



# Washington Council Ernst & Young

## *Legislative Alert*

September 10, 2008

### *Comparing Tax Proposals of the Presidential Candidates*

The 2008 presidential election comes as the nation approaches fiscal and budgetary crossroads that will require a determination of whether the income tax policies of the past 8 years—for individuals, corporations, and investors—are retained or significantly changed.

The Bush administration and a Republican-led Congress enacted major tax cuts in 2001 and 2003 that will expire in 2010, forcing lawmakers to either extend the cuts or pursue a different course. Two major factors are likely to influence tax policy-makers in the coming debate: 1) a growing consensus to pursue a lower corporate rate, which is likely to be paired with the repeal of many corporate tax benefits; and 2) the looming entitlement crisis as the nation's baby boomers retire en masse, which will exacerbate the nation's need to collect more revenue or pursue major entitlement reform.

Further, the Alternative Minimum Tax's (AMT) creep into the middle class has given rise to a yearly exercise of temporarily increasing the AMT exemption amount, given that a permanent fix is extremely costly. Finally, high gas prices and heightened awareness about environmental concerns have put enormous pressure on lawmakers to develop new energy policies that encompass the extension and enhancement of incentives for renewable energy delivered through the tax code.

Although the technical details are sparse (and must be gleaned from campaign summaries and sporadic statements by the candidates), there are significant differences between the tax proposals advanced by the campaigns of Sens. Barack Obama (D-IL) and John McCain (R-AZ). In general, Sen. Obama has vowed to redistribute the benefits of the Bush tax cuts from higher-income Americans to the middle and lower classes and seems intent on broadening the corporate tax base, while all indications are that Sen. McCain would retain much of the current system.

Both candidates have offered general reform proposals. Sen. McCain seeks to install a 60-vote threshold for Senate approval of tax increases, and has proposed an optional alternative tax system with two rates and a standard deduction. Sen. Obama also seeks simplicity in the tax system, with plans to consolidate credits and provide taxpayers the option of pre-filled returns that would be verified and signed.

If, for federal budget purposes, it is assumed that the Bush tax cuts and the AMT patch will not expire, Sen. Obama's proposals would raise revenues by about \$600 billion between 2009 and 2018, while Sen. McCain's proposals would lose \$600 billion, according to an Aug. 28 analysis by the Tax Policy Center.

### **Corporate and other Business Tax Proposals**

Apart from proposals relating to oil companies (described below in the section dealing with energy), Sen. McCain has not focused on the area of international taxes. In contrast, although he has not adopted the anti-deferral stance that was supported by Sen. Hillary Rodham Clinton (D-NY), Sen. Obama has stated his intent to "end tax breaks for companies that send jobs overseas." In addition, according to campaign materials, his plan would "limit the ability of multinational corporations to use tax havens to hide income overseas" and codify the economic substance doctrine. Sen. Obama plans to create an International Tax Evasion Watch List to monitor offshore tax havens, use economic pressure to encourage those countries to share tax information, and penalize companies that report income from tax havens on the list.

Campaign materials also reference a Senate Permanent Subcommittee on Investigations finding that "offshore tax abuse" results in a \$100 billion revenue loss to the U.S. per year. Leaders of the Subcommittee have used the investigation to trumpet legislation, the Stop Tax Haven Abuse Act (S. 681), originally cosponsored by Sen. Obama, that would establish rebuttal procedural presumptions in the government's favor to combat tax strategies involving entities located or operating in an "offshore secrecy jurisdiction" (as defined by a statutory list).

The Obama campaign has said the candidate intends to use the money gained from the repeal of policies that benefit corporations that retain their earnings overseas to lower corporate tax rates for companies that begin or expand operations in the United States.

Sen. McCain's tax plan would gradually reduce the corporate tax rate from 35 percent to 25 percent. The rate would be lowered to 30 percent in fiscal year 2010, then to 28 percent in FY2012, 26 percent in FY2014, and 25 percent in FY2015 and thereafter. The McCain plan would also allow the expensing of 3- and 5-year equipment through 2013, but deny the interest deduction for money borrowed to purchase such equipment.

The McCain plan would also repeal the domestic production activities deduction, eliminate "corporate welfare" in the code, and repeal the last-in/first-out (LIFO) method of accounting.

In a patch of common ground, Sen. Obama would make the R&D credit permanent, while Sen. McCain would establish a permanent tax credit equal to 10 percent of wages spent on R&D.

