Obama vs. Romney on Taxes

Elections 2012
Where Do the Candidates Stand?

Small Business & Entrepreneurship Council

The Candidates and Tax Policy

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Taxes affect entrepreneurship, small businesses and the economy in significant ways. Hence, taxes usually are, and should be, center to any policy debate during a presidential campaign. The U.S. tax code is becoming more complex, messy and volatile. Indeed, the pending "fiscal cliff," where a host of major tax relief measures will expire by year-end if not addressed, is the cause for much concern among entrepreneurs and small business owners. Many have taken note of the harmful consequences, including the Congressional Budget Office (CBO) as it recently reported the economy would dip back into a recession in early 2013 if Congress and President Barack Obama allowed the tax cuts to expire and sequestration to move forward.

Small business owners want a stable, simple and fair tax system. So, where do the candidates for U.S. president stand on this most critical issue?

In terms of small business and the economy, two of the effects of tax policy stand out as most important.

Incentives. The first impact that must be considered is the effect on incentives. Namely, how do current taxes and/or proposed tax policy changes affect incentives for

• starting up and building a business;
• investing in a new or expanding business;
• capital expenditures made by a business;
• where to locate a firm and its facilities, hiring workers, and so on?

Basically, the question is: Given the considerable risks involved in entrepreneurship and investment, to what extent does tax policy create disincentives for undertaking such economically critical activities?

The Tax Drain. Second, and obviously related to the first, simply is the amount of resources drained from entrepreneurs, businesses and investors by taxes. If not siphoned off by the government, those resources would be used in the private sector, including for starting up, building, expanding, and investing in entrepreneurial ventures.

While government imposes seemingly countless taxes and fees, the following eight levies stand out as most important as to their impact on entrepreneurship, investment and economic growth:

• **Personal Income Tax.** The individual income tax affects incentives for working, saving and entrepreneurship (again, consider the risk-reward tradeoff). Obviously, the higher the tax rate, the lower the incentive for risk taking. In addition, the personal income tax directly impacts the bottom line of most businesses. According to the latest IRS tax returns data (2007), 92.7 percent of businesses in the United States paid the personal income tax (as, for example, sole proprietorships, partnerships, S-Corporations, and LLCs), rather than the corporate income tax. However, the Joint Committee on Taxation puts it even higher – at 95 percent of businesses paying the personal income tax.

• **Capital Gains Tax.** From the entrepreneur's perspective, the capital gains tax arguably is the most damaging or destructive tax, since it is a direct tax in risk taking. That is, it diminishes the potential returns on starting up, running and investing in a business. Along the same lines, an increase in the capital gains tax means fewer resources in the hands of investors for investment in private-sector ventures. In the end, a higher capital gains tax means less entrepreneurial activity. It also must be noted that since capital gains are not indexed for inflation, the real capital gains tax is higher than the stated nominal rate. That is, the higher the inflation rate, the higher is the real capital gains tax rate.

• **Corporate Income Tax.** The same issues raised by the personal income tax, in terms of the incentives effects and the problem of reduced private-sector resources, apply to the corporate income tax as well. Also, consider that when state corporate income taxes are factored in, the combined average rate in the U.S. is 39.2 percent, which is the highest corporate tax rate among developed economies in the Organization for Economic Cooperation and Development. In fact, the U.S. rate is 57 percent higher than the average tax rate among OECD nations. In addition, the U.S. corporate income tax rate applies to corporate capital gains. For good measure, it's not just large corporations that pay the corporate income tax, as 99.2 percent of corporations have fewer than 500 employees, and 84.8 percent have less than 20 workers (latest U.S. Census Bureau data from 2007).

• **The Death Tax.** After a lifetime of paying all kinds of taxes and fees, the government shows up at death seeking a percentage of one's assets. That's devastating to a family business, to an investor, and to investment in general. Clearly, having to hand over a large percentage of assets to the government at death – for example, a tax rate of 35% in 2012, scheduled to rise to 55% in 2013 – is a real disincentive for business investment and expansion, and a blow to the amount of resources on hand for businesses and investors. Indeed, the death tax ranks as a serious threat to the very existence of many businesses.

• **Expensing of Capital Expenditures.** Allowing businesses to expense capital expenditures – i.e., to fully write off capital spending in the year made, rather than doing so over a lengthier period of time according to depreciation schedules – serves as a significant incentive for investment by business. Unfortunately, the effectiveness of expensing often is limited due to it being a temporary tax measure.

• **Research and Experimentation (R&E) Tax Credit.** Similar to expensing, the R&E tax credit (formerly R&D tax credit) provides an incentive for research undertakings by private businesses. Again, though, this measure is temporary, which tends to limit its effectiveness, and artificially affect the timing of investments.

