

**Written Remarks for Presinomics:
Tax Plans of McCain and Obama
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Good evening, and thank you for inviting me. My task in the next few minutes is to characterize the tax proposals of the two presidential candidates. To prepare these remarks I have reviewed the tax-related proposals that appear in the candidates' policy plans as posted on their websites, and I have relied on analysis of the plans as prepared by the Tax Policy Center of the Urban Institute and Brookings Institution.

These documents can be found here:

McCain Plan: <<http://www.johnmccain.com/Images/Issues/JobsforAmerica/briefing.pdf>>.

Obama Plan: <<http://www.barackobama.com/pdf/ObamaBlueprintForChange.pdf>>.

Tax Policy Center analysis:

<http://www.taxpolicycenter.org/UploadedPDF/411749_updated_candidates.pdf>.

Background and Setting

Before launching into the two plans, it is important to understand the general context of the proposals. The federal tax law changes since 2001 have been numerous and arcane. It is unnecessary—and undesirable—to go through them in detail here. So I will focus on four of the most important features.

The graph on slide 1 illustrates some components of the background and the candidates' plans. The graph depicts the tax rates for the various income tax brackets. So, for example, the year 2000 rates start with a 15% tax rate for the lowest taxable income bracket, a 28% rate for the next highest taxable income bracket, and so on.

1. In 2001, a phased reduction in federal income tax rates began for most tax brackets, and a new lower 10% bracket was created for married couples. In 2003, the pace at which these rates were to fall was accelerated so that they reached their new levels earlier than planned under the 2001 legislation. Those lower rates are indicated in the graph as “2008 rates.”
2. In 2003, the tax rates on dividends and capital gains were also lowered in a two-step phase.
3. In both 2001 and 2003 the Alternative Minimum Tax, the parallel tax system meant to insure that high-income taxpayers pay some tax, was temporarily “patched” to prevent its application to an increasingly large number of taxpayers.
4. Finally, the 2001 legislation started a phased reduction of the estate tax rates and a phased increase in the exemption levels until the estate tax is repealed in 2010.

However, under existing law, ALL of these changes are only temporary and they will be reversed after 2010: The lower ordinary income tax rates and the dividend and capital gains rates go back to their

higher 2000 levels, the estate tax is resurrected in 2011 and the AMT exemptions are removed in 2008—making the number of taxpayer that face the AMT jump from about 3.5 million taxpayers last year to more than 26 million taxpayers this year.

These higher, already scheduled, rate increases are depicted in the graph as “2011 rates.”

Thus, the way that these laws were written means that there will be a large tax increase after 2010—and an 8-fold increase in the number of taxpayers subject to the AMT this year. All of this will occur unless Congress acts.

Candidate Plans

The two candidates' plans must be viewed in light of this rather dramatic background. The Tax Policy Center has analyzed the candidates' plans and presents its results relative to two baselines: First, against “current law” in which the tax policy “train wreck” just described occurs in 2011, and second against “current policy” (the Bush Administration's desired policy) that permanently extends the tax rate reductions and the AMT patch.

McCain would essentially adopt “current policy” and make the 2001/2003 tax rate cuts permanent. Obama would keep the 2001/2003 tax rate cuts except for those in the two highest brackets (that is, for a couple with more than \$200,000 of taxable income). Under the Obama plan, the two highest tax rates would be increased to their pre-2001 levels ahead of their currently-scheduled increase to those levels in 2011.

These proposed rates are indicated, respectively, in the graph as “McCain rates” and “Obama rates.”

Obama would also revise and offer new refundable income tax credits targeted at lower-income taxpayers. Refundable credits mean that if the value of the credit exceeds the tax liability, then the taxpayer receives a refund. These credits include:

1. Expanding and making refundable the child & dependent care credit.
2. Extending the Earned Income Tax Credit.
3. A new refundable credit on earnings up to \$8,100.
4. 10% home mortgage interest credit for non-itemizers.
5. Elimination of income tax for seniors making less than \$50,000.
6. A renaming and expansion of the Hope Credit for college tuition in exchange for 100 hours/year of community service.
7. Make refundable the saver's credit.