## Tax Proposals Applicable to Individuals

### *Dividends, Capital Gain, and Other Income*

Sen. Obama proposes a 20 percent top rate for dividends and capital gains for a married couple with adjusted gross income (AGI) over \$250,000. The threshold for singles would be AGI of \$200,000. The current 15-percent rate would remain for those with income below those thresholds. Capital gains taxes would be eliminated for investments in small business start-ups, and “carried interest” would be taxed as ordinary income (instead of the current treatment as capital gain).

Under the Obama plan, the top two income tax rates would increase to 36 percent and 39.6 percent, as they were in the 1990s, and the 1990s levels for personal exemption and itemized deduction phase-outs (PEP and Pease) would be restored. The current rates of 28 percent, 25 percent, 15 percent, and 10 percent would remain. Sen. Obama has said that rescinding tax cuts for the wealthy could be delayed if he takes office during a recession. Income taxes would be eliminated for seniors earning less than \$50,000 per year. He would also extend the AMT patch and index it for inflation.

Sen. McCain plans to make permanent most of the 2001 and 2003 Bush tax cuts, including the income and investment tax rates. As for the AMT, Sen. McCain would index the AMT exemption amount for inflation through 2013, before increasing the amount for inflation plus 5 percent until the exemption reaches \$143,000. Sen. McCain would also double the personal exemption for dependents from the current \$3,500 to \$7,000, phased in fully by 2016; the exemption would increase to \$4,000 in FY2010, then increase \$500 in each subsequent year until reaching \$7,000 in FY2016. The \$7,000 exemption amount would take effect in 2010 for families with less than \$50,000 in annual income.

Internet access taxes and new cell phone service taxes would be banned under Sen. McCain’s plan.

### *New Tax Credits*

Sen. Obama plans a Making Work Pay tax credit of up to \$500 per person and \$1,000 per working family, as well as a 10-percent universal mortgage credit to homeowners who do not itemize. He also plans a refundable \$4,000 American Opportunity tax credit applicable to qualified college tuition expenses. Sen. Obama plans to expand the Earned Income Tax Credit (EITC) to increase eligibility, increase benefits available to noncustodial parents who fulfill child support obligations, increase benefits for families with three or more children, and reduce the EITC marriage penalty.

Sen. McCain’s plan includes a health-related tax proposal to provide a direct refundable tax credit of \$2,500 for individuals and \$5,000 for families to offset the cost of health insurance. Employer-based coverage would still be an option, although Sen. McCain further proposes to repeal the current income exclusion for employer-provided healthcare benefits.

An Obama administration would propose an estate tax rate of 45 percent with an exemption of \$7 million per couple—the regime currently scheduled for 2009, which some Democrats in Congress have rallied around as a palatable long-term policy. Sen. McCain would set the rate at 15 percent and the exemption at \$10 million per couple.

### **Energy Policy**

The energy plans of both Sens. McCain and Obama feature some proposals that would be implemented through the tax code, though most are non-tax provisions.

Sen. McCain seeks to “rationalize” the patchwork of temporary tax credits for renewable energy into an “even-handed” system of tax credits that would remain in place only until the market is strong enough to do without taxpayer dollars. Under a McCain administration, a \$300 million prize would be offered for the improvement of battery technology allowing for full commercial development of plug-in hybrid and fully electric automobiles, and a \$5,000 tax incentive would be provided for zero-emissions vehicles. Sen. McCain has also proposed a summer gas tax holiday.

The McCain plan also contemplates the following changes in the tax treatment of oil companies:

- expensing of exploration and development costs would be eliminated and replaced with regular depreciation;
- the 15 percent tax credit for enhanced oil recovery costs for tertiary wells would be eliminated;
- foreign tax credit rules and limitations regarding foreign oil and gas extraction income would be reformed to eliminate excessive use;
- the exception to uniform capitalization rules (allocation of costs to inventory) for intangible drilling costs with respect to oil and gas wells would be eliminated;
- special depreciable lifetimes for assets used in offshore drilling and domestic drilling (5-year depreciable life), exploration assets (7-year life), refining (10-year life), and pipeline transportation (15-year life) would be eliminated and regular depreciation lives would be applied;
- working interests in oil and gas would be subject to the passive loss rules; and
- the Bureau of Land Management would be encouraged to charge market royalty rates instead of the current minimum of 12.5 percent.

Sen. Obama’s energy plan would provide tax incentives for biofuels and establish a Renewable Portfolio Standard (RPS) to require that 10 percent of the electricity consumed in the U.S. be derived from clean, sustainable energy sources like solar and wind by 2012. Sen. Obama would also seek to invest \$150 billion over 10 years to promote the development of commercial scale renewable energy, make advancements in biofuels and fuel infrastructure, and transition to a new digital electricity grid. The Obama plan seeks to have one million plug-in electric vehicles on the road by 2015, in part through a \$7,000 tax credit for the purchase of advanced technology vehicles and conversion credits.

