

The Climate in Washington: Partly Cloudy with a Chance of Change

IFG Wealth Management Forum

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The Climate in Washington

- The stark realities
 - Debt as a percentage of GNP is at its highest level since World War II
 - The path is unsustainable

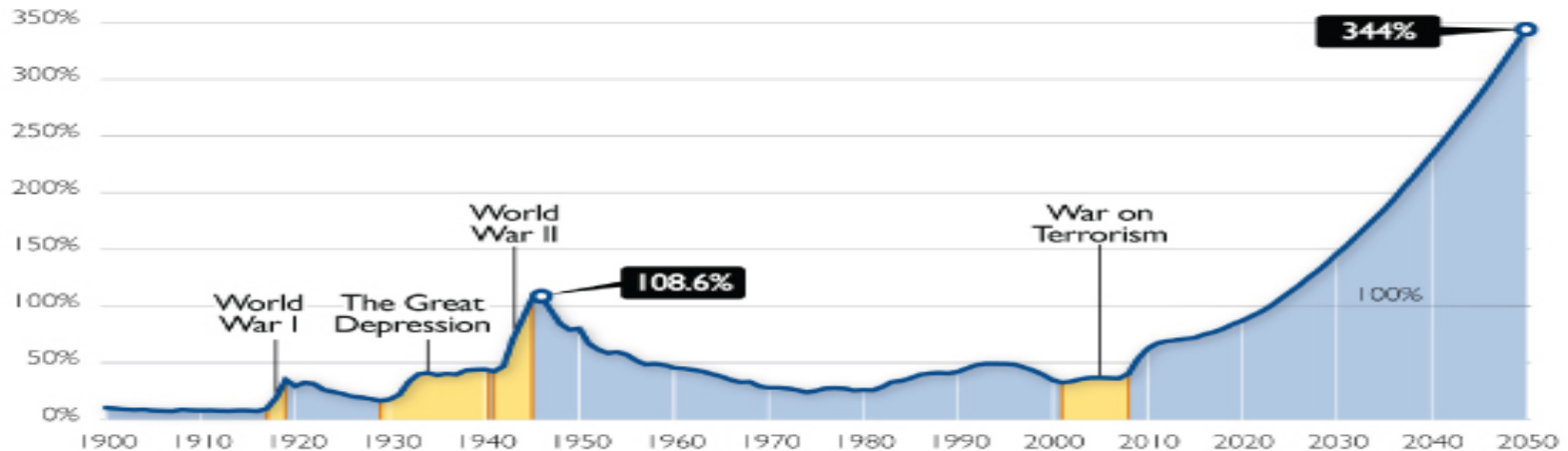


The Climate in Washington

National Debt Set to Skyrocket

In the past, wars and the Great Depression contributed to rapid but temporary increases in the national debt. Over the next few decades, runaway spending on Medicare, Medicaid, and Social Security will drive the debt to unsustainable levels.

PERCENTAGE OF GDP



Source: Heritage Foundation calculations based on data from the U.S. Department of the Treasury, Institute for the Measurement of Worth, Congressional Budget Office, and White House Office of Management and Budget.

