From the Editor:

Begich Plan for Social Security an Overreach

By Jeremy Scott — jscott@tax.org

Mark Begich benefited from a bit of luck in his successful bid to become a Democratic senator from Alaska. He ran against longtime incumbent Ted Stevens, who was on trial for corruption during most of the campaign. Stevens was ultimately convicted, which was a crippling blow for his campaign. However, soon after the election a court threw out Stevens's conviction. By then, however, Begich had already taken over the seat — just one of many Democratic pickups during the party's highwater mark in 2008. (In a curious aside, former Gov. Sarah Palin thought that Begich should resign, but the Democrat decided not to oblige her.)

Begich will be lucky to win a second term. Alaska is a solid Republican state, and he has several votes in the Senate that will likely weigh his candidacy down. However, that hasn't stopped the senator from pushing a very progressive agenda on Social Security. Begich has proposed eliminating the earnings cap on FICA taxes. This would be a significant tax increase for anyone making more than the cap. But it would ensure the solvency of Social Security indefinitely, according to Begich. Progressives, of course, praised the plan.

Begich's plan is ambitious — too ambitious, according to Joseph Thorndike. He writes that the senator is trying to raise taxes too much and that liberals would be better off spending their political capital elsewhere. Social Security simply doesn't need such a drastic change, Thorndike says. The program is reasonably secure, at least when compared with Medicare. Thorndike also explores the history of the earnings cap, finding that it is hard to pin down why Congress originally enacted it. (For Thorndike's analysis, see p. 937.)

Reforming payroll taxes is tricky, as Begich will probably discover if he tries to push his plan. Congress has shied away from fixing obvious defects in the payroll tax regime, according to Willard Taylor. He writes that there are clear defects in the rules, including the different tax bases for SECA and FICA taxes. Taylor favors even more radical reform than Begich. He would like to see the payroll tax regime integrated with personal income taxes. He argues that policymakers need to start looking at FICA and SECA taxes as taxes, not quid pro quos for government benefits. (For Taylor's special report, see p. 983.)

Democrats would like to raise taxes on upper-income taxpayers. On the surface, that is exactly what the Begich plan would do. The earnings cap would disappear over seven years, raising marginal tax rates significantly. But the money would go toward securing an already relatively secure program. Begich's colleagues in the Senate and House would probably prefer to use any revenue they can get from the rich to lower the deficit or pay for revenue-neutral corporate tax reform. As Thorndike points out, Begich's bill is aspirational — meaning it has no chance of being taken up by Congress. While the Senate might not take much notice of Begich's plan, you can bet potential Republican challengers in Alaska have noticed. What the senator has essentially done is set himself up to be attacked as favoring a massive tax increase during a weak economic recovery.

Deduction Caps

A cap on deductions and credits has been discussed as a possible pay-for in revenue-neutral tax reform. A cap was part of Mitt Romney's plan to reduce tax rates, and it has been frequently included in President Obama's budgets. Unless it is carefully constructed, however, it might end up raising marginal rates for many taxpayers and could harm economic growth, Martin Sullivan writes. A deduction cap can be structured in four different ways, according to Sullivan, who looks at plans from Obama, Romney, Martin Feldstein, and the phaseouts that will return if the Bush tax cuts expire. Each plan could raise marginal tax rates, he points out. Congress must consider the damaging incentive effects of higher marginal rates resulting from caps, Sullivan concludes. (For his analysis, see p. 939.)

Commentary

In *Love v. Commissioner*, the Tax Court allowed several taxpayers to convert more than $10 million of compensation into appreciation on S corporation stock. The IRS asserted that the taxpayers should not be allowed to deduct the losses resulting from paying the compensation to them after the stock purchase. The Tax Court, however, sided with the taxpayers. Robert Feldgarden analyzes the decision and points out several lines of argument that the

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IRS could have used to better effect (p. 973). Originally the IRS relied on section 382, which applies to limit the amount of certain loss deductions. Feldgarden speculates that the IRS dropped this line of reasoning because of a safe harbor in Notice 2003-65. He also asserts that the IRS might have had more success if it had tried to characterize the $10 million as excessive compensation.

Deferred tax positions can be controversial. The IRS has sought to bring some light to the area through the UTP disclosure regime. The size of deferred tax positions has also been cited as a reason that some businesses might not be in favor of reducing corporate tax rates. It is an area that must be addressed if tax reform is to move forward. Jana Raedy, Jeri Seidman, and Douglas Shackelford provide a comprehensive analysis of the information on deferred tax and rate reconciliation items located in the tax footnotes of the *Fortune* 250's financial statements from 1993 through 2007 (p. 997). They find that the largest deferred tax position is property, plant, and equipment. The largest rate reconciliation items are foreign and state tax rates. Disclosures in tax footnotes vary across years and industries, they conclude.

In an unprecedented move, the Congressional Research Service recently withdrew a report by Thomas Hungerford that found there was no linkage between the top tax rate and economic growth. Conservatives and Republicans attacked the report's method and alleged bias. Bruce Bartlett writes that Republicans frequently attack any credible study that challenges aspects of their economic dogma (p. 1007). He reviews the controversy over the Hungerford report and finds many arguments used to refute the report's conclusions unconvincing. He finds it ironic that if Republicans had simply ignored the Hungerford report, it would have received little attention. However, he concludes that the CRS is in danger of Republican retaliation and possible budget cuts.

Many plaintiffs assign their rights to a recovery for charity. This can be a very efficient practice, writes Robert Wood (p. 1013). Any assignment of recovery rights must be complete, according to Wood. If the assignment is done properly, while the outcome of the case is uncertain, it should not have any adverse tax consequences for the plaintiff, he concludes.

Master limited partnerships have become popular for investment funds in recent years. MLPs are limited partnerships that can be traded on a securities exchange. Most MLPs have operations related to the energy industry. Kara Friedenberg and Meredith Jensen look at how the tax law treats MLPs (p. 1019). Investing in MLPs can be complicated, so taxpayers should consult with their advisers and make sure that the investing fund has reviewed the offering memorandum and is aware of the consequences of making the trade, they conclude. ■

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