Both candidates would extend and index the 2007 AMT patch.

Both candidates would keep the estate tax

McCain would have a \$5m exemption and a 15% rate.

Obama would have a \$3.5m exemption and a 45% rate.

McCain would phase-in a reduction of the corporate tax rate from 35% to 25%.

These are the major features of the two candidates' plans. There are several other tax-related features. A few of the most interesting include:

McCain

- Reduce to 10% the tax on the first \$50,000 of withdrawals from IRAs and 401ks
- Exempt unemployment insurance from tax in 2008-2009 for those with less than \$100,000.
- Reduce tax on long-term capital gains to 7.5% in 2009 and 2010.
- Suspend rules requiring IRA distributions at age 70.5.

Obama

- Refundable credit of \$3,000 per employee for firms that increase in employment.
- Eliminate the taxation of unemployment insurance.
- Increase the capital gains rate to 20% for those earning more than \$200,000.
- Impose additional 2-4% Social Security tax for those with incomes greater than \$200,000.
- Impose a windfall profits tax on oil and gas companies.

A side-by-side comparison of the two plans is available from the Tax Policy Center here:

<http://taxpolicycenter.org/tpccontent/tax_plan_matrix_0908.pdf>.

Analysis of Tax Plans

As I mentioned, the Tax Policy Center, associated with the Urban Institute and the Brookings Institution has done some analysis of the plans. I have culled some of the results of that analysis under the two background scenarios: (1) Current law in which most of the 2001/2003 tax changes go back to their pre-2001 status in 2011, and (2) Current policy in which the 2001/2003 changes are made permanent and the AMT patch is extended.

The table on the second slide compares the two plans in 2012 against these two background scenarios: current law (tax changes revert to 2000 levels in 2011) and current policy (tax changes are made permanent). The table shows the effects on different cash-income groups by three measures: the change in after-tax income, the change in average income tax paid, and the change in the average federal tax rate.

Columns 2 and 3 indicate that under the McCain plan the highest income groups receive the largest increases in after-tax income, with the highest increases going to the top 1 percent or top one-one thousandth. Conversely, under the Obama plan, columns 4 and 5 show that lower income groups see larger percentage increases in after tax income and the higher income groups face reductions in after-tax income. Because there will be a large tax increase in 2011 under current law, McCain's plan shows larger savings to high-income groups compared to what would happen under current policy. Symmetrically, under Obama's plan, higher income groups see larger reductions in after-tax income compared to current policy (that is, permanent extensions of the 2001/2003 tax cuts) than under current law.

Columns 6 and 7 show that under the McCain plan all quintiles receive a tax reduction, with the largest tax cuts (in dollars) going to the highest income groups. In contrast, under Obama's plan while most income groups receive tax reductions, the highest income groups will see tax increases. Under current law, the Obama tax increases affect the top 1 percent, while under current policy the Obama plan implies that the top 10 percent of income earners would face tax increases.

Finally, columns 10 through 13 summarize the effects on the average federal tax rates in

percentage points. Under either current law or current policy, the McCain plan implies tax rate reductions for all groups, with the largest percentage point reductions for the highest income groups. Conversely, the Obama plan has the largest tax rate reductions going to lower income groups, with the highest income groups facing average tax rate increases.

