CCH Tax Briefing:

TAX POLICIES OF THE PRESIDENTIAL CANDIDATES

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Highlights:

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Presidential Candidates Outline Tax Policies

As the U.S. prepares to elect its 44th president, tax and accounting professionals and their clients are looking for details about the tax policies of the candidates of the two major parties. This special CCH Briefing describes the tax policies of John McCain, the Republican Party candidate for president, and Barack Obama, the Democratic Party candidate, with analysis of the potential impact of their tax policies.

Planning tip. Although McCain and Obama have outlined their tax policies, they have left many of the details, especially how they would pay for new tax breaks, unspecified. While presidents recommend tax policy, Congress is the ultimate decision maker. Currently, Democrats control both the House and Senate; their majority in the Senate is just one vote. However, Democrats are expected to increase their numbers in the Senate, possibly by enough to prevent future filibusters of tax bills.

Whoever is elected on November 4 will likely unveil his tax policies soon after taking office so Congress can begin holding hearings and drafting legislation. Once Congress begins its work, practitioners and taxpayers can expect to see more details about changes in federal tax policy. The track record for newly-elected presidents to get a large tax bill passed during their first year in office is good. That makes 2008 year-end tax planning especially challenging and urgent since the door may close after this year on many current tax breaks.

Comment. Looming large over tax policy is increasing concern about the fragile state of America's financial institutions. Revenue that could fund more tax incentives may have to be diverted to help troubled financial institutions. The continuing housing crisis also worries many lawmakers, especially state and local governments that are seeing real property tax revenues plummet. Health care along with Social Security and Medicare funding will also be on the agenda of the next Administration.

Caution. *In the fluid dynamics of every political campaign, positions of the candidates may change. CCH has based this Tax Briefing on what it considers accurate, nonpartisan and unbiased information at the time of publication.*

INDIVIDUALS

McCain and Obama have put forward a large number of tax proposals impacting individuals. Many of their proposals are driven by the soon-to-expire tax cuts enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).

INDIVIDUAL INCOME TAX RATES

Before EGTRRA, the individual marginal tax rates were 15, 28, 31, 36 and 39.6 percent. EGTRRA and subsequent legislation gradually phased in lower rates, which for 2008 are 10, 15, 25, 28, 33, and 35 percent. EGTRRA also created the 10 percent rate, which subsequent legislation expanded and accelerated. Because of EGTRRA's sunset provision, the pre-EGTRRA rates are scheduled to return after 2010.

McCain

McCain has endorsed making all of the lower individual income tax rates in EGTRRA permanent.

Obama

Obama has proposed making the 10, 15, 25, and 28 percent rates permanent while restoring the pre-EGTRRA rates of 36 and 39.6 percent.

Impact. *Taxpayers in the top bracket saw the largest reduction on a percentage basis as a group. If the higher rates return, they will see the largest increase on a percentage basis. Of course, they also would benefit from the lower bracket reductions since the higher rates only affect the tax on their marginal income within those higher brackets.*

Impact. *When tax brackets are high, deductions are more valuable and vice versa. Taxpayers who find themselves in higher income tax rate brackets will, as a result, find that a closer look at maximizing all available deductions, credits or timing techniques is worth the time and expense.*

Comment. Obama has also proposed excluding individuals age 65 and older from federal income tax liability if they earn $50,000 or less along with creating a new "Making Work Pay" tax credit of up to $1,000 for lower and middle-income families ($500 for individuals) to offset federal payroll taxes.

PERSONAL EXEMPTIONS

Personal exemptions are allowed for the taxpayer, spouse and each qualifying dependent. The personal exemption amount for 2008 is $3,500.

Obama

Obama has not discussed increasing the personal exemption amount.

McCain

McCain has proposed increasing the dependent exemption (but not the personal exemption for the taxpayer and spouse) by $500 each year beginning in 2010 until it reaches $7,000 (in 2016), at which time it would be once again indexed for inflation.

PEASE LIMITATION ON ITEMIZED DEDUCTIONS AND PERSONAL EXEMPTION PHASE OUT

For 2008, single individuals begin to lose some of the value of certain itemized deductions when their adjusted gross income (AGI) exceeds $79,975 ($159,950 for married couples filing jointly). This is commonly referred to as the "Pease limitation," named after the member of Congress who first introduced the provision. Starting in 2008, taxpayers only lose one-third of the amount otherwise required under the phase-outs, down from two-thirds in 2006 and 2007.

McCain

McCain has proposed making all of EGTRRA's tax provisions permanent, including the phase-out of the Pease limitation.