Debt and Deficits Chart I • 2011 Budget Chart Book heritage.org

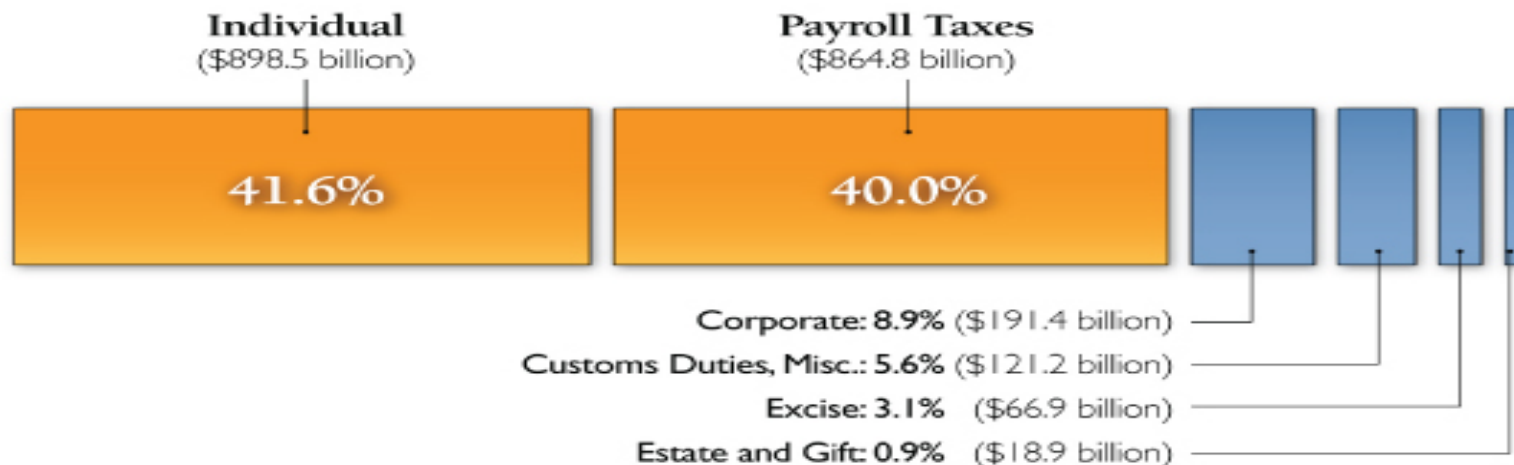


The Climate in Washington

Federal Revenues by Source

Most federal revenues come from individuals. Personal income taxes provide the largest portion of total tax revenues, though some of this is small-business income. Social Security and Medicare payroll taxes are the second-largest source.

PERCENTAGE OF TOTAL FEDERAL REVENUE (2010)



Source: Congressional Budget Office.

Federal Revenue Chart 4 • 2011 Budget Chart Book  heritage.org

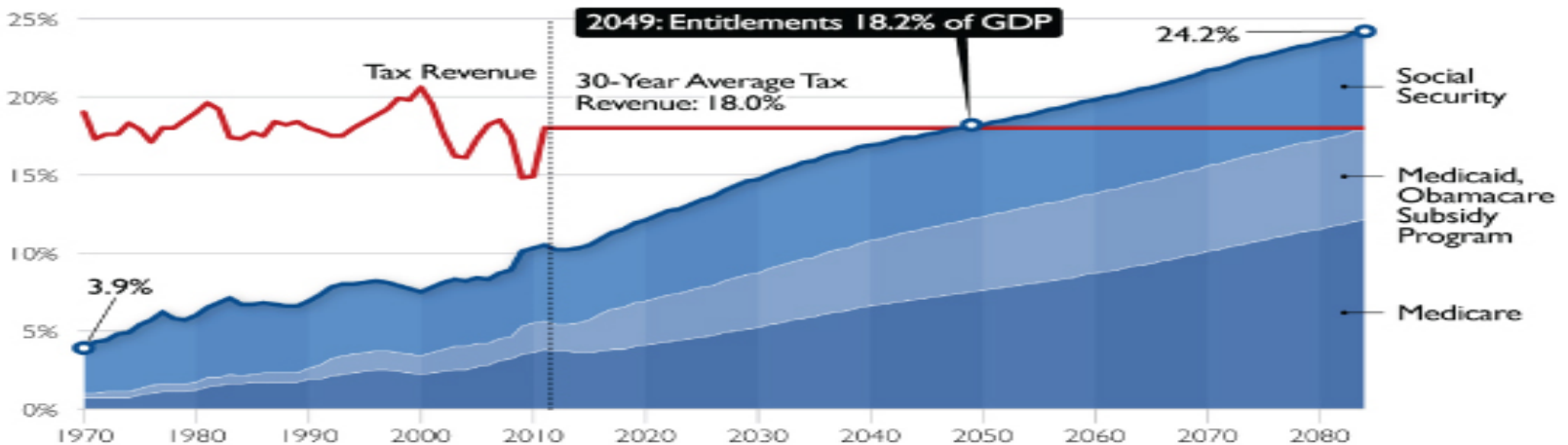


The Climate in Washington

Entitlements Will Consume All Tax Revenues by 2049

If the average historical level of tax revenue is extended, spending on Medicare, Medicaid and the Obamacare subsidy program, and Social Security will consume all revenues by 2049. Because entitlement spending is funded on autopilot, no revenue will be left to pay for other government spending, including constitutional functions such as defense.

