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FALL 2008

A Taxing Election: Analyzing the Tax Policies of a McCain versus an Obama Administration

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Among the many differences between Republican presidential nominee Senator John McCain and Democratic presidential nominee Senator Barack Obama is their federal tax policy. Here are several key facets of the candidates' respective tax plans that may impact you and your family.

Estate Tax

As it stands now, the federal estate tax exemption for 2008 is \$2 million, and the top rate is 45%, although it should be noted that transfers between spouses are generally tax-free. For 2009, the estate tax exemption will rise to \$3.5 million, with the top rate continuing at 45%.

Under the current law, the estate tax is repealed for persons dying in 2010, only to return again in 2011 with an exemption of \$1 million. It is almost certain however, that this legislation will be amended prior to 2010, in accordance with the next Administration's plan.

Senator McCain proposes raising the exemption to \$5 million and topping the rate at 15%. Senator Obama proposes a \$3.5 million exclusion and leaves the top rate at 45%.

Income Tax

Almost all of President Bush's 2001 and 2003 tax cuts are set to expire at the end of 2010. For 2008, the top federal rate of 35% generally applies to taxable income of more than \$357,700 and the second highest rate of 33% applies to taxable income above \$164,551 (filing single) or \$200,301 (filing jointly).

Senator McCain's proposal would make permanent all of the Bush income tax-related cuts, thus assuring that the 35% and 33% rates for the top two tax brackets remains intact. Senator Obama's proposal rolls back the Bush tax cuts and returns the top two ordinary income tax rates to 39.6% and 36%.

Capital Gains Tax

Currently, the top capital gains rate on stocks, bonds, mutual fund shares, and other securities held for over one year (long-term) generally is 15%. Senator Obama's proposal raises the long-term capital gains rate to approximately 25% or higher for families making more than \$250,000. For most investors, the same rate would apply to dividend income.

Senator McCain maintains that he will keep the current structure of tax rates on capital-gains and dividends, although a Democratic Congress may force him to

compromise on a capital gains rate increase.

Notwithstanding this certain increase in the capital gains tax rates, it is unlikely that an increase would occur until mid-2009.

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Social Security Tax

Under current law, the maximum amount of earnings subject to the Social Security payroll tax for 2008 is \$102,000. All employees pay a 6.2% tax on income up to this threshold. Senator Obama has called for an extension of the Social Security payroll tax on incomes above \$250,000 a year, although he would not apply the tax to annual incomes between \$102,000 and \$250,000.

Senator McCain does not plan to alter the \$102,000 earnings cap on the Social Security tax.

Alternative Minimum Tax

Currently, individuals must compute their federal taxes under both the regular tax and the alternative minimum tax (AMT) methods. In the event that the AMT exceeds the regular income tax, taxpayers must pay the AMT. Since 2001, the AMT "patch" has temporarily increased the exemption, allowing large numbers of taxpayers to avoid paying the tax. In 2007, the exemption was \$66,250 for joint returns and \$44,350 for singles and heads of households. For the 2008 tax year, the AMT exemption will revert to \$45,000 for couples and \$33,750 for singles and heads of household.

Senator McCain proposes to extend the 2007 AMT exemption amounts and allow individuals to claim personal non-refundable credits against the AMT. From 2009 to 2013, the AMT would be indexed for inflation. After 2013, the McCain proposal would increase the exemption by inflation plus 5%, until the joint exemption reaches \$143,000. Once this threshold is reached, the exemption rate will be indexed only for inflation.¹

Senator Obama also plans to extend the 2007 AMT exemption, indexing the exemption to inflation in future years. Senator Obama supports permanently allowing individuals to claim personal tax credits against the AMT.

Although these proposals are tentative and will be subject to changes by Congress, they are likely to be pushed hard by the next President at the beginning of his term, due to the sunset of the Bush tax cuts, among other economic and political factors.

NOTES

¹Senator McCain also has a tentative proposal allowing taxpayers to determine their taxes under an optional alternative tax system that would have two rates, a large standard deduction and an increased personal exemption.