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Advisers doubt Obama

With Democrats in power, many fear tax hits to high-income households

By Sara Hansard
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The majority of financial advisers have little faith in President-elect Barack Obama's ability to put the nation back on sound economic footing.

An exclusive *InvestmentNews* survey of 968 advisers last week found that 61% lacked confidence in the new commander-in-chief's ability to resolve the country's economic woes.

Bloomberg

Barack Obama: *An InvestmentNews poll found that 61% of advisers lack confidence that he will be able to get the economy back on track.*

Besides restoring economic stability, 39% of advisers who responded said the development of a workable energy policy was the most important issue facing the country, the survey found. Terrorism, the war in Iraq and health care were picked as the No. 1 issue by 23%, 21% and 17% of respondents, respectively.

The online survey was conducted last Thursday and Friday.

After last Tuesday's historic vote in which Mr. Obama was elected the nation's first black president, advisers across the country began considering ways to protect client assets from changes that could go into effect under the incoming new Democratic-controlled government.

Washington experts, however, warned that tax increases may be made retroactive and that tax breaks for retirement savings accounts for upper-income people are in jeopardy.

"We've been telling clients for three years that taxes will likely go up," said Bob Klosterman, chief executive of White Oaks Wealth Advisors Inc. of Minneapolis, which manages about $230 million.

"The election clearly is making that probability more tangible," he said.

In his registered investment advisory practice, Mr. Klosterman is counseling clients to realize capital gains.

"Recognizing capital gains at the current rates is not a bad thing," he said, because tax cuts enacted during the Bush administration are set to expire in 2010 and Mr. Obama has called for higher income tax and capital gains rates on households making more than $250,000 per year.

However, one Washington pundit thinks that the incoming administration will push to make tax increases for higher-income people retroactive.

"Very possibly, we'll be looking at a retroactive tax increase for upper-income people to Jan. 1, 2009," Federal Policy Group managing director Ken Kies told more than 1,000 advisers who participated in InvestmentNews' post-election webcast last Wednesday.

The Federal Policy Group is a Washington-based tax consulting unit of Clark & Wamberg LLC of North Barrington, Ill.

Such an increase is likely to extend to both income tax and capital gains tax rates, with capital gains rates rising to 20% to 25%, from 15%, said Mr. Kies, who was chief of staff of the congressional Joint Tax Committee from 1995 to 1998.

Early tax increases will be called for by the new administration to pay for a host of tax credits that Mr. Obama has called for to benefit lower-income people, Mr. Kies said.

"The sheer magnitude of what our economy is facing means that if they're going to deliver on any of the programs they've proposed, then taxes have to go up, virtually on everyone," especially upper-income taxpayers, said Michael Jones, president of Lifetime Financial Solutions Inc. in Louisville, Ky., which manages about $30 million.

“Now more than ever, consumers and advisers need to be keenly interested in what’s going on in our economy and speak up to their various representatives, and even the president, about their concerns,” said Mr. Jones, a member of the Government Relations Committee of the Financial Planning Association of Denver.

He said he was speaking on his own behalf and not for the FPA.

Some advisers are looking at carrying over losses as a way of lowering future capital gains tax bills.

“In this kind of market, instead of simply buying and holding, if the security is at a loss, we’ll go in, sell the security and realize the loss, and then take the proceeds from that sale and buy a proxy security in the same industry that’s similar to the security that we sold,” said John Phoenix, chief executive of Metamorphosis Money Management LLC in Denver.

If the market rallies at year’s end, as some expect, that strategy would enable clients to maintain exposure to the markets, said Mr. Phoenix, whose investment advisory firm manages $100 million and specializes in tax management for investment platforms, broker-dealers and family offices.

There is likely to be increased investor interest in tax-preferred investment accounts, such as municipal bonds, insurance, annuities, Roth individual retirement accounts and Section 529 college savings plans, said James Delaplane, a partner with Washington law firm Davis & Harman LLP and former legislative counsel to House Ways and Means Committee member Earl Pomeroy, D-N.D.

Mr. Delaplane also participated in the InvestmentNews post-election webcast.

Noting that the House Education and Labor Committee is considering reducing tax breaks for 401(k) plans, Mr. Delaplane, a retirement policy specialist, said that there is talk in Congress of converting tax deductions into tax credits that would not be as available to upper-income people.

“There is a decent chance that it could be seriously debated,” he said.

Not all advisers are worried about the incoming Democratic-controlled government or about Mr. Obama’s abilities to lead the country out of the financial crisis.

Taxes are not as important as getting the financial system back in order, said FPA Government Relations Committee member Michael Marvin, who also spoke on his own behalf.

“Economies are going to cycle, but [Mr. Obama] can help return confidence in the underlying system,” said Mr. Marvin, a principal of Tam Financial Advisors LLC in Annapolis, Md., who was chief of staff to the late Rep. Silvio Conte, R-Mass, ranking member of the House Appropriations Committee in the 1980s.

Mr. Marvin’s firm manages $20 million.

Mr. Obama is “inheriting a toxic economic stew,” commented Stuart Sweet, president of Capitol Analysts Network Inc., a Washington political-risk-management consulting firm that serves institutional investors.

“Is he really going to go through with investor-hostile tax increases?” Mr. Sweet asked. “Is he really going to raise taxes on investments in the middle of a recession and torpedo the stock market so that he can make progress on the deficit?”

Mr. Sweet believes that any tax increases will come after 2009 to take effect in 2010.

But then, he warned, “the tax increase will be significant, and it’s going to be a lot more than anything he campaigned on.”

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