

Historic Obama victory could mean higher taxes for some

13 NOVEMBER 2008

CATEGORY:
[ARTICLE](#)

President-elect Barack Obama campaigned on a platform of change, and for many high-income taxpayers that change will mean more than the pocket variety. On the campaign trail, Obama pledged to reverse the Bush tax cuts for the wealthy and end tax haven abuse. While Obama's plan is hardly a model of Marxist ideology, it is unabashedly a more progressive tax system that will shift a larger burden onto the nation's top earners.

Given the current economic climate, there is uncertainty over the time frame for the implementation of tax increases. Some commentators have suggested that such increases will be delayed until 2010 or until the economy has improved. However, others believe that tax increases could be considered within the first 100 days of Obama's presidency to offset the cost of tax cuts for the middle class.

The specifics of the Obama tax plan are not entirely clear; both candidates painted in broad strokes with respect to their proposals during the campaign. Discrepancies between promises made on the campaign trail and proposals in the platform drafted by advisors further muddy the waters. Of course, the Democratic-controlled Congress will play a significant role in determining which of Obama's proposals become reality, and compromise is inevitable in the legislative process. Despite these variables, it is possible to speculate about what changes could be in store during the Obama presidency.

Income tax

Obama consistently promised to raise taxes on individuals earning more than \$200,000 and married couples earning more than \$250,000 – the so-called 'top earners.' These increases would be coupled with reductions for a large number of lower-bracket taxpayers.

Obama has pledged a partial extension of the 2001 and 2003 Bush tax cuts, preserving the savings afforded middle-income Americans. However, taxpayers in the top two brackets would see their rates return to Clinton-era levels, with the 33 percent bracket increasing to 36 percent and the top bracket of 35 percent increasing to 39.6 percent. The other brackets would remain the same at 10, 15, 25 and 28 percent.

In addition to the rate increases, Obama has also proposed to restore certain phase-outs of personal exemptions and itemized deductions for top earners, further increasing the tax ultimately due.

Tax on capital gains and dividend income

Under current law, the tax rate for most capital gains (on assets held for more than 12 months) will increase from 15 to 20 percent beginning in 2011. In addition, 'qualified dividends' are set to lose their preferred tax treatment beginning in 2011 and become subject to ordinary income tax rates (currently as high as 35 percent but proposed to be 39.6 percent under Obama's plan).

Obama has proposed raising the top capital gains rate to 20 percent, but only for top earners. Individuals earning less than \$200,000 (or \$250,000 for married couples filing jointly) will continue to benefit from the 15 percent capital gains rate. The proposal would retain a preferred rate for qualified dividends, but would raise the rate on such dividends to 20 percent for top earners.

The proposal also calls for an elimination of capital gains tax for start-up companies and small businesses, but specifics of this proposal have not been given.

Estate and gift tax

The US estate tax system is currently in a state of flux. In 2009, up to \$3.5 million of assets will be exempt and the maximum estate tax rate will be 45 percent. A one-year repeal of the tax is scheduled for 2010. The estate tax is then set to return in 2011 with a top tax rate of 55 percent with the exemption amount reduced to \$1 million.

Obama has pledged to retain the estate tax, with some of his campaign officials labelling it 'The Paris Hilton Tax.' Under his proposal, the first \$3.5 million of an individual's estate would still be exempt from tax with the excess subject to estate tax at a rate of 45 percent. Obama's advisors have claimed that such a change will effectively repeal the estate tax for 99.7 percent of all estates.

Payroll tax

The payroll tax subsidizes programs such as Social Security and Medicare and is levied on employees and employers through the Federal Insurance Contributions Act (FICA) tax and the Self Employment (SE) tax. The FICA and SE taxes are comprised of two elements: the Old Age, Survivors and Disability Income (OASDI) program with a tax rate of 12.4 percent and the Medicare program with a tax rate of 2.9 percent. The OASDI portion is capped and does not apply to wages over \$102,000, but the Medicare portion applies to all wages.

Obama has been particularly vague with respect to his plans for the payroll tax, but he has acknowledged that he intends to increase the tax to help extend the solvency of the Social Security system. Obama has suggested a further tax of between 2 and 4 percent for top earners (divided between employer and employee under FICA). The mechanics of such a tax are not clear, but it appears that an individual's wages above \$200,000 would be subject to the 2 to 4 percent payroll tax.

Conclusion

In anticipation of these changes, some individuals are considering entering into transactions this year to take advantage of more favourable tax treatment. In the US, sports agents for athletes have already discussed breaking with usual practice and signing contracts before January and having a larger portion of the contract paid in a signing bonus to avoid ongoing income taxation.

Of course, much could be lost in the translation between campaign promises and final legislation, and the threat of a long recession will no doubt force Congress to weigh economic stimulus against certain tax priorities. However, Obama's insistence during the campaign that the top earners should shoulder

a larger tax burden is unlikely to wane significantly, particularly with favourable Democratic majorities in the House and Senate. It is unclear how soon Obama and the Congress will act on these proposals, but for individuals earning more than \$200,000, Obama's election is likely to fulfil at least one promise of change – higher taxes.