic allies work to make good on their campaign promises.*

Comment. *At the time this Briefing was prepared, it was unclear if Congress will return for a lame-duck session and if it will tackle a second stimulus bill. On the campaign trail, Obama indicated his support for a second round of economic stimulus payments, but*

Impact. *Taking into account restoration of PEP and the Pease limitation, the top marginal individual*

income tax rate would effectively be above 40 percent.

Comment. Avoiding tax increases on families making less than \$250,000 would apply to joint filers. The threshold for one-parent families (heads of household) is not spelled out but would presumably fall between \$200,000 and \$250,000. Obama's statements so far have also left unclear whether the cut-off amounts apply to wages, gross income, adjusted gross income, or taxable income.

Impact. An increase in the tax burden for higher-income individuals is now a given. The only questions that remain are "how much" and "when." Since odds are good that the "when" will take place retroactively to January 1, 2009, when enacted, 2008 year-end tax planning should consider the possibility of accelerating some income into 2008 and/or deferring some deductions until 2009.

Impact. Executives with deferred compensation packages should now also consider the impact of recognizing that income under a higher income tax rate structure; they will be taxed at the current rates rather than the rates in effect when the income was initially deferred.

INDIVIDUAL TAX RATES FORECAST

EGTRRA	Obama
10	10
15	15
25	25
28	28
33	36
35	39.6

Impact. Higher-income earners will likely pay more in payroll taxes, too. Obama has indicated his support for a payroll "surtax," possibly as high as four percent, on earnings above \$250,000. The OASDI wage base is already scheduled to rise to \$106,800 in 2009, from \$102,000 in 2008. The HI portion of Social Security taxes has no wage cap.

Comment. Obama also promised to eliminate taxes for senior citizens making less than \$50,000 a year.

AMT

The record-high federal budget deficit will likely prevent Obama and Congress from permanently repealing the alternative minimum tax (AMT). Instead, the president-elect has indicated his support for continuing and possibly making permanent the annual AMT "patch."

Reminder. The AMT patch for 2008, which was enacted only this October in the Emergency Economic Stabilization Act (P.L. 110-343) retroactive to January 1, 2008, sets the AMT exemption amount at \$69,950 for married couples filing jointly and surviving spouses, and \$34,975 for married couples filing separately.

Impact. If the pre-EGTRRA tax rates of 36 and 39.6 percent return in an Obama Administration, some higher-income taxpayers would no longer be within reach of the AMT because of their higher regular tax liability.

CAPITAL GAINS/DIVIDENDS

Higher-income individuals will likely pay more in capital gains and dividend taxes in an Obama Administration. The president-elect has proposed a 20 per-

cent capital gains and dividend tax rate for taxpayers in the top two income tax brackets, adjusted to affect only individuals making over \$200,000 and families making over \$250,000.

Reminder. For 2008 through 2010, qualified dividend income and capital gains tax rates are zero percent for taxpayers in the 10 and 15 percent tax brackets, and 15 percent for taxpayers in the higher tax brackets.

Impact. Many retirees continue to count on an income stream from dividends, making the extension of the capital gains rates to include dividends good news. For those in the higher brackets, and not yet retired, the rate changes add a new twist: whether to maximize retirement savings in tax-deferred accounts that are taxed as ordinary income when withdrawn or in taxable accounts in which capital gains and dividends are taxed at a lower rate.

The president-elect has also indicated his support for eliminating all capital gains taxes on investments in small and start-up firms but has not discussed the specifics of this proposal.

Comment. Under current law, taxable gain on the sale of "qualified small business" stock by an original investor is reduced 50 percent if the stock is held more than five years. A qualified small business can have assets as high as \$50 million. Another provision treats losses on the sale of S corporation stock as ordinary, instead of capital, losses, up to \$50,000 per taxpayer.

RETIREMENT

Nothing has caused more anxiety for Americans than to see their retirement

portfolios fall in the recent market crash. Obama has proposed relaxing the rules that strongly discourage early distributions from IRAs and other arrangements, possibly allowing distributions of 15 percent, up to \$10,000, from retirement accounts without penalty for 2008 and 2009. Coordination of this withdrawal benefit with current emergency withdrawal rules (for health needs, hardships and so on) must be hammered out.

The president-elect also indicated his support for temporarily suspending the required minimum distribution (RMD) rules for IRAs and other arrangements to help retirees retain a larger portion of their savings by not withdrawing funds at the bottom of the market.

