From the Editor:

Obama Tries to Recapture Momentum on Tax, Deficit Issues

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After releasing a milquetoast fiscal 2012 budget proposal that would do little to control the deficit or reform the tax code, President Obama took a second bite at the apple last week and presented a deficit reduction and tax reform plan in a major speech on April 13. Obama's new plan, which would cut $4 trillion from the deficit over the next 12 years, contains a mix of proposals from the Bowles-Simpson commission and past White House budgets. Besides the odd use of a 12-year window, Obama's plan falls short of the fiscal commission's proposal, and the tax components are very similar to ideas that Congress has already rejected or declined to take up.

The expiration of the Bush tax rates on upper-income taxpayers is the centerpiece of the tax portion of Obama's ''new'' plan. The president called for the broad elimination of tax expenditures, although he provided few details. One would assume that any proposal to raise revenue from reduced tax expenditures would involve caps on the mortgage interest deduction or a restructuring of how employer-provided healthcare is taxed, but Obama mentioned neither program specifically. The most innovative aspect of the proposal involves the use of mandatory spending and tax changes if deficit reduction goals are not met. These triggers were emphasized in the president's speech and fact sheet released by the White House, but exactly how they would work is unclear. In the past, Congress has been very reluctant to automatically cede much of its fiscal policy authority.

In contrast to House Budget Committee Chair Paul Ryan's budget resolution, Obama's plan would do little to restructure Medicare. The president also declined to touch Social Security, claiming that it was not part of the budget crisis. The Ryan plan is probably what forced Obama to rethink his decision not to endorse any part of the Bowles-Simpson proposal, and the president made it quite clear that he did not share Republicans' desire to avoid any tax increases. ''I say that at a time when the tax burden on the wealthy is at its lowest level in half a century, the most fortunate among us can afford to pay a little more,'' Obama said. (For coverage, see p. 235.)

Although both parties spent the week sniping at each other after the unveiling of the Ryan and Obama plans, the fact is that there is broad agreement between them on the need for deep cuts to discretionary spending. The Republicans have managed to shift the deficit reduction debate in their favor. The question is now whether any tax increases will be part of the effort, while the sharp spending cuts favored by conservatives are just assumed to be on the table. That success has to at least be partly because of the president's failure to take the lead in this area at the beginning of the year. If Obama was ready to propose a $4 trillion deficit reduction plan in April, why didn't he include it in his budget in February?

High-Income Taxpayers

Despite Obama's repeated insistence that the wealthy can afford to pay a bit more to help the United States solve its budget crisis, not everyone agrees. In a rebuttal of both the president's position and a recent David Cay Johnston column, Kip Dellinger argues that how a nation treats its wealthy can reveal a lot about its economic system and health (p. 325). Dellinger writes that seizing the fruits of others' labor is not a virtue and will harm the long-term economic health of the country. He also points out that as tax rates increase, lobbyists become more aggressive in seeking to carve out exceptions. This produces a more complicated tax code, according to Dellinger. He concludes that 1986-style tax reform, which included higher tax rates on capital gains, does not really produce the prosperity that many claim.

One argument against raising taxes on the wealthy is that it leads to increased tax evasion, as high-income taxpayers seek new methods to avoid more burdensome rates. Richard Cebula and Christopher Coombs evaluate some of the major aspects of that theory and find evidence that it is true (p. 299). They look at the Bush tax cuts and the two-year extension passed at the end of 2010, finding that it was probably unwise to pass a temporary tax cut extension. They argue that a temporary extension of the Bush rates will not produce much economic growth and that the president's continuing push for higher taxes on the rich will dampen any stimulative effect. They also agree with Dellinger's premise that increased rates on the wealthiest taxpayers will cause equity problems within the tax code, especially since the top 1 percent of all earners already pays 38 percent of all federal personal income taxes.

Commentary

Politicians who find themselves in legal or ethical trouble frequently run up large legal defense bills. These situations have given rise to the use of legal defense funds, most famously by President Clinton. However, Clinton is not alone. In recent years, legal defense funds have been used by John Ensign, Larry Craig, David Vitter, Ted Stevens, and Roland Burris. Ensign's fund differed from other legal defense funds by registering as a section 527 political organization. Ellen Aprill writes that Ensign's move is unusual and perhaps unique for a member of Congress (p. 277). In her special report, she reviews the advantages of, and difficulties with, registering a congressional legal defense fund as a political organization. She analyzes whether contributions to funds that are not section 527 organizations are income to the official and whether there are matching deductions. She concludes that Congress should amend Senate and House rules on legal expense funds to explicitly recognize section 527 funds.

The *Mayo* decision by the Supreme Court has thrown the tax community into an uproar, as both practitioners and the government attempt to determine the effect of increased deference to tax regulations. *Mayo* lowered the standards that the government must satisfy in defending Treasury regulations and might have significantly raised the bar for taxpayers challenging regulations. Stuart Bassin and Beatrice Larkin address the effect of *Mayo* on retroactive regulations and find that while the decision might have eliminated several arguments used by taxpayers, it leaves retroactive guidance vulnerable to validity challenges (p. 293). The IRS is still required to establish unambiguous statutory authority for a retroactive regulation under section 7805, Bassin and Larkin write. They conclude that without this statutory hook, a retroactive regulation will fail, even after *Mayo*.

The IRS administers several tax programs designed to benefit businesses. These subsidies total more than $365 billion per year and contribute greatly to the federal deficit. Robert McIntyre argues that the programs are among the most wasteful and inefficient of federal programs and that eliminating them would improve economic efficiency and make the United States a more equitable society (p. 309). According to McIntyre, corporate subsidies are so high that they reduce the effective corporate tax rate to barely half its statutory level. Subsidies for foreign activities, accelerated depreciation, energy credits, the domestic production deduction, and the research credit are the subjects of McIntyre's ire. Eliminating these tax expenditures is the logical first step in any deficit reduction plan, he concludes.

Attorney fee structures are common, but Robert Wood writes that it is not clear whether court-awarded attorney fees can be structured (p. 315). Court-awarded fees can be very large, especially in class action lawsuits. After reviewing the change in the IRS's position after the *Childs* decision, Wood concludes that there is no reason that court-awarded fees can't be structured. He advises practitioners and taxpayers to pay close attention to the nature of the court order and whether it calls for periodic payments.

The Ryan budget plan would slash nearly $6 trillion from the federal deficit and would also lower both personal and corporate income tax rates. In some ways, this seems a remarkable (if improbable) achievement. Bruce Bartlett doesn't believe that Ryan's plan is workable and criticizes the vague nature of the tax sections of the budget resolution and the use of the Heritage Foundation to score it (p. 321). The budget resolution contains many unsupported assumptions, particularly about economic growth, that makes its claim to raise 19 percent of GDP in revenue in perpetuity dubious, Bartlett writes. The Ryan plan is unlikely to make it past the Senate or White House, Bartlett predicts, although he also cautions that Democrats should be wary of accepting portions of Ryan's proposal as the price for raising the debt limit. ■