Emergency energy rebates of \$500 per individual and \$1,000 per married couple would also be provided under the Obama plan, paid for with funds redirected from a tax on windfall oil company profits. Sen. McCain explicitly opposes a windfall profit tax for oil companies, on the grounds that such a tax would increase the nation's dependence on foreign oil and hinder investment in domestic exploration.

### **Retirement Policy**

With regard to the future solvency of the Social Security system, Sen. Obama is considering a plan to, within 10 years, increase by 2 to 4 percent the current 12.4 percent Social Security payroll tax for those earning over \$250,000 annually. Sen. McCain does not support raising taxes to shore up the system, and instead supports supplementing the current Social Security system with personal accounts "but not as a substitute for addressing benefit promises that cannot be kept," according to campaign materials. In the area of retirement savings, Sen. Obama supports automatic enrollment and would make the Saver's Credit refundable and expand the credit to match 50 percent of the first \$1,000 in savings for a family earning under \$75,000 annually.

### **Party Platforms**

Naturally, many of the candidates' proposals overlap their respective parties' platforms. Many of Sen. Obama's tax proposals are included in the Democratic platform, including college tuition tax incentives, the capital gains exemption for small businesses, permanency of the R&D credit, and a vow to "end the tax breaks that ship jobs overseas." The platform also calls for tax reform, a tax increase on families earning over \$250,000 annually, and an immediate middle-class tax cut.

The Republican platform includes a critique of current budget policy that generally assumes tax relief will be temporary and fails to recognize the impact that lowering tax rates has on economic growth (i.e., static, rather than dynamic, scoring). The platform also includes McCain's proposals to double the exemption for dependents, permanently ban Internet access taxes and stop all new cell phone taxes, and provide taxpayers an optional two-rate system. The platform also advocates repealing the AMT, fighting the estate tax, and lowering the corporate tax rate.

Guiding principals for tax reform are laid out in the GOP platform, including an opposition to retroactive taxation, maintaining the tax exemption for religious organizations and charities, guarding "against the possibility of hypertaxation of the American people," and providing that any value-added tax or national sales tax must be tied to simultaneous repeal of the Sixteenth Amendment, which established the federal income tax. The platform also advocates a long-term energy tax credit equally applicable to all renewable power sources.

# *Major Tax Proposals of 2008 Presidential Candidates*

	<b>Sen. John McCain (R-AZ)</b>	<b>Sen. Barack Obama (D-IL)</b>
<b><i>Corporate Taxes</i></b>	<ul style="list-style-type: none"> <li>▪ gradually lower corporate tax rate from 35% to 25%</li> <li>▪ immediate expensing of 3- and 5-year equipment but disallow interest deduction for expensed equipment (from 2009 to 2013)</li> <li>▪ repeal domestic production activities deduction</li> <li>▪ repeal LIFO</li> </ul>	<ul style="list-style-type: none"> <li>▪ codify the economic substance doctrine</li> <li>▪ lower corporate tax rates for companies that begin or expand operations in the U.S.</li> <li>▪ broaden the corporate tax base</li> </ul>
<b><i>International</i></b>		<ul style="list-style-type: none"> <li>▪ limit the ability of large MNCs to use tax havens to hide income overseas</li> <li>▪ create International Tax Evasion Watch List, penalize companies that report income from tax havens on the list</li> <li>▪ reform deferral to deter corporations from keeping operations overseas</li> </ul>
<b><i>R&amp;D Credit</i></b>	<ul style="list-style-type: none"> <li>▪ permanent, equal to 10% of wages spent on</li> </ul>	<ul style="list-style-type: none"> <li>▪ permanent</li> </ul>

