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OBAMA'S PROPOSED 2013 BUDGET & THE TAXPAYER

How does the President want to modify tax rates?

March 2, 2012

The wealthiest taxpayers could be hit hard if the tax hikes in President Obama's 2013 federal budget proposal become law. The good news is that the tax changes outlined by the President in mid-February may be softened by eventual bipartisan compromise. As currently proposed, they would impact the wealthiest Americans on several fronts.

The Bush-era tax cuts could expire for the rich. As envisioned, the top tax rate would reset to 39.6% for individuals earning more than $200,000 a year and couples earning more than $250,000 a year. The EGTRRA/JGTRRA cuts would be extended for the vast majority of taxpayers.[1]

A new kind of AMT could emerge. President Obama would like to see a "Buffett rule", basically a simplified take on the Alternative Minimum Tax. This new rule (inspired by Warren Buffett's now-famous *New York Times* editorial) would impose a 30% income tax floor for anyone earning more than $1 million a year. Yet while President Obama has mentioned this idea in speeches, the proposed 2013 budget contains no details of it. The White House says that the President would prefer to get to the details after broader revisions to the tax code. Even then, a "Buffett rule" might be hard to implement in practice.[1,2]

Tax rates on capital gains & dividends would rise. Long-term capital gains would be taxed at 20% instead of 15%. Dividends amassed by businesses and taxpayers in the highest income tax bracket would be taxed as ordinary income, at 39.6%.[1]

Investment income could be reduced by a healthcare surtax. As a condition of the Health Care & Education Reconciliation Act of 2010, the highest-earning U.S. households would be hit with a new 3.8% Medicare tax on unearned income in 2013.[1]

This levy would only affect taxpayers who realize huge amounts of investment income; gains exceeding $250,000 for an individual or $500,000 for a married couple. (The Tax Foundation estimates it would affect 2% of U.S. households.) For these taxpayers, dividends would effectively be taxed at 43.4%. The tax would also apply to income derived from real estate investment.[1]

Deductions would be decreased. The President's 2013 budget would cap deductions of qualified expenses at 28% for those in the top two income brackets. Right now, these taxpayers can deduct 33% and 35% of qualified expenses. Non-profits, the real estate industry and state and local governments seem likely to disfavor the cap.[1]

Estate taxes would rise. In 2012, we have a 35% federal estate tax with a $5.12 million individual exemption. The proposed 2013 federal budget would put the estate tax at 45% with a $3.5 million individual exemption.[1]

Other tax proposals. The envisioned 2013 federal budget would also:

- Make the $2,500 American Opportunity Tax Credit permanent
- Make the R&E credit for businesses permanent
- Authorize gradual increases in estate and gift taxes and revise rules for taxing different forms of trusts
- Offer a tax credit to employers expanding payrolls in 2012 (of up to 10% of the increase in wages subject to payroll taxes)
- Carry the bonus depreciation extension (on new equipment) for businesses through 2012
- Hike taxes on global corporations headquartered in the U.S. across the next ten years through less lenient foreign tax credits and restrictions on opportunities to defer taxes on foreign profits
- Recoup costs from the 2008 Wall Street bailout through fees charged to financial institutions holding more than $50 billion in assets
- Cut assorted tax breaks for energy companies[3]

How much of this budget draft will make it through Congress? Good question. Much of what the President is proposing may not be realized, but with the federal government badly needing to reduce its deficit, many of these changes could end up taking effect. Taxpayers and their advisors will want to keep their eyes on Washington.

Citations.

1 - money.msn.com/tax-tips/post.aspx?post=4bb02697-fe82-4c9a-ad0f-a164f50ce7c8 [2/17/12]
2 - www.nytimes.com/2012/02/17/us/politics/white-house-sees-buffett-tax-rule-more-as-a-guide.html [2/17/12]
3 - www.kansascity.com/2012/02/13/3426281/obamas-proposed-tax-hikes-at-odds.html [2/13/12]