From the Editor:

'Gang of Six' Takes Center Stage

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When the Bowles-Simpson commission released its chairs' recommendations, President Obama declined to endorse the plan. The White House argued that it would not be in the president's interest to support the controversial scaling back of tax expenditures and federal spending before it received significant support from Congress. As a result, six senators (three Republicans and three Democrats) began work on drafting legislative language that incorporated most of the commission's plan. For almost nine months the so-called Gang of Six worked on their bill, even though many in Congress believed events had passed them by. Last week the senators finally unveiled their tax and budget reform proposal, and Obama, with his usual impeccable sense of timing, announced his support.

The Gang of Six plan is not as radical as Bowles-Simpson. It would result in $4 trillion of deficit reduction over the next 10 years. It includes no specific revenue raisers, instead directing individual taxwriting committees to fill in the gaps. It would lower individual and corporate rates to somewhere between 23 and 29 percent and move the United States to a territorial system. The Gang of Six made an effort to tie their plan to the debt ceiling talks, specifying $500 billion in immediate cuts that would be made in exchange for a ceiling increase, along with the promise of additional cuts if committees did not meet their targets.

Democrats, particularly in the Senate, embraced the Gang of Six plan. Obama signaled his support, and the White House began to suggest tying the plan to the Reid-McConnell proposal for a short-term debt ceiling extension. Republicans in the House were less enthusiastic, expressing their dissatisfaction with the revenue components of the plan and arguing for spending caps and a balanced budget amendment. The House plan was rejected by the Senate at the end of last week. House Speaker John Boehner tried to rein in optimism that the Gang of Six would lead to a compromise with the White House, pointing out that he had never voted for a tax increase and didn't plan to. (For coverage, see p. 346. For an analysis of the balanced budget amendment, see Diana Furchtgott-Roth's article on p. 427. For Caroline Harris's take on the debt ceiling debate, see p. 431.)

Who knows what would have happened if Obama had supported Bowles-Simpson right from the start. Perhaps the Gang of Six could have worked more openly, and the repeated fits and starts in the debt ceiling talk could have been avoided. More likely, the holes in the plan would have been discovered more quickly. As House Republicans pointed out, to meet the Gang of Six's targets would require scaling back employer-provided healthcare exclusions, child tax credits, or the mortgage interest deduction (or some combination of all three). We'll see if lawmakers overlook that and use the Gang of Six as the basis for a deal, or if the long-awaited plan was simply another red herring in these torturous talks.

Credit Default Swaps

The Dodd-Frank Act was intended to tighten the regulation of the financial industry and reduce the use of risky products that increased leverage in the system. However, the act failed to target credit default swaps, which should have been banned by Congress, according to Lee Sheppard. The government's failure to develop guidance on credit default swaps may come back to haunt it as important questions about the products are now before a bankruptcy court, Sheppard writes. While reviewing the case of Ambac and discussing the eurozone crisis, she argues that a court of equity might set precedent that is bad for the tax law. (For her analysis, see p. 323.)

Foreign Tax Profiles

Large U.S. multinationals and domestic companies can have wildly different tax profiles. Martin Sullivan looks at the top 50 U.S. companies and compares their before-tax profits, worldwide effective tax rates, foreign profits, and foreign effective tax rates. He finds that oil and energy companies generally pay high effective tax rates, while technology and pharmaceutical companies are more able to take advantage of low-tax jurisdictions to reduce their foreign effective tax rates. (For the analysis, see p. 330.)

Commentary

The debt ceiling debate in Washington has brought sobering attention to the federal budget situation. The government faces large fiscal deficits for the foreseeable future. The short-term deficits might be seen as helping the economic recovery, but

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the long-term deficits projected over the next 10 years are sources of major concern, according to Alan Auerbach and William Gale (p. 375). They calculate that the debt-to-GDP ratio will reach 87.4 percent by 2021 and that deficits are likely to exceed 6 percent of GDP for the foreseeable future. Even the most optimistic forecasts show a situation that needs to be addressed sooner rather than later, Gale and Auerbach write.

In part 2 of their look at the Dodd-Frank Act's effect on taxation, Viva Hammer, John Bush, and Paul Kunkel address securitization, derivatives, and executive compensation (p. 389). The authors review the act's new risk retention requirements in securitization transactions, lawmakers' attempts to limit the effect of the act on derivatives' treatment under section 1256, and the new requirements for shareholders to be directly involved in executive compensation decisions. They advise practitioners and taxpayers to pay close attention to the development of guidance on the Dodd-Frank Act and the tax consequences of the myriad reforms.

In recent years, Congress has been concerned about the use of devices to bail out corporate earnings without dividend tax treatment. Section 304, which treats the sale of stock to a related corporation as a constructive redemption, is one of the laws designed to prevent those devices. William Brown writes that because these rules apply differently to parent-subsidiary stock sales, section 302(b)(1)'s dividend equivalency rules should be applied more flexibly (p. 415). He also advocates changes to section 304 to eliminate or modify circular attribution of ownership in a parent-subsidiary stock sale.

Many policymakers, including the president, would like to reduce the corporate tax rate. Although there is a difference in opinion about whether such a rate cut should be paid for by eliminating tax breaks for businesses, almost everyone agrees that a lower corporate rate would benefit U.S. competitiveness and discourage the migration of capital overseas. However, a lower U.S. corporate rate would also affect the value of companies' deferred tax assets and liabilities, an aspect of reform that is frequently overlooked. Tom Neubig, Chester Abell, and Morgan Cox write that a lower corporate tax rate could result in significant financial statement effects in the period of enactment (p. 423). They analyze the size of deferred tax assets and liabilities for the top 50 public corporations and find that it would be hard to predict the effect of a change in tax rate without a more detailed analysis of each company. The authors also discuss how this issue was addressed in 1985 and during Ohio's corporate tax reform efforts in 2005.

The origin of the claim doctrine controls the tax character of payments made as a result of settlements. The code does not allow deductions for any fine or penalty paid to the government as a result of a violation of law. Robert Wood and Christopher Karachale write that this can cause great controversy when it is not clear whether a fine or penalty would be imposed in the absence of a settlement (p. 433). The nondeductibility of fines creates incentives to avoid the rule, which leads to controversial deductions, they argue, using the settlement of the Exxon Valdez oil spill litigation as an example.

Charitable deductions related to conservation easements have become a heavily litigated area for the government and taxpayers. The government frequently disputes the valuation of such deductions. In Estate and Gift Rap, Wendy Gerzog writes that conservation easements and mortgages don't usually mix, and she reviews the *Kaufman* decision by the Tax Court (p. 437). In addition to the portions of the decision related to mortgaged property, Gerzog also reviews the court's emphasis on evidence establishing the value of the donor benefit.

The use of the gift tax exclusion is a staple in estate planning. Used annually, gift tax exclusions can transfer a substantial amount of wealth out of a taxable estate over the lifetime of a donor. Bridget Crawford calls for limiting the gift tax annual exclusion to outright transfers and transfers in trust that will be included in the beneficiary's gross estate (p. 443). She argues that the exclusion has caused taxpayers and their advisers to create trusts with overly complicated terms that serve no meaningful purpose. ■

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