PERCENTAGE OF GDP

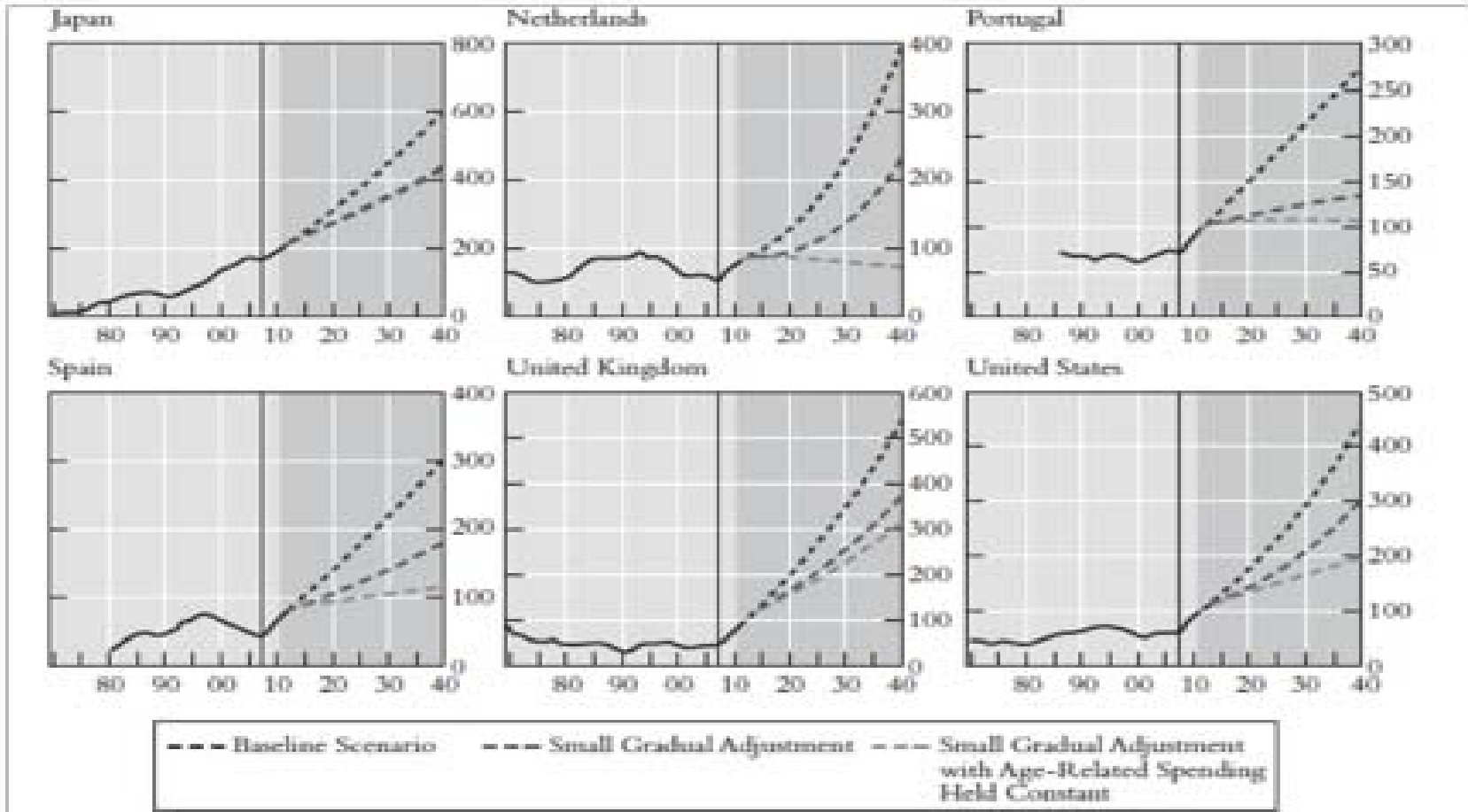


Source: Congressional Budget Office.

