When I wrote this article, President Obama was still President-Elect Obama and his tax proposals were merely campaign promises. Perhaps as you read this, those promises are much closer to being reality. Realized or not, the President’s promises and proposals provide much insight into his program for tax changes and how those changes will impact you, the dentist.

The President promised his tax changes would provide tax breaks to the majority of all Americans, as many as 95%? Who will pay for these savings? President Obama has referred to them as “high income individuals” or the remaining 5%. Who makes up the 5%? From what he has said, it is those Americans making more than $250,000. At this point, we can not tell what the $250,000 represents. Is it adjusted gross income, net income, taxable income or some other figure? He has not clearly defined this figure, although he referred to this number on many occasions during his campaign.

Each year I prepare an income and expense survey from the dentist who I work with. For 2008, the survey of dentists showed that our average single general dentist made a profit in his or her dental practice of $293,000 (before depreciation expenses). My survey showed all specialties making more than the general dentist.

Comparing the survey results of other Academy of Dental CPA (ADCPA) members across the country, shows a majority of the dentists represented by the ADCPA would be included in the 5% of Americans making more than $250,000.

What are the tax savings proposed and how much will they cost the 5%? At present we do not have answers to either question, but the following examples from the President’s proposals clearly show the cost to the 5% could be significant:

“With hard work and commitment, 2009 can be a great year for you and your team.”

-Bob Creamer

Refundable Tax Credits
Tax credits have been part of the tax law for a long time. However, most have not been refundable. President Obama’s tax proposals would include expanding the availability of the credits to a larger number of Americans and then to make these credits refundable should the credit exceed taxes owed. Examples of such refundable credits include the following:

1. Mortgage Interest Credit – Interest paid on home mortgage is tax deductible for tax payers who itemize their deductions, subject to certain income and deduction thresholds. Non-itemizers cannot deduct mortgage interest.

President Obama has proposed a new refundable universal mortgage credit, which would enable non-itemizers to claim a credit equal to 10% of their mortgage interest with a cap of $800.

2. Child Tax Credit – The current $1,000 child tax credit was first increased and then accelerated by subsequent legislation. The child tax credit, which is not indexed for inflation, is scheduled to remain $1,000 until it expires after 2010.

The President has indicated his support for making the $1,000 child tax credit both permanent and refundable. For married individuals, the credit starts to phase out once their adjusted gross income reaches $110,000. Therefore, few dentists qualify.

3. Child and Dependent Care Credit – The Child and Dependent Care Credit is a percentage of the amount of work-related child and dependent care expenses a qualifying taxpayer paid to a care provider. The credit...
can reach as high as 35% of qualifying expenses.

The President has proposed making the Child and Dependent Care Credit refundable and enhancing it to reach as high as 50% of qualifying expenses.

4. Earned Income Tax Credit - The Earned Income Tax Credit (EITC) is a refundable federal income tax credit targeted to lower-income taxpayers. When the EITC exceeds the amount of taxes owed, it generates a refund to those who claim and qualify for the credit.

The credit is $428 for (0) children, up to $4,824 for (2) children. Phase-out begins at $7,160 and is completely eliminated at $38,646 of adjusted gross income.

President Obama proposes expanding the EITC to cover more families and more children and boosting the phase-out income threshold.

5. Hope and Lifetime Learning Credit – The President proposes to rename the Hope and Lifetime Learning Credit by calling it the American Opportunity Tax Credit. In addition, he would like to increase the maximum amount of this currently nonrefundable credit from $1,800 to $4,000 and make the credit refundable.

6. Making Work Pay Credit – This proposed $500 credit would apply to the first $8,100 of wages. The credit basically offsets the employee’s 6.2% share of Social Security tax on wages of $8,100. However, the credit would not be available for those making $250,000.

What makes the above credits so costly for the 5% who will provide the money for them? First, those making $250,000 are not eligible for the previously mentioned credits. Second, for those receiving the credits, there are no requirements to pay in any money to the government to qualify for the credit. Further, if the credit is more than their tax owed, they will actually receive a check for the difference. I have heard it said, “Those who do not qualify to receive the benefits of such credits are the ones paying for them.” I believe this statement is very accurate as it applies to President Obama’s proposals.

The President has made several proposals for how those making $250,000 or more will be taxed to pay for refundable credits and his other tax proposals. One way is to increase the marginal tax rates for those making $250,000 or more. Presently, the top two tax rates are 33% and 35%. President Obama proposes to increase these tax rates to 36% and 39.6%. Unfortunately for tax payers, the current 33% tax bracket already includes individuals with taxable income starting at $200,300, which is $50,000 less than the $250,000 figure he uses to describe “high income individuals.” At the same time, he proposes
phasings out certain deductions for those reaching these tax brackets.

Currently, there is a personal and dependent exemption of $3,650 for each qualifying member of the household. President Obama would phase this deduction out for higher income individuals. There would be a similar phase out of certain itemized deductions, such as mortgage interest, property taxes and charitable contributions. The phase out of personal and dependent exemptions and of itemized deductions effectively will increase the proposed marginal tax rates of 36% and 39.6% to as high as 41%.

Another revenue raiser would be President Obama’s proposal to increase payroll taxes by 4% (2% from the employer and 2% percent from the employee) on wage income of those making over $250,000. Most dentists are both the employer and the employee, thereby funding the full 4%.

We do not know which of the President’s tax proposals will become law or the actual additional tax each dentist will pay, but the amount could be substantial.

We do know that each dental office is part of America’s small business economy. Further, more than half of America’s private sector employees work in small businesses, and over half of the nation’s private sector gross domestic product comes from small businesses. Placing an unreasonable load of additional tax on this segment of the economy could be very challenging for dentists and their small business.

The election of President Obama sent a clear message that Americans wanted a change. We all now have an opportunity to help the change take place. In my last Catalyst article, “Tough Times Require Tough People,” I referred to my belief that dentists and the dental industry are resilient in troubled times. I believe that wholeheartedly.

This could be a year of challenge, but with challenge comes the opportunity for growth through individual and team commitment. With hard work and commitment, 2009 can be a great year for you and your team. After all, it’s just good business.