Obama

Obama has proposed allowing the phase-out of the Pease limitation to sunset after 2010.

The deduction for personal and dependent exemptions may be reduced or eliminated for higher income individuals. EGTRRA gradually reduces the exemption phase out until it is completely eliminated for tax years beginning after 2009. However, because of EGTRRA's sunset rules, the exemption phase out would return after 2010.

McCain

McCain has endorsed making EGTRRA's elimination of the personal exemption phase out permanent.

Obama

Obama has proposed restoring the phase-out for personal exemptions.

Impact. *Higher-bracket taxpayers received a back-door tax cut in EGTRRA through the gradual elimination of the overall limitation on itemized deductions and the phase-out for personal exemptions. The limitation effectively reduces by 80 percent the value to high-income taxpayers of all itemized deductions other than for medical expenses, investment interest expenses, casualty or theft losses, or allowable wagering losses). Statistically, this is one reason why more higher-income taxpayers apparently took the standard deduction than middle-income individuals prior to the EGTRRA phase-out starting in 2006.*

MARRIAGE PENALTY

EGTRRA and subsequent legislation increased the standard deduction and tax rate brackets for married couples filing jointly to twice the amount applicable to single taxpayers to help close the so-called marriage penalty. Marriage penalty relief is scheduled to sunset after 2010.

Obama

Obama has indicated his support for making marriage penalty relief permanent.

McCain

McCain has endorsed making all of EGTRRA's tax cuts, including marriage penalty relief, permanent.

Comment. The marriage penalty reflects the disparity in tax liability between married couples and single individuals. Before EGTRRA, two single filers generally had a larger combined 15 and 28 percent tax brackets than their married counterparts, often resulting in a lower combined tax liability. Generally, married couples whose incomes are split about evenly would suffer a marriage penalty. Married couples whose incomes are largely attributable to one spouse may receive a marriage "bonus."

CHILD TAX CREDIT

The current $1,000 child tax credit was first increased by EGTRRA and then accelerated by subsequent legislation. The child tax credit, which is not indexed for inflation, will remain at $1,000 until EGTRRA sunsets after 2010.

McCain

McCain has supported making all of EGTRRA's tax incentives permanent, including the enhanced child tax credit.

Obama

Obama has indicated his support for making the $1,000 child tax credit permanent.

Comment. The child tax credit is refundable to the extent of 15 percent of the taxpayer's earned income in excess of $10,000 ($12,050 as adjusted for inflation for 2008). The House has approved legislation (H.R. 6049) to reduce this floor to $8,500.

CHILD AND DEPENDENT CARE CREDIT

The child and dependent care credit is a percentage of the amount of work-related child and dependent care expenses a qualifying taxpayer paid to a care provider. The credit can reach as high as 35 percent of qualifying expenses.

Possible Revenue Raisers

Both candidates have described possible revenue raisers:

Obama

Some of Obama's proposals for tax offsets include:

- Taxing "carried interest"—profits paid to compensate hedge-fund managers—as ordinary income
- Codifying the economic substance doctrine
- Requiring information reporting of basis for gains

McCain

Some of McCain's revenue raisers include:

- Corporate base broadening
- Reduction in certain business tax preferences
- Elimination of oil/gas "loopholes"

Obama

Obama has proposed making the child and dependent care credit refundable and enhancing it to reach as high as 50 percent of qualifying expenses.

McCain

McCain has not addressed the child and dependent care credit.

Impact. *The child and dependent care credit is currently not refundable. If the credit is made refundable when a taxpayer's credit amount is higher than his or her tax liability, the unused portion would be paid to the taxpayer.*

FEDERAL ESTATE TAX

EGTRRA gradually reduces the federal estate tax rates and totally repeals the federal estate tax for 2010. EGTRRA also gradually increases the exemption amount. After EGTRRA sunsets, the pre-EGTRRA tax rates and exemption amount ($1 million) return.

Comment. The top marginal estate tax rate is 45 percent for 2008 and 2009.

McCain

McCain has proposed a 15 percent federal estate tax rate and a $5 million exemption amount.

Obama

Obama has proposed a 45 percent federal estate tax rate and a $3.5 million exemption amount. It is unclear at this time whether the rates will be progressive and at what level the 45 percent rate would apply.

