Obama Presents Less Ambitious Fiscal 2011 Budget

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President Obama's fiscal 2010 budget contained several reform proposals, including measures to reduce the deficit, pay for healthcare reform, alter international taxation rules, and collect revenue from climate change legislation. Almost none of the major elements of the budget became law. Healthcare reform dragged on through the summer and fizzled when Republican Scott Brown won a special election for Edward Kennedy's seat. The House climate change bill was never seriously considered by the Senate. And most of Obama's international tax revenue raisers never made it into bills in either chamber of Congress.

This year's budget proposal is significantly less ambitious. There is still a placeholder for healthcare reform, although no details are provided on the pay-fors. Climate change legislation doesn't appear anywhere in the fiscal 2011 proposal. Obama even scaled back his international tax proposals, despite personally presenting them and the lack of any serious consideration in Congress. Check-the-box repeal was dropped entirely, much to the relief of the business community, whose lobbying efforts might have been responsible for the administration's quiet retreat. Less optimistic economic forecasts also have reduced the administration's deficit reduction targets, despite the furor over the proposed freeze on discretionary spending.

So what is left of the administration's tax agenda? Obama is still determined to allow the Bush tax cuts to expire for those earning more than $200,000 a year. The president also revived his proposal to cap deductions at 28 percent (an idea that prompted an unwilling Senate to pass a resolution in 2009 promising that healthcare reform would not be paid for by capping charitable deductions). The budget proposal would revive Superfund taxes, repeal tax preferences for oil and gas companies, and extend the Making Work Pay tax credit (albeit only for one year). (For coverage of the fiscal 2011 budget, see p. 691, p. 693, and p. 708. For a comparison of the 2011 and 2010 budget proposals, see p. 694.)

Although many in Congress promised to consider tax reform in 2010, it seems unlikely that the administration is going to spend its scant political capital pursuing an aggressive tax agenda. In 2009 Obama presented an ambitious series of proposals to Congress, only to have virtually all of them stall in the Senate or be ignored by Congress. With Democrats increasingly fearful of large GOP gains in the 2010 midterm elections, the Obama budget's prospects seem even darker this year.

News Analysis

One major tax item in the budget is the financial crisis recovery fee, Obama's de facto tax on large banks. Lee Sheppard and Martin Sullivan combine to present a detailed analysis of the bank tax and the costs of the bailout of the financial sector. They say the bank tax cannot possibly recover the true cost of TARP and other government assistance to banks. The fee fails to take into account the substantial assistance the Fed has provided to financial institutions (both directly and through near-zero interest rates). The authors outline many of the aid programs and conclude that the government has provided approximately $9.7 trillion to prop up the financial sector. TARP only accounts for $700 billion of that figure, and the bank tax would only recover about $117 billion over 10 years (which is supposedly the net cost of TARP after repayments with interest are made). Sheppard and Sullivan conclude that the bank fee's best use would be to create a kind of insurance program for the next financial meltdown, which might be coming sooner than expected. (For the article, see p. 697.)

In a separate analysis piece (p. 710), Sullivan takes issue with the claim that the expansion of U.S. multinationals abroad creates jobs in the United States. Sullivan points to data that show that multinational employment in the United States has declined over the last 10 years, while multinationals have added jobs overseas.

The IRS Office of Professional Responsibility and the regulation of return preparers have both been in tax news quite a bit lately. OPR's increasing prominence has some practitioners worried that the office will begin to use a new willfulness standard when prosecuting Circular 230 ethical violations. Jeremiah Coder looks at the new willfulness standard and the questions about the appellate process in Circular 230 cases. Coder finds that many practitioners are wary of Treasury's new delegate for appeals, Ronald Pinsky, because of a perceived conflict of interest. Coder's analysis focuses on Pinsky's recent decision in *Gonzales*. (For Coder's analysis, see p. 718.)

Commentary

Economic stimulus packages usually look somewhat similar, and a common feature of the stimulus bills in 2001, 2008, and 2009 was bonus depreciation for businesses. Prof. Theodore Seto, however, thinks that Congress does not properly calculate the cost of bonus depreciation and that the provision might actually be responsible for what he terms a ''jobless recovery.'' Seto argues that money is not created out of thin air and that bonus depreciation encourages businesses to allocate funding from labor to capital, resulting in slow job growth. In his article on p. 782, Seto concludes that the solution is simple: Congress should not enact tax incentives that favor capital at the expense of labor.

President Hoover and his Treasury secretary, Andrew Mellon, are common scapegoats for the Great Depression. Their names have been evoked recently to criticize the spending freeze in Obama's fiscal 2011 budget. Amity Shlaes writes that the characterization of Hoover as a proponent of laissez-faire economics and Mellon as a ''Scrooge'' is unfair and inaccurate (p. 799). Compared with other presidents who operated under the gold standard, Hoover pursued an activist policy and was not a believer in laissez-faire principles, according to Shlaes. Shlaes believes that there are things to be learned from Hoover and Mellon's policies, but to understand their actions they must be placed in the proper context.

Life insurance investment has always created numerous tax questions and difficulties for practitioners. In a special report on p. 751, Robert Cudd analyzes recent IRS guidance on the taxation of life insurance policies. This guidance has raised just as many questions as it answered, according to Cudd. He writes that there are many opportunities for investors to substantially enhance their returns from the ownership of life insurance contracts. In particular, he cites the interaction between single premium annuity policies and life insurance policies as presenting interesting possibilities for investment, while also reducing the longevity risk. He does point out that careful tax planning is necessary to make those transactions profitable.

In a viewpoint, Carlton M. Smith updates the practitioner community on the status of the *Tucker* case and the argument that collection due process hearing officers need to be appointed under the Constitution's appointment clause (p. 777). Smith believes that the Tax Court is taking the appointments clause argument seriously and has ordered five sets of memorandums on the issue. He expects the court won't reach a decision until the summer of 2010 at the earliest.

Qualified settlement funds are becoming increasingly common features of litigation. A QSF allows a defendant to pay money into a fund and be entirely released from liability in the underlying litigation. QSFs are attractive to defendants because of the immediate deductibility of the payment, even though the plaintiff does not take possession of the funds until sometime in the future (usually after a settlement is concluded or the litigation ends). Robert Wood reviews a recent IRS letter ruling that allows even more flexibility in the creation of QSFs (p. 793). The guidance concerned a relations-back election that can effect QSF treatment belatedly. Wood writes that the lenient ruling on a late-filing taxpayer's QSF should please litigants as well as those who help them wind up their cases.

Depreciable assets used in business benefit from an asymmetry in which gains are eligible for capital gains treatment, but losses can be deductible from ordinary income. Calvin Johnson would like to end that asymmetrical treatment. In this week's Shelf Project, he advocates the repeal of section 1231 and says that business assets should be subject to capital loss limitations (p. 787).

Following up on an earlier article, Katherine Black, Michael Black, and Stephen Black address several questions left in the wake of the *Banks* decision by the Supreme Court on the deductibility of attorney fees and costs. The authors point out that the Court has inadvertently created a two-part analysis for the taxation of fees: one for the income from the lawsuits and another for the deductions (p. 745).

The effective tax rates for households with similar incomes can vary widely according to the Tax Policy Center's data on p. 785. The median tax rate for middle-income taxpayers is 3 percent, but 10 percent of those households face a tax rate of 9 percent, and another 10 percent receive a net government subsidy equal to 4 percent of their cash income. ■