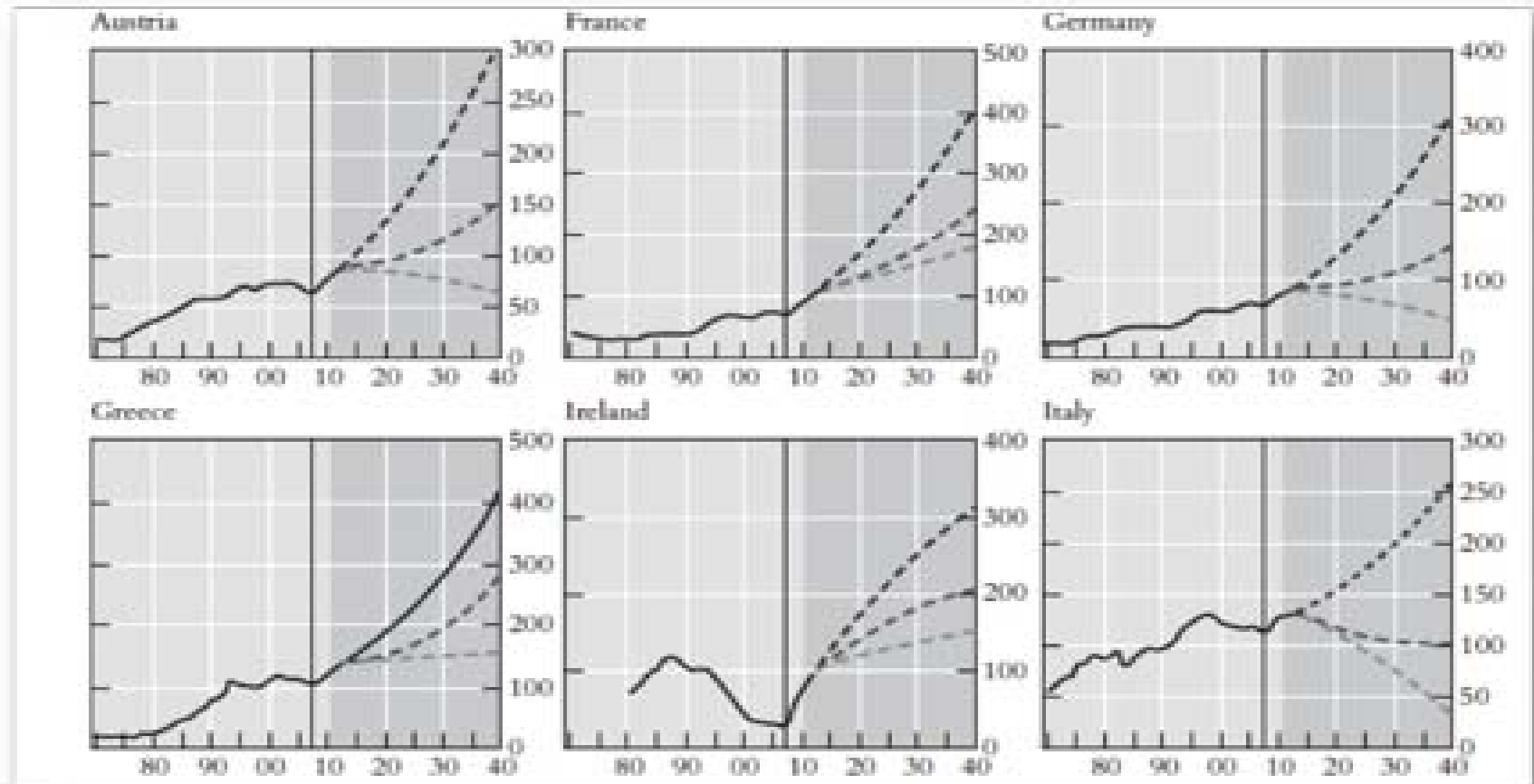
Entitlements Chart I • 2011 Budget Chart Book heritage.org