Impact. *The one-year repeal of the federal estate tax has made planning extremely difficult. However, it is very unlikely that Congress will let full repeal of the federal estate tax take place in 2010, making legislation on the estate tax likely in 2009. Lower tax rates and a higher exemption amount (compared to the pre-EGTRRA rate and exemption amounts) are expected to be enacted no matter who becomes the 44th president.*

Impact. *Neither candidate has addressed whether the stepped-up income tax basis of assets received from an estate will continue. Currently, estate beneficiaries receive a basis in property pegged to date of death value, thereby significantly reducing the capital gains realized should the beneficiary sell the asset. While rejected in the past, a carryover basis rule, in return* *for elimination of the estate tax on most estates by increasing the exemption amount, would provide offsetting revenues for other tax cuts that both candidates champion.*

HEALTH BENEFITS

A majority of Americans are covered by employer-provided health benefits. Code Sec. 106(a) generally excludes from an employee's gross income employer-provided coverage under an accident or health plan.

Obama

Obama would preserve the current income tax exclusion for employer-provided health benefits. Obama has also indicated his support for targeted health care tax credits, largely to help lower-income individuals and also for a small business health care tax credit to offset the cost of providing health benefits.

McCain

McCain has proposed treating employer-provided health benefits as taxable compensation to the employee for federal income tax purposes. McCain has also proposed creating a refundable tax credit of $5,000 for families and $2,500 for single individuals to offset the loss of the exclusion.

Impact. *Congress has been cool to the idea of scrapping the long-time exclusion for employer-provided health benefits. One idea with more widespread support is a refundable health coverage tax credit, such as the one created by the Trade Adjustment Assistance Act of 2002. It pays 65 percent of the health plan premium for eligible individuals enrolled in qualified health plans and is available on a monthly basis (to pay insurance costs as they come due) or on an annual basis (when individuals file their returns).*

ALTERNATIVE MINIMUM TAX

Nearly 40 years ago, Congress created the alternative minimum tax (AMT) to prevent a small number of very wealthy individuals from evading taxation. Today, largely because the AMT was not indexed for inflation, tens of millions of taxpayers are potentially liable for the tax. However, Congress has kept the AMT from encroaching on middle income taxpayers by enacting so-called "patches." The patches increase the AMT exemption amounts and allow taxpayers to use most nonrefundable personal credits to offset AMT liability.

McCain

McCain has endorsed higher AMT exemption amounts and allowing taxpayers to use most of the nonrefundable personal credits to offset AMT liability. McCain has also indicated his support for "phasing out" the AMT but has not provided details of how the federal government would pay for the loss of AMT revenues.

Obama

Obama has proposed extending the 2007 AMT patch and indexing the exemption amounts for inflation.

Impact. *According to the Treasury Department, the patch kept more than 20 million taxpayers from paying AMT in 2007.*

DIVIDENDS AND CAPITAL GAINS

Qualified dividend income and capital gains tax rates for 2008 through 2010 are zero percent for individuals in the 10 and 15 percent tax brackets, and 15 percent for individuals in the higher tax brackets. When the lower rates sunset in 2011, the capital gains tax rate will increase to 10 percent for taxpayers in the 15 percent tax bracket, and 20 percent for taxpayers in higher brackets, while qualified dividend income will lose its preferential tax treatment (and dividend income will once again be subject to ordinary income tax rates).

Reminder. Certain types of dividend income are specifically excluded from the rate cut, such as dividends paid from a corporation exempt from tax.

Obama

Obama has proposed increasing the maximum tax rate on capital gains to 20 percent. One variation on the proposal has the 20 percent rate increase applicable only to families with incomes of more than $250,000 ($200,000 for individuals).

McCain

McCain would maintain the current tax rates for both qualified dividends and long-term capital gains at five to 15 percent.

Impact. *Recent market events may change attitudes toward an increase in the capital gains rate, based on the fear that capital markets would become further depressed as a result of the prospect of investors keeping less of their profits. Elimination of the capital gains rate entirely, a proposal that had been seriously discussed only several years earlier, appears completely off the table for now.*

RETIREMENT SAVINGS

The Tax Code includes numerous tax incentives to encourage individuals to save for retirement. One of these incentives is the nonrefundable saver's credit. In addition, the Pension Protection Act of 2006 enhanced the ability of employers to provide automatic enrollment.

McCain

McCain has not addressed the saver's credit or automatic enrollment.

Obama

Obama has proposed expanding the saver's credit and making it refundable and has indicated his support for automatic enrollment in 401(k)s, IRAs and similar arrangements.

Impact. In spite of legislation that encourages Americans to save for retirement, savings continue to decline. According to the 2008 Retirement Confidence Survey, one-third of workers who have saved for retirement report having less than $25,000 in savings, excluding the value of their home and any defined benefit plans.

