

From the Editor:

U.K. Austerity Package Shows Deficit Reduction Possibilities

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After 13 years in office, the U.K. Labour Party fell to a Conservative-led coalition earlier this year. Part of the problem was the unpopularity of former Prime Minister Gordon Brown, but the economy and Labour's attempts to bring the United Kingdom's growing debt-to-GDP ratio under control also undermined Brown's chances to stay in power. But if voters were expecting the Conservative-Liberal Democrat coalition to roll back Labour's belt-tightening proposals, they are likely to be sorely disappointed.

The new U.K. government recently unveiled its planned austerity budget, which is designed to reduce the country's deficit to 1.1 percent of GDP by 2016. According to Martin Sullivan, the proposal is far beyond anything that the United States could hope to accomplish in the near future (p. 1204). The British budget calls for a mixture of tax increases, tax reform, and spending cuts to achieve its goals, according to Sullivan. Almost 80 percent of the deficit reduction is accomplished through spending cuts. The other 20 percent comes from an increase in the United Kingdom's VAT. Sullivan writes that if the United States were to attempt a similar package, it would require \$7.7 trillion in spending cuts over the next 10 years, along with \$2.6 trillion in tax increases. He concludes that there is little chance of President Obama's fiscal commission coming up with such a radical package.

Some might argue that the British budget is a preview of things to come in the United States. After all, aren't the Republicans expected to take over the House (and possibly the Senate) this fall, just like Cameron's Conservatives won a plurality of Parliament in the spring? The reality is that a right-of-center takeover in the United States is likely to hinder the adoption of a deficit reduction package, rather than speed it up. If Republicans do win back a large measure of national power this fall, they are unlikely to be in the mood for compromising with the White House over the makeup of a budget package. A Republican House makes it far less likely that there will be significant tax or budgetary reform during the rest of Obama's term.

Healthcare and the Bush Tax Cuts

The constitutionality of the healthcare reform law has been a topic of discussion since the individual mandate was proposed last year. But now the talk is starting to transform into action, as the lawsuits filed by Virginia, Florida, and 19 other states work their way through the judicial system. Lee Sheppard looks at the constitutional status of the individual mandate following a Virginia district court decision that allowed the state's suit against the law to proceed (p. 1195). Sheppard criticizes the healthcare reform law for failing to tackle the fundamental issue of the United States' reliance on employer-provided healthcare and private payments processors. She writes that the critical issue in the constitutional debate is whether the mandate can be considered a tax, which aids the government's argument that the requirement for all individuals to purchase insurance is an acceptable use of federal power. Congress might be better off repealing the healthcare law and reenacting it as simply a reform of Medicaid and Medicare taxes, Sheppard concludes.

Extension of the Bush tax cuts is likely to dominate Congress over the next few weeks, as Democrats work to unify their fractured caucus and Republicans angle to secure current rates for all taxpayers for as long as possible. Full extension of the Bush tax cuts, including the rates for the top 2 percent of taxpayers, is an ineffective way to deliver stimulus, Sullivan writes. Unless upper-income earners are convinced such tax cuts are permanent, they will be wary of increasing saving and investment in response to an extension, according to Sullivan's analysis. (For coverage, see p. 1213. For Sullivan's overview, see p. 1201.)

Commentary

Excise taxes on "sin" have been a feature of federal revenue collection since the foundation of the republic. The taxes are popular with governments because they can be sold to the public both as a means to support spending and a way to promote social good. According to Bruce Bartlett, sin taxes may prove to be an effective way for states and the federal government to cope with the latest financial crisis. In his debut column on p. 1289, Bartlett addresses the push to legalize and tax the sale of marijuana in California. He also estimates how much revenue could be raised by a full legalization of drugs in the United States. Prohibiting nonviolent activities and substances that people are going

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to insist on doing or using anyway is an ineffective way to stamp them out, Barlett concludes, adding that legalizing them may allow society to keep them within acceptable bounds while raising significant government revenue.

The tax-free treatment of corporate reorganizations depends on taxpayers observing numerous technical rules. One such rule is that the stock of the parent of the acquiring corporation can be used in a tax-free merger, but not the stock of a grandparent corporation. That rule might have changed with the lapse of the remote continuity doctrine, according to Michael Schultz (p. 1249). Schultz believes that the remote continuity doctrine was rendered superfluous by 1998 Treasury regulations that implemented the continuity of business enterprise requirement. Although most practitioners would find it surprising, it is now possible to use grandparent stock, according to the author. He hopes that the IRS will clarify this issue in the future, but he concludes that a statutory amendment is not required.

The IRS's uncertain tax position reporting proposal has received a great deal of criticism from the tax practitioner community. Many believe that it will impose an undue burden on corporations, and others question whether the Service even has the authority to implement it. The IRS maintains that it will increase tax efficiency by allowing audits to be more streamlined. J. Richard Harvey, a former senior adviser to the IRS commissioner, writes that Schedule UTP is both necessary and reasonable (p. 1259). In fact, he is concerned that taxpayers will try to avoid disclosure and proposes several ways that the IRS can minimize the opportunities for corporations to skirt the requirements. Harvey also proposes a compromise whereby the IRS will agree not to investigate specific tax reserves that are adequately disclosed. If the IRS is able to obtain a description of all material corporate tax issues and some indication of their size, it will have made a giant step forward in auditing corporate returns, Harvey concludes.

There are many commentators who believe that the government should eliminate all capital gains taxation. While it is highly unlikely that Congress

would eliminate the capital gains tax soon, it is possible that the tax will be changed if serious deficit reduction or tax reform packages emerge later this year. Excessive complexity has developed in the area of capital gains taxation, according to Philip Harmelink, William VanDenburgh, and James Hasselback (p. 1262). They argue that Congress should radically simplify the way the tax is imposed and the calculation of all the various rates that apply to tax capital gains. Schedule D contains four worksheets, and the steps required are virtually unworkable, the authors write. Using a series of examples to illustrate the needless complexity of the law, they propose several alternatives for simplification that would have little to no revenue impact.

The taxation of derivatives is incoherent under current law and the Dodd-Frank financial reform bill did little to clear it up, writes Yoram Keinan in this week's Shelf Project (p. 1269). Keinan believes that the rules try to follow too many models and are subject to complicated antiabuse overrides. His proposal is to use a single, coherent approach under which most positions in derivatives would be marked to market, and gains and losses would be ordinary in character and sourced to the residency of the recipient. He concludes that current realization rules distort the economic decisions of taxpayers and create inefficiency by virtue of tax planning.

In a follow-up to his analysis of the tax return preparer registration rules proposed by the IRS, Kip Dellinger criticizes the reaction of the CPA community to the IRS proposal (p. 1291). Dellinger writes that CPAs are overreacting to the proposals, which he concedes are overbroad. In his conclusion, Dellinger writes that the proposals will probably hurt employment and that the government once again has failed to take into account the costs to the private sector when implementing a new regulatory process.

Robert Wood criticizes the tax advice given to plaintiffs by their attorneys in his column on p. 1285. Specifically, Wood targets the practice of obviating withholding and filing Form 1099 for monies paid to plaintiff attorneys. He calls it inappropriate and advises defendants to object. ■

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