The Climate in Washington



The Climate in Washington



The Climate in Washington

- Democrats and Republicans are in their respectful corners
 - Compromise only when facing extreme consequences



The Climate in Washington

- Recent battles
 - Government Shutdown Averted in April 2011
 - Measure cuts \$38 billion from federal budget through end of September 2011
 - Debt Ceiling Agreement Signed in August 2011
 - \$1 trillion in cuts over 10 years. Created the Super Committee to find another \$1.5 trillion of savings
 - \$2.1 trillion increase.
 - Collapse of Super Committee



The Climate in Washington

- Collapse of the Super Committee
 - Requested a \$1.5 trillion cut in the deficit, including \$866 billion gained from allowing Bush tax rates to expire for households with \$250K income
 - President Obama challenged the Deficit Reduction Committee to simplify our tax system, reduce rates, close loopholes and cut specific tax breaks
 - Introduced “Buffett Rule” – no household with \$1 million of income should pay a smaller tax percentage than a middle-class family



The Climate in Washington

- Collapse of the Super Committee
 - Committee Democrats required a minimum of \$1 trillion in higher taxes.
 - Republicans insisted on 20% tax rate cut along with reduced spending of \$750 billion.
- Lack of agreement results in \$1.2 trillion in automatic spending cuts over 10 years, beginning in 2013.



The Climate in Washington

- Sequestration Details
 - Anticipate \$216 billion in lower interest costs on reduced national debt
 - Cuts to be divided equally between defense and non-defense domestic programs
 - Programs exempt from cuts:
 - * Social Security
 - * Veteran Benefits
 - * Food Stamps
 - * Medicaid
 - Medicare cuts limited to no more than 2% of its budget



The Climate in Washington

- Sequestration Details
 - Average reduction of \$55 billion per year from Department of Defense – resulting in smallest ground force since 1940s
 - Reduced government spending expected to further dampen our slow growing economy
 - Allows the Bush tax cuts to expire at the end of 2012