EDUCATION TAX INCENTIVES

Beginning in 2008, the maximum amount of the nonrefundable Hope scholarship credit is $1,800 (100 percent of the first $1,200 and 50 percent of the next $1,200) per eligible student for qualifying higher education expenses.

Obama

Obama has proposed making the Hope credit a 100 percent refundable credit for the first $4,000 of qualified higher education expenses.

McCain

McCain has not addressed education tax incentives.

EARNED INCOME TAX CREDIT

The Earned Income Tax Credit (EITC) is a refundable federal income tax credit targeted to lower-income taxpayers. When the EITC exceeds the amount of taxes owed, it generates a refund to those who claim and qualify for the credit.

McCain

McCain has not addressed the EITC.

Obama

Obama has proposed expanding the EITC to cover more families and children and boosting the phase-out threshold for married couples filing jointly.

MORTGAGE INTEREST

Interest paid on a home mortgage is tax deductible for taxpayers who itemize subject to certain thresholds. Non-itemizers cannot deduct mortgage interest.

Obama

Obama has proposed a new refundable universal mortgage credit, which would enable non-itemizers to claim a credit equal to 10 percent of their mortgage interest with a cap of $800.

McCain

McCain has not addressed the treatment of mortgage interest by non-itemizers.

SOCIAL SECURITY TAXES

Social Security is funded by payroll taxes. However, workers pay Social Security tax only on the first $102,000 of their annual incomes for 2008. (There is no wage cap for the Medicare tax.).

McCain

McCain has not addressed the Social Security payroll tax cap. He has discussed various alternatives for retirement savings, such as creating personal accounts for younger employees.

Obama

Obama has proposed a payroll tax of four percent (two percent each from employer and employee) on wage income of higher-income individuals (such as over $250,000).

BUSINESSES

Obama and McCain have also proposed corporate tax reform. Their proposals, among other things, would lower the U.S. corporate tax rate and make the research tax credit permanent.

CORPORATE TAX RATE

Currently, the U.S. has the second highest corporate income tax rate among industrialized nations. The current top corporate income tax rate is 35 percent.

Obama

Obama has proposed reducing the corporate tax rate and broadening the corporate income tax base.

McCain

McCain has proposed gradually lowering the corporate income tax rate from 35 percent to 25 percent, as well as broadening the corporate income tax base.

Impact. Many manufacturers believe that the 35 percent corporate tax rate puts the U.S. at a competitive disadvantage in the world marketplace. The U.S. rate is significantly higher than the corporate tax rates of many of the country's trading partners.

RESEARCH TAX CREDIT

Qualifying taxpayers may claim a tax credit of 20 percent for research and experimentation expenses above a certain base amount. The research tax credit is a nonrefundable credit. The research tax credit expired at the end of 2007.

McCain

McCain would expand the research tax credit and make it permanent.

Obama

Obama has indicated his support for making the research tax credit permanent.

SMALL BUSINESS EXPENSING AND DEPRECIATION

Congress has relied several times over the past few years on enhanced Code Sec. 179 small business expensing and accelerated depreciation to stimulate economic growth, most recently in the Economic Stimulus Act of 2008. Lawmakers are likely to continue these incentives in the future.

Obama

Obama has not addressed small business expensing and depreciation.

McCain

McCain has proposed an immediate, but temporary, first-year deduction of the full cost of 3- and 5-year business equipment purchased between 2009 and 2013, during the year in which the equipment is placed in service. McCain has also proposed eliminating the interest deduction for expensed equipment.

DOMESTIC PRODUCTION ACTIVITIES DEDUCTION

Code Sec. 199 allows a deduction for qualifying manufacturing activities. When fully phased in by 2010, the deduction will equal nine percent of the lesser of qualified production activities for the year or taxable income for the year.

McCain

McCain has endorsed repealing the Code Sec. 199 deduction.

Obama

Obama has indicated his support of repealing the Code Sec. 199 for oil and gas companies.

ENERGY

Congress has used the Tax Code several times in recent years to encourage consumers and businesses to make energy-efficient purchases and conserve energy. Many of the tax incentives, however, are temporary.

Obama

Obama has proposed expanding and extending renewable energy and conservation tax incentives and repealing tax incentives for oil and gas companies. Additionally, he has discussed energy rebates for individuals to help offset the cost of home heating.

> ***Impact.*** *Some popular energy-related tax breaks have already expired, such as the tax credit for energy efficient home improvements and tax credit for construction of new energy efficient homes and appliances.*

McCain

McCain has proposed an end to ethanol subsidies and has discussed a temporary federal gas tax holiday. In addition, McCain has also proposed a tax credit for buying zero emission cars.