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## Tax Planning – prepare for change

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On November 4, the nation voted in historic fashion to elect Barack Obama as our next President. Given President-elect Obama's tax-related promises during the course of his campaign, the need for tax planning in the coming months and over the next few years may be no less historic. The timing of major tax legislation will be somewhat in doubt until the current economic situation and President-elect Obama's strategy for governing come into sharper focus. In the interim, taxpayers should take advantage of the remaining time to engage in appropriate planning under present law, and to prepare for change in future tax law.

From an economic perspective, the current downturn may lead President-elect Obama's administration to delay a comprehensive tax program as it addresses other urgent matters. Alternatively, the administration could conclude that its vision of sound tax policy should be enacted promptly to support a long-term economic turnaround. Regardless of how this decision is made in the coming weeks, we believe three things will be true:

- First, some tax relief will be proposed early in the new administration, or even during "lame duck" sessions within the next few weeks, as part of economic recovery legislation. Hopefully this will include business incentives aimed at creating new jobs.
- Second, later in the year as Congress and the White House confront the need to extend a variety of expiring individual and business tax provisions, as well as another year of AMT relief, the ballooning deficit projections that have accompanied the current economic crisis and recovery efforts will make President-elect Obama and Democratic lawmakers much less sympathetic to pleas that these provisions be extended without offsetting tax increases.
- Third, by no later than January 1, 2011, and perhaps sometime during 2009 or 2010, President-elect Obama and the Democratic Congress are very likely to have succeeded in their desire to raise the effective tax rates on ordinary income, capital gains and dividends for the highest income individuals.

President-elect Obama's core tax plan follows the Democratic blueprint of increasing taxes on the wealthy to pay for tax cuts and other benefits for low- and middle-income taxpayers. For individuals, he has promised a return to tax policies more similar to those of the Clinton administration by:

- Making the tax cuts adopted in 2001 permanent for all but higher-income taxpayers;
- Restoring the Clinton-era top rates for individuals making more than \$200,000, and couples earning more than \$250,000;

- Adding an array of targeted tax relief provisions for middle-and lower-income individuals;
- Providing an estate tax exemption of \$3.5 million per person and an estate tax rate of up to 45 percent; and
- Raising taxes through eliminating “loopholes” and other largely unspecified special interest tax provisions.

Notably, President-elect Obama’s campaign did not focus extensively on business tax reform other than to identify targeted areas for raising revenue. He expressed support for lowering the top corporate tax rate from 35 percent to an as-yet unspecified rate, and offsetting the cost through specific revenue raisers and other unidentified “loophole” closers totaling an estimated \$76 billion per year.

Enclosed are brief summaries of President-elect Obama’s core tax proposals. Please contact your GBQ tax representative to discuss the potential impact on you and your business. The time to start planning is now.

#### Ordinary income tax rates

- Reinstate pre-2001 top individual tax rates of 39.6 and 36 percent for families making over \$250,000 (\$200,000 for singles).
- Make permanent certain Bush tax cuts, including \$1,000 child credit, marriage penalty relief, and 10, 15, 25, and 28 percent individual tax rates.
- Restore personal exemption phase-out and itemized deduction phase-outs at an increased threshold of \$250,000 for joint filers (\$200,000 for singles). Index threshold amounts for inflation.

#### Capital gains and qualified dividends

- Raise capital gains and qualified dividend rates to 20 percent for families earning more than \$250,000 (\$200,000 for singles).
- Eliminate capital gains taxes on “start-ups and small businesses” (as yet unidentified) to encourage innovation.

#### Individual alternative minimum tax

- Extend and index 2007 patch.

#### Social Security tax

- Retain existing Social Security tax on first \$102,000 of income (indexed for inflation). Exempt income from \$102,000 to \$250,000 then reinstate a 2-4 percent payroll tax (combined employee and employer) on income above \$250,000. According to President-elect Obama, this proposal would not take effect for at least 10 years, which would coincide with current projections of the timing of Social Security tax shortfall.

#### New individual tax cut proposals

- Eliminate all income taxes for seniors (age 65 and over) earning under \$50,000 a year.
- Create a refundable Making Work Pay Credit equal to 6.2 percent of up to \$8,100 in earnings for those making less than \$75,000 a year (maximum \$500 credit per spouse).
- Create a refundable 10 percent Universal Mortgage Credit for nonitemizers (up to a maximum of \$800).

- Replace existing Hope credit with a refundable American Opportunity Tax Credit, providing up to \$4,000 per year for qualifying higher education expenses.
- Expand the earned income tax credit program.
- Mandate automatic employee enrollment in 401(k) plans where employers offer retirement plans. Require employers that don't offer retirement plans to provide employees with access to automatic IRAs.
- Expand Savers Credit and make it refundable. For working families earning under \$75,000, government would match \$500 of first \$1,000 saved and deposit into account.
- Increase child care dependent maximum credit rate to 50 percent and increase phase-out threshold to \$30,000.
- Provide taxpayers who take the standard deduction prefilled tax forms to verify, sign, and return.

### Estate and gift tax

- Increase exemption level to \$3.5 million per person (\$7 million per couple) and increase top rate to 45 percent. Note that the exemption level is scheduled to increase to \$3.5 million in 2009 under current law. Also under current law, barring action in the interim, there would be no estate tax during 2010 and the exemption would revert back to \$1 million starting in 2011.

### Business tax incentives

- Make research tax credit permanent.
- Lower corporate tax rate for companies that expand or start operations in the U.S.

### Business-related revenue raisers

- Raise \$76 billion a year in largely unspecified revenue offsets.
- Eliminate oil and gas tax incentives.
- Require information reporting of securities transactions for purposes of determining taxpayers' gains.
- Codify the economic substance doctrine.
- Reform international tax rules, including modifying Subpart F deferral to "end-incentives for companies to ship jobs overseas" and closing the "offshore pension loophole."
- Establish an international "tax havens watch list" of countries that do not share information returns with the U.S.
- Tax publicly traded partnerships as C corporations.
- Tax carried interest as ordinary income.
- Close loopholes in "corporate tax deductibility of CEO pay."

## Economic recovery: President-elect Obama's temporary tax stimulus proposals

### Proposals affecting businesses

- Refundable tax credits for new hires—Create a New American Jobs Tax Credit, available in 2009 and 2010, for existing businesses that hire additional full-time employees in the U.S. (\$3,000 credit for each full-time employee).
- Section 179 expensing limit—Extend section 179 small business expensing limit of \$250,000 through December 31, 2009.

### Proposals affecting individuals

#### *Withdrawals from tax-preferred accounts*

- Allow penalty-free hardship withdrawals of 15 percent (up to \$10,000) from retirement accounts in 2008 and 2009; withdrawals would be subject to normal income taxes.

#### *Mandatory retirement account withdrawals*

- Temporarily suspend requirement that retirees over age 70 1/2 withdraw funds from tax-preferred accounts.
- Temporarily exempt from taxation withdrawals made by retirees over age 70 1/2 up to the required minimum amount.

#### *Taxation of unemployment benefits*

- Temporarily suspend taxes on unemployment insurance benefits.

#### *Accelerated tax cuts for workers, families, seniors*

- According to a summary provided by the Obama campaign, President-elect Obama would accelerate his already proposed "permanent tax cut of \$500 for workers and \$1,000 for families" by having the IRS mail out direct payments to taxpayers "based on tax returns already filed for tax year 2007." The summary also indicates that "Obama would extend these expedited tax credits to senior citizens who are retired as a down payment on his plan to eliminate taxes for all seniors making up to \$50,000."