



Memo

To: MDE Clients & Friends
From: Oleg Ikhelson, JD, CPA – VP of Tax Planning
Date: October 20, 2008
Re: Presidential Candidates' Tax Policies

Presidential candidates *Senators John McCain* and *Barack Obama* have proposed differing tax and retirement plan measures to deal with the economic downturn. Still, whichever candidate is elected in November, there are likely to be big changes proposed to the tax code. The presidential candidates' proposed tax policies include changes to individual and business income taxes, the estate tax, and Social Security.

We have prepared a brief summary below that not only explains the candidates' tax policies, but also how they may affect you directly, and how they may define our financial and tax planning approach in 2009 and beyond. Of course, we are not about to rush into a drastic overhaul of our investment strategy and tax planning once the election results are known, since history teaches us that not everything that is said during election campaigns ultimately becomes law. However, we will actively stay abreast of any developments in the new administration, and evolve our existing strategies, or develop new strategies, to optimize our clients' wealth in the long run.

Individual Tax

McCain wants to make the Bush tax cuts permanent, including the lower marginal ordinary income tax rates, capital gains rates, and tax rates on dividend income. He also proposes gradually doubling the personal exemption amount to \$7,000. He would pay for these proposals by eliminating congressional earmarks and through cuts in government spending. He would extend and index the increased AMT exemption amounts, and has proposed an election for a separate and simplified alternative tax system.

In addition, *McCain* proposes increasing the amount of capital losses that can be used in 2008 and 2009 to offset ordinary income, from \$3,000 to \$15,000. Even more radically, he suggests cutting in half the maximum tax rate on long-term capital gains, from 15% to 7.5%, in 2009 and 2010. The latter move, if implemented, could become a centerpiece of our portfolio allocation strategies for the next two years.

McCain also proposed that the first \$50,000 withdrawn from individual retirement accounts and 401(k) plans by people over the age of 60 should be taxed at the lowest rate of 10% in 2008 and 2009. He also called for suspending the tax rules that require seniors to begin taking distributions from their IRA and 401(k) accounts when they reach age 70½.

Obama proposes a number of tax credits for families with incomes less than \$75,000 and a universal mortgage credit of 10%. He would extend the current marginal rates for the lower tax brackets and proposes to eliminate the federal income tax on seniors with incomes below \$50,000. To pay for these tax breaks, he proposes restoring the 36% and 39.6% tax brackets, raising the capital gains and dividend tax rate to 20% for families with incomes over \$250,000 and restoring the phase out for itemized deductions and exemptions.

Business Taxes

On the business side, both Obama and McCain seem to support reducing the corporate tax rate; *McCain* proposes a corporate tax rate of 25% to encourage investment in the United States. These tax reductions would be paid for with spending cuts or corporate loophole closers, identifying some of the tax breaks for oil and gas companies, and repealing the domestic production activities deduction.

Obama generally supports corporate tax reform and hints of corporate tax rate reductions for domestic business activity tied to repealing other business tax breaks and closing loopholes to pay for the rate reductions.

Estate Tax

Obama would preserve the estate tax as in effect in 2009: a 45% top tax rate and a \$3.5 million exemption. Currently, there is a \$2 million exemption for 2008; \$3.5 million for 2009; and no estate tax for 2010 when the current law sunsets and the estate tax system reverts back to what it was before 2001. Many practitioners have long believed that Congress will amend the new law before 2010, even before it became a contentious issue of the election debate.

McCain wants to preserve the estate tax with a 15% top tax rate and a \$5 million exemption. If this law takes effect, it would likely cause us to rethink our approach to lifetime estate planning, since there will be a much smaller incentive to engage in aggressive estate planning and a larger incentive to concentrate on the income tax aspect of wealth management.

Social Security

Obama would preserve the existing Social Security structure but help cover the growing deficit by imposing a payroll surtax of 4% (2% each from employer and employee) on incomes over \$250,000, in addition to the existing Social Security and Medicare tax of 7.65%.

McCain has proposed adopting personal accounts for younger employees, similar to proposals previously made by the Bush administration.

Looking Beyond November 4th

It remains to be seen to what extent those campaign promises outlined above will be implemented. Presuming the winner in the elections lives up to his proposed tax policies, our preliminary analysis suggests that your overall tax burden would decrease under McCain's administration. Conversely, if Senator Obama were to become President, most, if not all, of our clients will see increased tax bills. Also, McCain's tax policy is more predictable and thus would require the least amount of change. McCain's proposals are mostly based on the existing taxation system, upon which our long-term, strategic wealth management models are currently built. Under Senator Obama, we would likely have to rethink well-established income and estate tax minimization tools and go back to the planning approaches we utilized in the 1990s.

It has always been our intent to keep you up to date on the important developments that may affect your wealth and financial well-being. We have tried to go beyond pure theory and academics you hear and read in mass media to show you how the events may affect you personally. Even though we do not know what is going to happen in the immediate future, as always, we stand committed to look beyond the headlines and provide you with the proactive and creative financial and wealth management advice you have come to rely upon during these past years as *your family's most trusted advisor*.