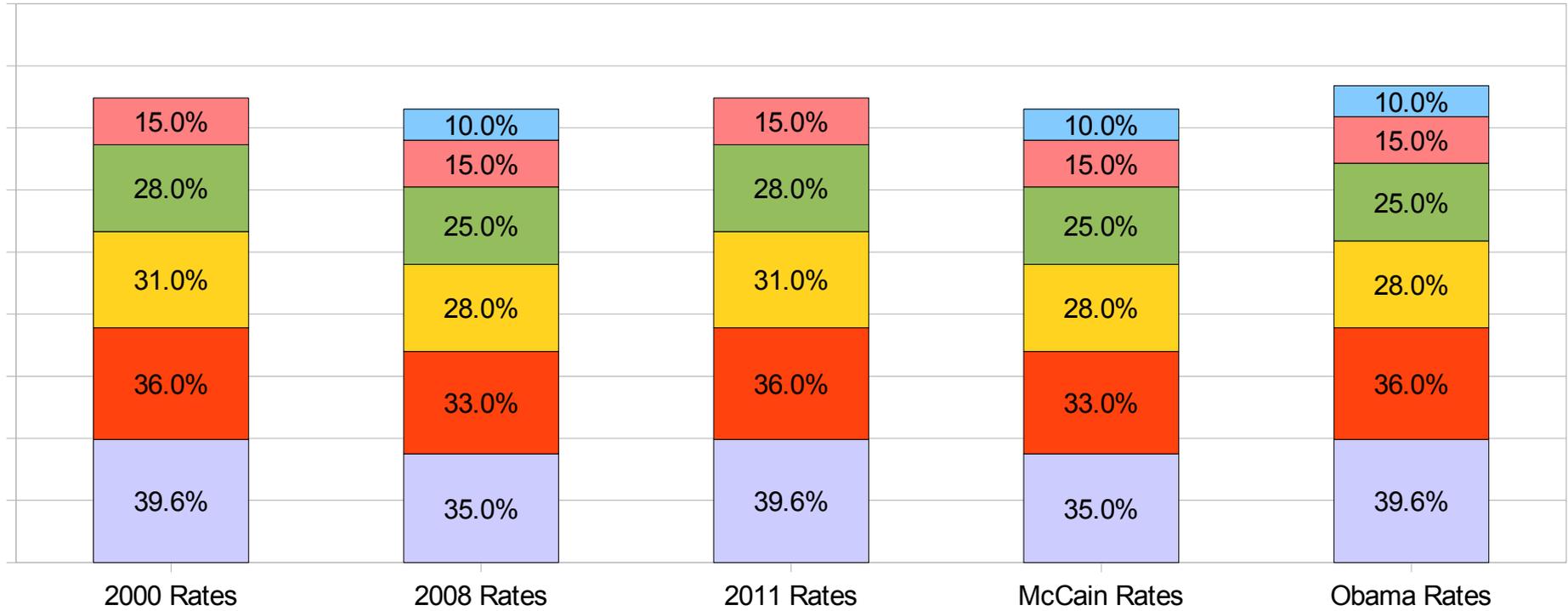
The bottom portion of this table reports the estimates on tax revenue—and, hence, the budget deficit—of the two plans against the two background scenarios. In general, the McCain plan has a larger negative effect on tax revenue than the Obama plan. Against current law (that is, the train wreck in 2011), the McCain plan will bring in about \$1.5T less over 4 years, while the Obama plan brings in just under \$1T less. Over 8 years, under current law, the McCain plan lowers revenue by more than \$4T while the Obama plan costs just under \$3T. Against current policy (that is, making the 2001-03 tax cuts permanent and extending the AMT patch) the McCain plan lowers revenue by \$330B over 4 years and by \$596B over 8 years. In contrast, the Obama plan against current policy increases tax revenue over 4 years by about \$180B and by about \$627B over 8 years.

Because this is crystal clear, I'm sure there are no questions.

Thank you.

Background and Candidate Tax Plans

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Background: Elements of Current Law

- 2001-03: Reduction in income tax rates from 2000
- 2003: Lower capital gains & dividends rates
- Alternative Minimum Tax “patch”
- Phased reduction/elimination of estate tax

By 2011 ALL of these features reversed back to 2000 status.