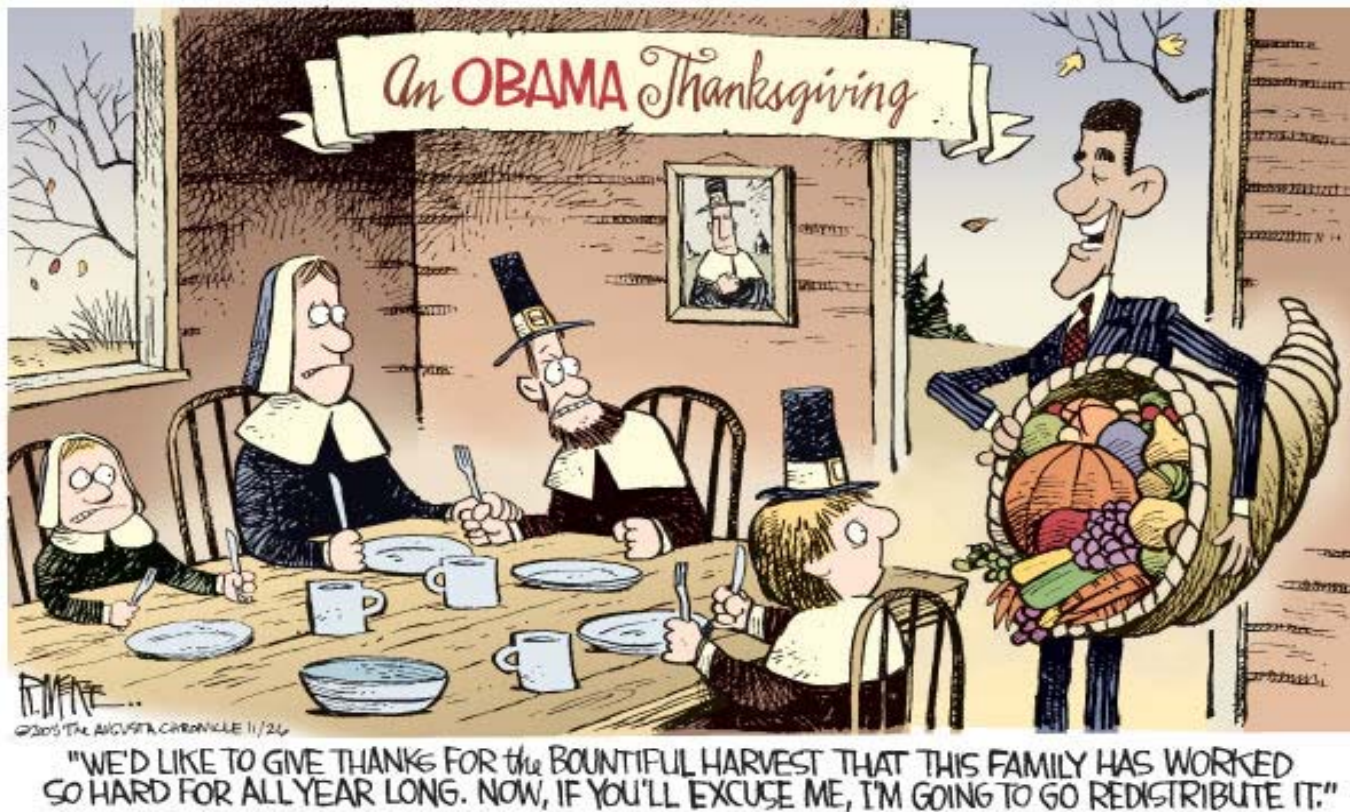
The Climate in Washington

- Competing Budgets
 - President's Budget
 - Unanimously rejected by House and Senate in 2012
 - Mitt Romney
 - In February 2012 began promoting a policy that keeps most of the existing code but reduces rates 20%, across the board.
 - The Ryan Plan (Path to Prosperity)
 - Mitt Romney has endorsed the Ryan Plan that passed the House in 2011. The House Budget Committee has passed the plan for 2012.



The Climate in Washington

- Revenue – Expiration of the Bush Tax Cuts



The Climate in Washington

- Individual Income Tax
 - Rates on Ordinary Income
 - President
 - Let Bush-era tax rates expire for those making more than \$250,000. Increases 33% bracket to 36% and 35% bracket to 39.6%.
 - Restores phase-out of personal exemptions and itemized deductions.
 - Plus the 3.8% Medicare surtax from new health care law starts on January 1, 2013. Increasing the top tax rate to 43.4%
 - Mitt Romney
 - Reduces all tax rates by 20% to 8, 12, 20, 22.4, 26.4 and 28%.
 - Avoids Medicare surtax via repeal of Obama Care
 - Ryan Plan
 - Consolidate six tax brackets to just two brackets of 10% and 25%.
 - Avoids Medicare surtax via repeal of Obama Care



The Climate in Washington

- Individual Income Tax
 - Dividends and Capital Gains
 - President
 - Let Bush-era tax rates expire for those making more than \$250,000.
 - Dividends now taxed at ordinary rates.
 - Capital gains taxed at 20%.
 - Plus the 3.8% Medicare surtax from new health care law starts in 2013.
 - Mitt Romney
 - Extends Bush-era tax rates.
 - Ryan Plan
 - Extends Bush-era tax rates.



The Climate in Washington

- Individual Income Tax
 - Alternative Minimum tax
 - President
 - Retains
 - Add the “Buffett Rule” for millionaires to pay a minimum rate of 30% on all income.
 - Mitt Romney
 - Eliminates.
 - Ryan Plan
 - Eliminates.



The Climate in Washington

- Individual Income Tax
 - Reduction of tax deductions
 - President
 - Limits deduction on mortgage interest, charitable contribution, tax-exempt interest, employer sponsored health insurance, retirement contribution and selected above-the line deductions to a 28% tax rate for couples making over \$250,000.
 - Eliminate or limits other various “loopholes” including oil and gas tax preference, depreciation on corporate airplanes and carried interest capital gain treatment.
 - Mitt Romney
 - No specific plan
 - Ryan Plan
 - Reduce complexity of tax code, removing “loopholes” in the code. No specifics provided, but has made comments concerning deductions like state income taxes and mortgage interest.



