



WHERE ARE TAXES HEADED AFTER THE ELECTION?

In short, they aren't going down for us or most of the people we know.

Now that the conventions have officially given us the candidates, it's a good time to look at what taxes might be like in the future. This article highlights some of the current differences between the McCain and Obama tax platforms as well as state and local taxes. Certainly, presidents, governors, and mayors don't pass tax bills and campaign promises don't always turn into law. Even so, here are some likely possibilities for the future.

"Get ready for higher capital gains taxes" - Wall Street Journal June 18, 2008. This is based on the likelihood that Democrats will increase their majority in Congress.



The current federal tax laws expire on December 31, 2010.

These "Bush Tax Cuts" brought us lower marginal rates (35% from 39.6%), lower capital gains rates (15% from 20%), lower dividend rates (15% from ordinary rates), while also reducing estate tax rates, and increasing lifetime estate tax exemptions among other provisions. Most retirement plan provisions of the "Bush Tax Cuts" were permanent but the others "sunset" or expire on 12/31/10. Under the "sunset provisions", in the absence of any new legislation, estate taxes would revert to their 2001 levels of a \$1 million lifetime exemption and a maximum rate of 55%. That said, there currently is no federal estate tax scheduled for 2010. McCain plans to raise the exemption to \$10 million per person with a 15% rate. Obama would raise the exemption to \$3.5 million with a 45% rate.

McCain would extend the "Bush Tax Cuts" while Obama would keep some and repeal others. Obama would not increase taxes on the middle class (perhaps \$200,000 or \$250,000 in annual income), but would increase the tax on top wage earners. Further, Obama would

propose capital gains rates and dividend income rates to increase to a range of 20% to 28%. McCain would repeal the AMT for everyone while Obama would protect the middle class from AMT. McCain would also double the personal exemption for dependents and provide tax-free accounts for health care and education. Obama would expand the earned income credit and propose a new college education credit and a low-income savers credit. Lastly, Obama would close the "carried interest" loophole.



For businesses, McCain proposes to reduce corporate taxes from 35% to 25%. Obama will crack down on offshore tax havens, and look for a windfall profits tax on oil companies. Both candidates would make the research and development tax credit permanent. In order to combat global warming, both will favor the cap-and-trade system. Both are also open to raising the social security cap on payroll.

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Following traditional politics, neither candidate addresses the tough questions. They speak of many promises, but never promise to pay for it. Let's face it: Our government's revenues are not meeting expenses. Social security and Medicare are broke. Federal deficits continue to grow. Entitlement program payouts will increase as baby boomers retire. The economy is slowing and consumption is waning. All the while, taxes are at all time lows. This equation is not balanced and something has to give.

Politically, it is always easier to tax the rich; hence, increased capital gains and dividend taxes are likely. A reversion of top tax rates to at least 39.6% are also likely. Furthermore, the estate tax will probably not be repealed, but new limits and rates will be established before 1/1/2010.

Federal taxes are only part of the story. What about state and local government finances? The Wall Street Journal reported on July 24, 2008: "States are Slammed by Tax Shortfalls". The article continued to state that "the stumbling U.S. economy is forcing states to slash

spending and cut jobs in order to close a projected \$40 billion shortfall in the current fiscal year."

States are receiving smaller sales tax collections due to decreased purchases. Personal income tax collections are down because of rising unemployment, and falling profits have reduced corporate income taxes. Unlike federal governments, most states are required to balance their budgets (no money printing on the state level). Most states have resisted tax increases so far, and are cutting back on services. Education, health care, and social services have all been hit hard.

As for the plummeting real estate market, it has reduced real estate transfer taxes in a big way. According to the Chicago Tribune on August 14, 2008, the city of Chicago's budget might be \$420 million in the red next year with the largest part of the shortfall caused by Chicago's bust in real estate. \$244 million was earned three years ago in revenues from real estate transfer taxes; but that number is down to \$155 million this year. On top of that, billions are needed to shore up the nation's bridges. USA

Today reported on July 25, 2008 that \$9.4 billion is needed over the next twenty years to eliminate all the bridge deficiencies in the United States. And that money is provided at a state level not the federal level. Lastly, many state and local governments have defined benefit pension programs, which are currently under funded. American taxpayers will be on the hook for billions of dollars just to provide these promised benefits.

In conclusion, we don't see the tax burden going down for our friends and clients. In particular, consideration should be given to getting portfolio rebalancing done now. The 15% federal capital gain tax is a bargain and will not last. Further, we think that Roth IRA conversions should be considered, especially for clients who intend to leave Roth accounts as part of their legacy for future generations.

If you have any questions about taxes for the future or their impact on your portfolio, please give us a call. We look forward to talking with you before and after Election Day.



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