The Taxing Cost of Obama's Jobs Act

www.vogelcg.com

President Obama is urging lawmakers to immediately pass his new jobs bill. Entitled the American Jobs Act of 2011 (Jobs Act), Obama submitted his bill to Congress on September 12, saying that it is based on proposals previously supported by both Republicans and Democrats.

With an estimated cost of $447 billion, the bill provides tax incentives to employers, extends unemployment benefits, and creates new work projects and training programs. The most expensive item is 2012's extended and expanded payroll tax cut for both employees and employers. Price tag: $240 billion.

So who would pay for Obama's jobs bill? The cost would be shouldered by high net worth individuals and their families.

A number of specific tax breaks are included in the proposed Jobs Act:

- Expansion of the current (temporary) cut in Social Security taxes for 2012. Rates would be reduced to 3.1% on employees, rather than the regular 6.2% rate. (The current temporary rate of 4.2% continues through the end of 2011).
- For the first time, employers would also receive the reduction and be subject to the 3.1% rate on their first $5 million of wages.
- A temporary payroll tax credit, beginning October 1, 2011, applicable where payroll is increased over the corresponding period in the previous year. The credit would be equal to the employer portion of Social Security tax imposed on the increased wages (up to $50 million annually), and is proposed to be in effect through December 31, 2012. *Example: an employer increases their annual social security wages from $5 million in 2011 to $6 million in 2012. Under this legislation, the employer would receive a tax credit of $62,000 (the amount of social security tax imposed on the $1 million increase).*
- Extension of the current 100% bonus depreciation through the end of 2012.
- Tax credits for hiring veterans out of work at least four weeks, and tax credits for employing individuals who have been unemployed for at least six months.

Whereas the proposed credits and deductions are temporary, generally expiring after 2012, the revenue raisers to pay for the benefits would be permanent changes in the tax law. The President has stressed that the cost of his Jobs Act is fully paid for over ten years. Paid by whom, you ask? Some of the very people this act is supposed to help.

The bill would be largely funded by limiting the tax effect of certain individuals' itemized deductions to a 28% rate, beginning in 2013. The limitation would apply to married couples with adjusted gross income of at least $250,000 and to singles with $200,000 of income, provided their taxable income (before itemized deductions) is in the 36% or higher tax bracket. This one proposal is intended to cover $400 billion of the cost of the Jobs Act.

Example: Assume a single individual earns $300,000 in 2013 and is otherwise subject to a top marginal rate of 39.6%. The proposal would result in most or all of his/her itemized deductions being subject to an increased tax *of 11.6% (39.6% - 28% = 11.6%). High income individuals residing in high income tax states would really feel the effect of this change. Residents in states such as Illinois, Wisconsin, California and New York will see one of their largest potential deductions, state income tax, cost more due to the reduced federal tax effect. Other deductions such as charitable donations and home mortgage interest would also yield a lesser tax benefit when limited to a 28% rate.*

With the 2013 effective date, this proposal is one more reason to have an income tax plan for the remaining months of 2011 and 2012. As a reminder, 2013 already contains increased taxes for higher income individuals in the form of a 2.9% tax on certain investment income, an additional 0.9% Medicare tax on wages over $200,000, and an uncertain future for extension of the current Bush era tax rates.

Other proposals included in the Jobs Act:

- A change in the taxation of "carried interests" in certain investment partnerships from capital gains to ordinary income tax rates. The proposal would also cause such income to be subject to self-employment tax, since the service partner would be treated as receiving this income from the performance of services.
- Repeal of various deductions currently allowed to oil and gas producers/investors.
- Slow-down of the depreciation rate applicable to corporate jets. A twelve year depreciable life would apply, just as it does to commercial aircraft.

The structure and timing of this bill may in fact hurt those it is supposed to help. Closely held business owners will effectively be paying for their own tax breaks. How so? Many small businesses, those Obama is encouraging to hire more employees, are organized as S corps or Limited Liability Companies (LLCs). With the scheduled and proposed tax increases in 2013, these business owners will likely be more cautious before adding new payroll.

How likely is the President's Jobs Act to become law? The Senate Minority Leader, Mitch McConnell, indicated on Tuesday that the plan had no chance to pass the Senate. But, several of these ideas and proposed tax increases have surfaced in the past, so you can expect that the President will continue to push for their passage.

For additional details, visit: www.americanjobsact.com

Vogel Consulting

Chicago
190 South LaSalle Street, Suite 610, Chicago, IL 60603
312.332.1022

Milwaukee
3415 Gateway Road, Brookfield, WI 53045
262.790.4960

Any advice concerning tax issues contained in this communication was not intended or written to be used, and cannot be used, for the purpose of avoiding any penalties that may be imposed by any governmental taxing authority or agency.