From the Editor:

Are the Democratic Budgets Fiscally Sound?

By Jennifer Brown — jbrown@tax.org

Obama's budget is toast, according to Martin Sullivan. And that's right — at this point it is all about the budget resolutions passed by Congress late last week. So what about Congress's replacement budgets? Are they fiscally sound? Unfortunately, the answer is no.

Sullivan has big problems with what the Democrats are doing — indeed, he believes their budgets are fiscally irresponsible. Why? Because they aren't sustainable. Sustainability is, according to Sullivan, the minimum standard for a good budget, and it is usually interpreted to mean that the national debt as a percentage of gross domestic product is stable. Thus, according to Sullivan, cutting the deficit in half — the proclaimed goal of the Democrats — does not necessarily equal fiscal responsibility. But is sustainability enough? No. Sullivan says we must also concern ourselves with the level of debt, which can have multiple adverse effects on the economy. First, more debt crowds out private capital formation; second, it hurts intergenerational equity; third, it increases the temptation for inflation; and fourth, it reduces fiscal breathing room for any future crisis. For Sullivan's economic analysis, turn to p. 7.

Both the House and Senate did pass budget resolutions last week, setting up debate over the estate tax and health care. The House resolution is a blueprint of Democratic priorities and as such is similar to President Obama's budget. Along with extending income tax rates and tax incentives for middle-income folks, it calls for patching the AMT for five years and maintaining the estate tax. While the House moved quickly on its budget, the Senate did not — it engaged in a ''vote-o-rama,'' in which senators are allowed to offer an unlimited number of budget amendments. Many amendments passed by the Senate were tax related, including one that provides for an exemption level of $5 million and a top estate tax rate of 35 percent. Other amendments passed included one authorizing deficit-neutral legislation to protect small businesses from tax increases, one to fund repeal of the 1993 increase in income taxes on Social Security benefits, and a proposal authorizing improvements to the employer-provided childcare credit. (For coverage of the passage of the House and Senate budget resolutions, see p. 11.)

The IRS and Tax Analysts have reached an agreement over treatment of e-mailed legal advice sought by Tax Analysts since a 2005 lawsuit brought under the Freedom of Information Act. The lawsuit sought disclosure of written legal advice in the form of e-mails from the IRS Office of Chief Counsel to field personnel. Nondisclosure of the advice under the so-called two-hour rule of Chief Counsel Notice 2004-012 violated section 6110, Tax Analysts argued. Resolution of the lawsuit came after numerous discussions by the parties on the scope of disclosure necessary. We hope the resolution of this case marks a new chapter of cooperation between Tax Analysts and the IRS that will help ensure the transparency necessary for good government. Tax Analysts has worked to force the transparency of the tax rules since it was founded in 1970 (p. 13).

The Obama administration has nominated scholar Helen Elizabeth Garrett to be the next Treasury assistant secretary for tax policy, a post traditionally held by a practicing tax attorney. Garrett is vice president for academic planning and budget at USC and codirector of the USC-Caltech Center for the Study of Law and Politics. Garrett was also a member of the President's Advisory Panel on Federal Tax Reform in 2005 (p. 18).

Commentary

The use of conservation and façade easements as charitable contributions continues to rise, according to the latest numbers provided by the IRS in a *Statistics of Income Bulletin*. Robert Honigman writes that partnerships face unique challenges when using this form of charitable deduction (p. 73). After discussing the general rules applicable to the contribution of conservation easements to charity, Honigman analyzes the capital account and tax basis issues present in these transactions when a partnership claims the deduction. Honigman is concerned about the lack of guidance on the proper interaction of charitable contribution deductions and subchapter K.

As the cost of government rises, the public's willingness to accept new taxes could become a key issue. In this week's On the Margin, Karlyn Bowman looks at how the American public perceives its tax burden, tracing opinion poll responses from the 1940s through the present. Bowman's data show that the Republicans have recently lost the upper hand on tax issues, that Americans believe that corporations and the wealthy pay too little in taxes, and that the percentage of respondents who think their tax burden is too high has dropped precipitously since the 1990s. Bowman's article begins on p. 99. In a viewpoint, Martin Lobel calls for businesses to give up their sense of entitlement and work with the government to produce equitable tax reform (which must involve tax increases and the loss of tax preferences) and fair regulatory improvements (p. 85). Current and Quotable features testimony by Prof. George K. Yin calling for Congress to resist the temptation to extend any of the George W. Bush income tax cuts, because the country simply cannot afford them (p. 117). Obama and congressional Democrats, however, are unlikely to heed this advice, as the Bush tax cuts on middle-income earners are expected to be extended in the final 2009 budget.

According to Robert Wood, everyone seems to think that all attorney fees are deductible. Deductibility provides some relief to rising legal costs. However, Wood believes that this is a misconception and points specifically to legal costs that are personal expenses. His practice article on p. 65 breaks down the various categories of legal fees and provides advice on how to successfully claim deductions. Wood also appears in a book review on p. 97, as former IRS Commissioner Lawrence Gibbs provides a favorable critique of Wood's treatise on qualified settlement funds and section 468B. William Potter and Corey Kessler analyze the final intercompany regulations released on December 24, 2008 (p. 67). Potter and Kessler conclude that while the new regulations are an improvement over the 1995 regulations, Treasury has fallen short of its objective of clarity for intercompany obligations extinguished within a consolidated group.

Although section 457A is widely viewed as an attempt to target the compensation of offshore hedge funds' U.S.-based managers, Andrew Oringer believes it has substantially broader applications. Specifically, Oringer focuses on Notice 2009-8, which expanded the definition of a nonqualified deferred compensation plan. Oringer thinks that Treasury's authority for doing so is not apparent (p. 93). Charles Hennig, John Everett, and William Raabe point to another instance in which Treasury seems to have overstepped its authority. Their viewpoint, on p. 86, addresses the reportable entity partner rules found in the instructions to the partnership schedule M-3. Designed to promote greater transparency to prevent the abusive use of off-balance sheet financing, the instructions rise to the level of rules and regulations and ''delve into the legislative function of lawmaking,'' the authors argue. Robert Willens writes about a downstream transfer in a recent IRS letter ruling in Of Corporate Interest on p. 107. What Were They Thinking by Jasper L. Cummings, Jr. looks at the Supreme Court decision in the 1941 *McClain v. Commissioner* case. Cummings believes the Court misstated the law that governs the overlap between sections 165 and 166 as applied to losses on debts (p. 111).

A letter by Prof. Nina Crimm analyzes Paul Krugman's recent op-ed on Treasury's plan to partner with private investors to purchase bad bank assets. Crimm also provides some suggestions on how Treasury can improve its Public-Private Investment Program (p. 123). In a follow-up to his previous letter to the editor, Jefferson VanderWolk clarifies the application of *Dickman v. Commissioner* to White House Chief of Staff Rahm Emanuel's rent-free use of a former colleague's house (p. 124). ■