• **Alternative Minimum Tax.** The alternative minimum tax (AMT) imposes a minimum tax rate that must be paid by individuals, regardless the tax credits or deductions taken. The AMT diminishes the effectiveness of potentially positive, pro-growth tax relief measures, while also raising the costs of tax compliance. The federal government imposes both individual and corporate alternative minimum taxes. Since it was never indexed for inflation, while originally imposed in the 1960s to redress the issue of a few hundred high-income earners not paying any income tax, the individual AMT now ensnares about 4 million taxpayers, and if the annual AMT patch were allowed to slip, the number would leap to more than 30 million taxpayers.

• **Dividends Tax.** The income tax rate applied to dividends obviously affects the returns on and incentives for investing, with a higher dividends tax rate reducing available resources for investing in small and mid-size enterprises.

Comparing the Tax Plans: The following table shows where tax policy stands currently in each of these areas, where current law puts policy next year if nothing is changed, and the plans offered by President Barack Obama (D) and Mitt Romney, the Republican presidential candidate.

Obama vs. Romney Tax Plans

Tax	2012	Scheduled 2013	Obama	Romney
Personal Income Tax	Brackets range from 10% to 35%. Add in Medicare tax, and top rate hits 37.9%.	Brackets range from 15% to 39.6%. Add in Medicare tax, and top rate hits 43.4%.	**-Brackets range from 10% to 39.6%. -Add in Medicare tax, and top rate hits 43.4%.**	**-Brackets range From 8% to 28%. -Add in Medicare tax, and top rate hits 30.9%.**
Capital Gains Tax	Top rate of 15%. A 100% exclusion for "qualified small business stock" held for five years, and issued between 9/27/10 to 12/31/11. Ended Jan. 1, 2012.	Top rate of 20%. Add in Medicare tax, and top rate hits 23.8%.	**-Top rate of 20%. -Add in Medicare tax, and top rate hits 23.8%. -Would make a 100% exclusion for "qualified small business stock" held for five years**	**-Top rate of 15%. -Below $200,000 income married filers and $100,000 single filers, 0%.**

			permanent.	
Corporate Income Tax	Top rate of 35%.	Top rate of 35%.	**Top rate of 28%**	**Top rate of 25%.**
Death Tax	35% tax rate, with exemption level of $5.12 million (indexed for inflation).	55% tax rate, with exemption level of $1 million (not indexed for inflation).	**45% tax rate, with exemption level of $3.5 million.**	**Repeals the death tax.**
Expensing	2011's 100% expensing cut to 50% for 2012. For small firms, 2011's full expensing up to $500,000 (phased out above $2 million in capital outlays) cut in 2012 to $139,000 (phased out above $560,000).	Only expensing for small businesses, with expensing up to $25,000 (phased out at $200,000).	**Small business expensing up to $250,000 (phase out level not specified).**	**Extends 100% expensing for an additional year.**
R&E Tax Credit	20 percent tax credit provided for qualified research and experimentation expenditures expired at end of 2011. No credit in 2012.	No credit in 2013.	**Make the R&E tax credit permanent.**	**Make the R&E tax credit permanent**
AMT	AMT patch levels: $74,450 for married filers and $48,450 for single filers.	AMT patch levels: $45,000 for married filers and $33,750 for single filers.	**Permanently adjust individual AMT for inflation.**	**Eliminate the individual AMT.**
Dividends Tax	Top rate of 15%.	Brackets range from 15% to 39.6%. Add in Medicare tax, and top rate hits 43.4%.	**-Top rate of 20%. -Add in Medicare tax, and top rate hits 23.8%.**	**-Top rate of 15%. -Below $200,000 income married filers and $100,000 single filers, 0%.**

Compared to where tax policy stands in 2012, a path of doing nothing – i.e., to go over the tax cliff – would be a huge negative for entrepreneurship, small businesses and the economy.

Obama Tax Plan Summary: As for the candidates' plans, compared to 2012, President Obama would increase personal income, capital gains, death and dividends taxes. Those tax increases would hit business and investment income, which would be negatives for entrepreneurship, investments, small businesses and the economy. He would reduce the corporate income tax rate, which would be a plus, but it is unclear as to whether or not this would result in a net corporate tax increase given what deductions and credits would be eliminated. Finally, the small business expensing, R&E tax credit, and individual AMT situations would improve under the President's plan.

Romney Tax Plan Summary: As for former Governor Romney, compared to 2012, his plan would reduce personal income, capital gains, corporate income, and dividends taxes, while eliminating the death tax and the individual AMT. This would have a significant and beneficial effect on the entrepreneurial sector and the overall economy, enhancing pro-growth incentives and leaving more capital in the private sector. Making the R&E tax credit permanent would be positive for business research and U.S. innovation. On expensing, the Romney plan would extend 100 percent expensing for all businesses for a year, but is unclear as to what happens after that point.

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