Impact. *Accessing retirement savings for immediate needs, whether because of a job loss, higher mortgage costs or another crisis, is a dangerous tactic. If the funds are not replaced, they will not be there for retirement. If the withdrawals are to be considered a loan under any proposed law change, the failure to replace those amounts within five years will subject the taxpayer to income tax and penalties.*

Caution. *The deadline for 2008 RMDs is December 31, 2008 (April 1, 2009, for those who*

first turn 70 1/2 in 2008), leaving Congress little time to temporarily suspend the rules.

BUSINESSES

Businesses can likely expect a mixed bag of tax cuts under an Obama Administration. The president-elect has appeared to endorse lowering the U.S. corporate tax rate, currently the second highest in the industrialized world, as long as unspecified business tax “loopholes” are closed.

As a short-term stimulus, Obama would establish a \$3,000 refundable credit during 2009 and 2010 for each full-time employee added to the workforce by existing businesses. However, businesses that move jobs outside the U.S. could find some current tax benefits curtailed or eliminated. The president-elect has also indicated his support for extending the first-year expensing limitation of \$250,000 through 2009 and making the research and development (R&D) tax credit permanent.

Impact. *One way to curtail tax incentives for businesses that move jobs outside the U.S. would be to place new limits on the use of foreign tax credits. The Obama Administration has this route under consideration.*

Comment. *The Emergency Economic Stabilization Act (EESA) generally limits the deductibility*

of executive compensation for financial institutions participating in the rescue program. EESA's limits on executive compensation could foreshadow more expansive curbs on the deductibility of executive compensation and the tax treatment of deferred compensation. On the campaign trail, Obama called for closing “loopholes” in executive compensation but offered few details.

ENERGY

Tax incentives are very likely to play a large role in encouraging the development of alternative energy. Obama has endorsed expanding current tax breaks for producers of wind, solar, biomass, and other alternative energy sources. Another proposal would send emergency energy rebates to individuals to help pay for home heating costs.

Comment. *During the campaign, the president-elect expressed support for a windfall profits tax on oil companies. However, those remarks were made when gas prices skyrocketed to all-time highs. Nonetheless, a windfall profits tax could be an attractive way to raise revenue and fund new programs, such as emergency energy assistance for homeowners.*

MAJOR TAX LEGISLATION IN 2009? HISTORY SAYS “YES”

Recent history supports the likelihood that there will be a major tax bill in 2009. The Taxpayer Relief Act of 1997 (P.L. 105-34) and the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) (EGTRRA) bear out the prediction that major tax legislation often takes place in the first year after a presidential election.

Also, based on historical data, a first term tax law will not pass until May (or most likely late July). But generally such legislation is retroactive to January 1.

ESTATE TAX

Under EGTRRA, the estate tax exclusion is \$2 million for 2008 and \$3.5 million for 2009, with a maximum tax rate of 45 percent. EGTRRA repeals the estate tax entirely for 2010, but reinstates the estate tax in 2011 at pre-EGTRRA levels, with a \$1 million exclusion and a top rate of 55 percent. Obama has proposed to establish the exclusion at \$3.5 million per indi-

vidual (\$7 million per couple) with a top rate of 45 percent.

Impact. According to the president-elect, his proposal would effectively repeal the estate tax for 99.7 percent of estates and would reduce the number of taxable estates by 84 percent relative to 2000.

Comment. The total inflation rate from 2001 until 2008 is 20.55 percent. If an estate tax exclusion of \$1 million in 2001 were indexed for inflation, it would have been worth \$1,205,500 in 2008.

REVENUE RAISERS

Several of Obama's revenue raisers are recycled proposals from past years. Obama has indicated his support for codifying the economic substance doctrine and taxing carried interest as ordinary income. The president-elect has also discussed, with little detail, cracking down on offshore tax havens and broadening the corporate tax base.

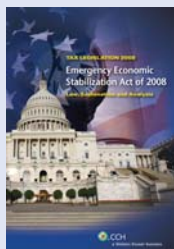
Comment. According to the Tax Policy Center, Obama's proposals would raise business-related taxes by a net \$770 billion over 10 years.

MORE PROPOSALS

The president-elect has discussed many other tax proposals, often without any elaboration. These include:

- Creating a new refundable mortgage interest tax credit;
- Enhancing and making refundable the child and dependent care tax credit;
- Expanding Earned Income Tax Credit;
- Creating a new healthcare credit for small businesses;
- New education tax credits; and
- Tax-free unemployment benefits for 2008 and maybe 2009.

Turn to CCH for recent legislation coverage.



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