The Climate in Washington

- Corporate Income Tax
 - President
 - Cuts to 28% while closing undefined “loopholes”
 - Mitt Romney
 - Cuts rate to 25%
 - Make R&D Credit permanent
 - Switch to territorial tax system
 - Repeal corporate Alternative Minimum Tax
 - Ryan Plan
 - Cuts rate to 25%
 - Switch to territorial tax system



The Climate in Washington

- Estate Tax
 - President
 - Returns to 2009 Parameters of 45% tax rates and \$3.5 million Estate and GST Exemption but only a \$1 million Gift Tax Exemption.
 - Has also discussed limits to estate planning vehicles
 - Required minimum term of 10 years for GRAT's
 - Elimination of marketability discounts for sales of closely held businesses.
 - Mitt Romney
 - Eliminates.
 - Ryan Plan
 - Supports elimination. 2012 FY Budget included extension of 2011/2012 rates and exemptions. 2013 Path to Prosperity does not discuss.



The Climate in Washington

- Government Spending
 - President
 - Spending increase to 25% of GDP in 2023
 - Increases spending by \$1.5 trillion versus the current path.
 - Budget never balances.
 - Mitt Romney
 - Reduces spending to 20% of GDP by end of 2016
 - Requires \$2 trillion in cuts from current baseline and assumes a 4% DGP annual growth rate
 - Ryan Plan
 - Reduces spending to less than 20% of GDP by end of 2016 and maintains that over the 10 year period ending 2022.
 - Versus the President's budget, spends \$5.3 trillion less.



The Climate in Washington

- 2011 Provisions That Have Expired
 - Alternative Minimum Tax Patch
 - After 2011 the AMT exemption is scheduled to be dramatically reduced, resulting in millions of additional AMT taxpayers
 - Exemption lowered from \$74,450 to \$45,000 for married couples (\$48,450 to \$33,750 for singles)
 - Tax-free distributions from IRAs to qualified charities for individuals age 70 ½
 - Sales tax deduction taken in lieu of state and local income tax paid



The Climate in Washington

- 2011 Provisions That Have Expired
 - Business Depreciation Incentives
 - Current bonus depreciation of 100% applies through the end of 2011; then limited to 50% for 2012 purchases
 - Limit for 2012 expensing is \$125,000 and a phase-out starting at \$500,000



The Climate in Washington

- Tax Gridlock Likely to Continue
 - Democrats and Republicans have vastly different views of role of government
 - Inability to find common ground has contributed to Congress' historically low approval rating (even lower than Obama's rating)
 - Possibility of no 2012 agreement on extension of Bush tax rates



Planning for 2012

- Income Tax
 - Accelerate Capital Gains
 - Could lead to increased merger and acquisition activity. Pre-financial crisis vintage private equity funds looking for exits.
 - Looking to lock-in carried interest income at long-term capital gains tax rates
 - Sale of concentrated positions with low cost basis
 - Provide example



Planning for 2012

- Income Tax
 - Defer the recognition of capital losses
 - Increase exposure to dividend paying or companies with large cash balances.
 - Large corporations have large cash balances
 - They have been using these balances to increase stock buy-backs
 - If rates do increase, may see corporations declare one-time dividends



Planning for 2012

- Income Tax
 - Accelerate Ordinary Income
 - Evaluate Charitable Gifting
 - May be beneficial to defer gifting to 2012 to increase tax benefit of deductions
 - If new tax law limits the deductibility of contributions, may end up receiving a lower tax benefit
 - Unwind Charitable Remainder Trusts with Deferred Long-Term Capital Gains



Planning for 2012

- Estate and Gift Tax – Will expand on these
 - Utilize Gift/GST Exemption of \$5 million
 - Utilize Valuation Adjustment for Planning
 - Consider GST/Dynasty Planning in States that have no rules against perpetuities
 - Implement Defective Grantor Trust (DGT) Structure
 - Laddered GRAT's
 - CLAT



The more you earn, the less you keep,
And now I lay me down to sleep.
I pray the Lord my soul to take,
If the tax collector hasn't got it before I wake.

