

Financial Bulletin

Regulations and developments affecting the financial services industry March 23, 2009

The Obama budget includes a trillion dollars in tax increases for wealthy individuals and business owners

The administration is proposing to raise taxes on high-income taxpayers by almost a trillion dollars. The proposed tax increases were included in the budget blueprint unveiled by President Obama in February. The Obama budget follows through on his campaign pledge to roll back the Bush tax cuts for high-income taxpayers, but also includes a new proposal to limit itemized deductions for things like mortgage interest and charitable contributions.

These tax increases would be imposed on the individual level, but would also affect many businesses. Businesses like partnerships, limited liability companies and S corporations are structured as pass-through entities and are taxed at the individual level. The increases would all take effect at the same income level: \$200,000 for singles and \$250,000 for married couples.



The Obama package includes provisions to raise marginal tax rates on high-income taxpayers, increase how much they pay on capital gains and dividends, and reduce or eliminate their personal exemptions and deductions. The administration has pledged not to implement any of the proposals before 2011, but they would still raise an estimated \$954 billion over the next 10 years.

Obama's budget is only a blueprint for Congress. However, the president will remain a key driver of policy and will have significant influence over the legislative process. The changes in his budget for taxpayers with incomes over the president's high-income thresholds include:

- **Rate increase** – The budget proposes to return the top two marginal rates to their levels before the Bush 2001 tax cuts. The top two brackets would increase from their current 33% and 35% rates to 36% and 39.6% in 2011.
- **Capital gains and dividends** – Long-term capital gains and qualifying dividends would be taxed at 20% for taxpayers above Obama's high-income threshold, while the rate would remain at 15% for everyone else. This would be a slight improvement over the rules before the 2003 Bush tax cuts, when long-term capital gains were taxed at 20%, but dividends were taxed as ordinary income up to a top rate of 39.6%.

The Obama budget includes a trillion dollars in tax increases for wealthy individuals and business owners (continued)

- **PEP** – The Obama budget would reinstate the personal exemption phaseout (PEP) in 2011 so that the value of personal exemptions taxpayers receive for themselves, their spouses and children (\$3,650 each in 2009) would be reduced by 3% for all incomes above high-income threshold. The Bush tax cuts in 2001 gradually repealed PEP so it will be completely gone in 2010.
- **Pease** – Bush’s 2001 taxes cut also gradually repealed the so-called “Pease” phaseout of itemized deductions at high income levels. Obama proposes to reinstate Pease in 2011, which would limit most deductions by up to 80% for income over his high-income threshold. Deductions for a few items such as medical expenses and theft losses do not phase out under Pease.
- **Deduction rate limit** – Obama is also proposing a brand new additional limit on all itemized deductions. The value of a deduction depends on a person’s tax rate. Someone paying taxes in the 28% bracket would generally save \$28 in taxes for every \$100 in deductions, while a taxpayer in the 39.6% bracket would save \$39.60. Obama would limit the value of all deductions to a maximum of 28% so taxpayers in the 36% and 39.6% brackets would save less on deductions for things like mortgage interest and charitable gifts.
- **Estate tax** – The estate tax is scheduled to completely expire in 2010 before coming back in 2011 with an exemption of just \$1 million and a top rate of 55%. Obama proposes to permanently extend 2009 estate tax law with an exemption of \$3.5 million and a top rate of 45%. •



For more information

For more information about these proposed tax increases, contact Cynthia Keveney at 212.624.5495 or Cynthia.Keveney@gt.com. For additional information on the Financial Services practice at Grant Thornton LLP, please visit www.GrantThornton.com.

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