Candidate Plans (Partial List)

- ♦McCain adopts “current policy,” making 2001-03 tax cuts permanent.
- ♦Obama keeps the 4 lowest rates and accelerates scheduled increase of 2 highest rates.
- ♦McCain lowers corporate income tax rate
- ♦Obama provides several refundable tax credits directed at lower-income groups.
- ♦Both candidates extend and index AMT patch.
- ♦Both candidates keep the estate tax:
 - McCain: \$5m exemption, 15% rate
 - Obama: \$3.5m exemption, 45% rate

Sources: McCain Plan: <<http://www.johnmccain.com/Images/Issues/JobforAmerica/briefing.pdf>>.

Obama Plan: <<http://www.barackobama.com/pdf/ObamaBlueprintForChange.pdf>>.

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Tax Policy Center Analysis of Presidential Candidate Tax Plans

| Cash-Income Percentile | Percent Change in After-Tax Income | | | | Average Federal Tax Change (\$) | | | | Change in Average Federal Tax Rate (% points) | | | |
|---|------------------------------------|----------------|--------------------|----------------|---------------------------------|----------------|-----------------------|----------------|---|----------------|-------------|----------------|
| | McCain | | Obama | | McCain | | Obama | | McCain | | Obama | |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 |
| | Current Law | Current Policy | Current Law | Current Policy | Current Law | Current Policy | Current Law | Current Policy | Current Law | Current Policy | Current Law | Current Policy |
| Lowest quintile | 0.9 | 0.2 | 6.2 | 5.4 | -101 | -21 | -698 | -617 | -0.8 | -0.2 | -5.8 | -5.2 |
| Second quintile | 2.8 | 0.5 | 5.9 | 3.4 | -763 | -124 | -1,589 | -950 | -2.5 | -0.4 | -5.1 | -3.1 |
| Middle quintile | 3.1 | 0.6 | 4.7 | 2.2 | -1,441 | -282 | -2,197 | -1,035 | -2.5 | -0.5 | -3.8 | -1.8 |
| Fourth quintile | 4.1 | 0.7 | 4.4 | 1.0 | -3,110 | -513 | -3,356 | -757 | -3.2 | -0.5 | -3.4 | -0.8 |
| Top quintile | 6.4 | 1.3 | 2.0 | -3.0 | -13,909 | -2,856 | -4,285 | 6,770 | -4.6 | -0.9 | -1.4 | 2.2 |
| Detail of Top quintile: | | | | | | | | | | | | |
| 80-90 percentile | 4.8 | 0.8 | 4.4 | 0.4 | -5,478 | -906 | -5,016 | -442 | -3.6 | -0.6 | -3.3 | -0.3 |
| 90-95 percentile | 4.8 | 0.7 | 3.8 | -0.3 | -7,692 | -1,142 | -6,104 | 448 | -3.6 | -0.5 | -2.8 | 0.2 |
| 95-99 percentile | 5.3 | 0.9 | 2.3 | -2.0 | -14,395 | -2,560 | -6,151 | 5,686 | -3.8 | -0.7 | -1.6 | 1.5 |
| Top 1 percent | 9.5 | 2.2 | -1.5 | -8.0 | -126,902 | -31,943 | 19,274 | 114,238 | -6.4 | -1.6 | 1.0 | 5.7 |
| Top 0.1 percent | 11.6 | 3.0 | -2.8 | -10.2 | -680,157 | -192,645 | 163,423 | 650,938 | -7.4 | -2.1 | 1.8 | 7.1 |
| | | | | | | | | | | | | |
| Impact on Tax Revenue (\$Billions) | | | Current Law | | | | Current Policy | | | | | |
| | | | 2009-2013 | 2009-2018 | 2009-2013 | 2009-2018 | | | | | | |
| McCain | | | -1,477.3 | -4,170.5 | -329.7 | -595.8 | | | | | | |
| Obama | | | -966.7 | -2,947.6 | 180.9 | 627.1 | | | | | | |

Source: Compiled from <http://www.taxpolicycenter.org/UploadedPDF/411749_updated_candidates.pdf>