Tax Proposals of the new Obama Administration*

The election of Barack Obama on Tuesday ended the longest campaign in history. During this time, Congress delayed addressing the impending expiration of the tax cuts passed by President Bush. Now that our new leadership is clear, Congress will have to take up these issues in 2009. Many of our clients have inquired about what it will mean for them personally and for their businesses. These are some of the topics we regularly address with our clients:

Personal Income Tax Rates

The highest personal income tax rates are currently 33% and 35%. The 33% bracket applies to families that earn over $195,851 per year. The 35% bracket applies to families that earn over $349,701 per year. Obama proposes raising the two highest tax brackets from 33% to 36% and from 35% to 39.6% respectively.

Estate Tax

In 2008, the personal exemption level is 2 million dollars per individual and is set to increase to 3.5 million dollars in 2009. Obama proposes keeping the personal exemption at 3.5 million dollars per individual and 7 million dollars per couple. Any additional amount above the exemption amount would be taxed at a rate 45%.

Dividends

The current rate on dividends is 15% and Obama proposes keeping this rate for families that earn less than $250,000. Obama proposes raising these rates to 20%-28% for families that earn over $250,000.

Capital-Gains

Families with incomes of less than $250,000 will continue to pay the current capital gains rate of 15% for long term holdings (holdings held longer than 1 year) and 25% for short term holdings. Obama proposes raising the long term rate to 20% for families that earn over $250,000.

Corporate Tax Rate

The corporate tax rate is currently 35%. Obama has proposed keeping the corporate income tax rate at 35% and closing the "loopholes" that allow companies to avoid the tax. For example, Obama has proposed taxing the international income of United States corporations. Currently, the U.S. tax code allows domestic companies to defer taxes on "unrepatriated income." Essentially, revenue that is earned by a company's foreign subsidiary goes untaxed by the Internal Revenue Service as long as it stays off of the U.S. books. Obama argues closing this loophole will increase revenue and prevent jobs from being transferred overseas. Many economists disagree with this proposition arguing that global technological advancement, increased openness of countries such as India and China, higher education of foreign workers in technological fields and reduced cost per foreign worker are the main reasons to transfer jobs overseas. Further, they argue that the United States corporate tax rate is higher than most of the world. This issue will be debated at length when the tax bill is in Congress.

Social Security

Currently, social security is only collected on earnings up to $102,000 per year. Obama proposes that social security tax continue to be imposed on earnings up to $102,000 per year, additionally earnings above $250,000 would be subject to social security tax as well.

What does this mean for me and my business?

The essence of President-elect Obama's proposals is that individuals who make less than $200,000 and families that make less than $250,000 will get a tax cut or pay the same in taxes. Individuals who make more than $200,000 and families that make more than $250,000 will pay more in taxes. There are certain structures that will be subject to additional taxation. For example, a C-corporation is subject to double taxation. This means that it is taxed on its earnings at the entity level and then taxed again when the earnings are distributed as dividends. Under the Obama proposals both rates may be increased. A C-corporation is a poor tax planning mechanism in most situations. If you currently have a C-corporation you should have your situation analyzed by a tax attorney.

The capital gains rate is going to go up. Over the past few years many people have advised IRC § 1031 exchanges and other techniques to defer taxation. At this point, if you have large amounts of capital gain you may want to pay the tax. The government has been running a tremendous deficit and there are additional expenditures planned so you may want to sell appreciated capital property and take advantage of the lower prices in the stock market.

All of these proposals will be subject to compromise in the political process. We will keep you informed of any developments. If you have any questions about the proposals you can contact us directly at peter@hausking.com.

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