	<b>Sen. John McCain (R-AZ)</b>	<b>Sen. Barack Obama (D-IL)</b>
	R&D	
<b>Technology</b>	<ul style="list-style-type: none"> <li>▪ ban new cell phone service taxes</li> </ul>	<ul style="list-style-type: none"> <li>▪ tax incentives to encourage broadband deployment</li> </ul>
<b>Investment</b>	<ul style="list-style-type: none"> <li>▪ extend lowered rates on capital gains, dividends</li> </ul>	<ul style="list-style-type: none"> <li>▪ increase capital gains/dividend income rates to 20% for families with AGI over \$250,000; 15% rate for those under</li> <li>▪ tax “carried interest” at ordinary income rates instead of capital gains rates</li> </ul>
<b>Estate Tax</b>	<ul style="list-style-type: none"> <li>▪ 15-percent rate, \$10 million (per couple ) exemption</li> </ul>	<ul style="list-style-type: none"> <li>▪ 45-percent rate, \$7 million (per couple ) exemption</li> </ul>
<b>Individuals</b>	<ul style="list-style-type: none"> <li>▪ extend and index AMT patch to inflation, with temporary bump up to inflation-plus-5%</li> <li>▪ extend 2001, 2003 rate cuts</li> <li>▪ phase-in doubling of dependent exemption: \$4,000 in FY2010, \$500 increase in each subsequent year until \$7,000 in FY2016</li> <li>▪ dependent exemption doubled in</li> </ul>	<ul style="list-style-type: none"> <li>▪ extend and index AMT patch to inflation</li> <li>▪ increase top rates to 36%, 39.6%</li> <li>▪ eliminate capital gains taxation for investments in start-up small businesses</li> <li>▪ Making Work Pay tax credit of up to \$500 per person and \$1,000 per working family</li> <li>▪ 10-percent universal mortgage credit to homeowners who do not</li> </ul>

	<b>Sen. John McCain (R-AZ)</b>	<b>Sen. Barack Obama (D-IL)</b>
	FY2010 for families earning less than \$50,000 annually <ul style="list-style-type: none"> <li>▪ ban Internet access taxes</li> </ul>	itemize <ul style="list-style-type: none"> <li>▪ \$4,000 American Opportunity Tax Credit applicable to college tuition expenses</li> <li>▪ expand EITC</li> </ul>
<b>Energy</b>	<ul style="list-style-type: none"> <li>▪ rationalize system of temporary tax credits</li> <li>▪ \$5,000 tax incentive would be provided for zero-emissions vehicles</li> <li>▪ summer gas tax holiday</li> <li>▪ replace expensing of exploration and development costs with regular depreciation</li> <li>▪ eliminate 15 percent tax credit for enhanced oil recovery costs for tertiary wells</li> <li>▪ reform foreign tax credit rules and limitations regarding foreign oil and gas extraction income to eliminate excessive use</li> <li>▪ eliminate the exception to uniform capitalization rules for intangible</li> </ul>	<ul style="list-style-type: none"> <li>▪ energy rebates of \$500 per individual and \$1,000 per married couple</li> <li>▪ windfall profits tax for oil companies</li> <li>▪ \$7,000 tax credit for the purchase of advanced technology vehicles</li> <li>▪ tax incentives for biofuels</li> </ul>



	<b>Sen. John McCain (R-AZ)</b>	<b>Sen. Barack Obama (D-IL)</b>
	<p>drilling costs with respect to oil and gas wells</p> <ul style="list-style-type: none"> <li>▪ replace special depreciable lifetimes for assets used in offshore drilling and domestic drilling, exploration assets, refining, and pipeline transportation with regular depreciation lives</li> <li>▪ subject working interests in oil and gas to the passive loss rules</li> </ul>	
<b>Health</b>	<ul style="list-style-type: none"> <li>▪ direct refundable tax credit of \$2,500 for individuals and \$5,000 for families to offset the cost of health insurance</li> <li>▪ repeal income exclusion for employer-provided health care</li> </ul>	<ul style="list-style-type: none"> <li>▪ tax credits to subsidize health insurance</li> </ul>
<b>Retirement Policy</b>	<ul style="list-style-type: none"> <li>▪ supplementing Social Security system with personal accounts, but not as a substitute for addressing benefit promises</li> </ul>	<ul style="list-style-type: none"> <li>▪ possible 2 to 4 percent increase in Social Security payroll tax for those earning over \$250,000 annually</li> <li>▪ automatic enrollment in retirement plans, with one-</li> </ul>

	<b>Sen. John McCain (R-AZ)</b>	<b>Sen. Barack Obama (D-IL)</b>
		time government contribution of \$500-per- worker <ul style="list-style-type: none"> <li>▪ refundable                Saver's Credit,                expanded to                include                government                match 50                percent of the                first \$1,000 in                savings for a                family earning                under \$75,000                annually</li> </ul>
<b>Budget</b>	<ul style="list-style-type: none"> <li>▪ 60-vote                threshold for                Senate approval                of tax increases</li> </ul>	<ul style="list-style-type: none"> <li>▪ supports pay-                as-you-go                budget rules</li> </ul>

If you have questions, or need additional information, please feel free to contact anyone here at Washington Council Ernst & Young at (202) 293-7474.