From the Editor:

'Buffett Rule' Distracts Attention From Real Tax Reform

By Jeremy Scott — jscott@tax.org

The presidential election campaign is fully underway, as both President Obama and Republican challenger Mitt Romney recently crossed paths in the battleground state of Virginia. While the general economy is likely to be the deciding issue of the campaign, tax policy has played a major role in both men's early rhetoric. Obama, in particular, has tried to make tax fairness resonate with voters, pushing gimmicks such as the "Buffett rule," which would require millionaires to pay at least 30 percent in taxes. Romney has tried to shift the tax fairness debate in a different direction, pushing for a rate reduction for all taxpayers as part of a major tax reform effort.

Campaign rhetoric might help attract attention to the issue of tax reform, but proposals like the Buffett rule or the elimination of subsidies for the highly profitable oil and gas industry only obscure the real reforms needed to raise revenue, spur growth, and simplify the tax code. That is the argument of Martin Lobel, who writes that it won't be easy to repeat the success of 1986. Everyone is in favor of eliminating tax expenditures, except those who benefit from them, Lobel argues, pointing out that often those that benefit from tax incentives are well connected enough to have gotten the subsidies in the first place. In his outline for tax reform, Lobel proposes increasing the top tax rate to 67 percent (which would raise $4 trillion over 10 years), leveling the playing field between domestic and multinational corporations by eliminating the bias for income shifting, and converting tax expenditures into direct appropriations that are more transparent. (For Lobel's article, see p. 875.)

Lobel is right to argue that the Buffett rule distracts Americans from more serious proposals for tax reform. Obama is aware of this, but he probably doesn't care. His push for tax increases on millionaires is an attempt to curry favor with voters, who polls show are strongly in favor of raising taxes on the wealthy. Republican opposition and the scant revenue raised by a Buffett rule make it unappealing as part of a reform compromise similar to the 1986 act. Perhaps the Obama administration is simply not that serious about tax reform. Obama has consistently failed to release a detailed plan, and the White House may have scrapped a white paper on tax reform being prepared by Treasury. While many commentators might not like the result, comprehensive tax reform is a lot more probable under a potential Romney administration than if Obama wins four more years.

Consumption Taxes as the Holy Grail

Many economists and conservatives support moving the United States to a consumption tax system. Consumption taxes, however, tend to be regressive, which robs them of progressive support. Alan Viard and Robert Carroll might have solved that problem by reviving the concept of the Bradford X tax, according to Martin Sullivan, who reviews their book *Progressive Consumption Taxation: The X Tax Revisited*. Sullivan writes that Viard and Carroll's proposal seems to combine the best features of an economically efficient consumption tax and a progressive income tax. While the X tax wouldn't solve the United States' problems with transfer pricing, it would be more efficient than the current tax system and might increase GDP by more than 2 percent, he concludes. (For Sullivan's review, see p. 807.)

Commentary

Exchange funds have been around since the 1930s in one form or another. However, the economic downturn has revived interest in them as taxpayers seek to avoid taxable diversification. David Herzig, who first wrote about exchange funds in 2009, writes that the IRS and Congress have failed to solve problems with exchange funds, namely that the policies behind section 351 were for start-up companies and not investment vehicles (p. 865). In his special report, he reviews the history of exchange funds and looks at the latest proposed legislation. He also analyzes the New York State Bar Association report and offers a proposal of his own.

On February 13 the IRS issued a revenue procedure that allowed partnerships to distribute Schedules K-1 electronically. The guidance allows partnerships to use electronic distribution and still comply with section 6031(b). While electronic distribution will improve efficiency and reduce costs, there are several key requirements that must be satisfied to comply with Rev. Proc. 2012-17, Scott Stein, David Steiner, and Judith Daly write (p. 873). They look at how to obtain consent for electronic delivery, data security, and the required disclosures, while also discussing the penalties for noncompliance.

In an earlier article, Sullivan wrote that if the Supreme Court struck down the individual mandate in the healthcare reform law, all tax incentives in the code could suddenly be at risk (*Tax Notes*, Apr. 2, 2012, p. 14). Sullivan's argument was mostly concerned with the economic equivalence of the mandate and many tax credits. Erik Jensen believes that Sullivan might have overreacted. In his response to Sullivan, Jensen points out that there is a legally important distinction between mandates and incentives (p. 879). Economic equivalence does not always mean legal equivalence, Jensen writes. He concludes that tax incentives must be considered on a case-by-case basis and that the Supreme Court's decision will not necessarily threaten the entire tax code.

The Republican Party has long pushed for the indexing of capital gains. In anticipation of a possible Romney administration, several lawmakers have argued that the Treasury Department has the authority to index capital gains for inflation without additional legislation. Bruce Bartlett writes that many legal scholars believe that the case for implementing indexing by fiat is stronger now than when the idea was first proposed (p. 883). Although it might be possible to implement the change without involving Congress, Bartlett argues that the chairs of the House Ways and Means Committee and the Senate Finance Committee would probably jealously guard their prerogatives and strongly recommend that such a change be made through legislation.

S corporation compensation continues to cause confusion and prompt new legislation. While the use of S corporation changes as a revenue raiser in a bill designed to keep student interest rates low was rejected by the Senate, the issue is likely not dead. (For coverage, see p. 824.) Robert Wood and Christopher Karachale examine the role of payroll taxes in the context of S corporations and look at the porous line between dividends and compensation (p. 893). The issue of reasonable compensation for S corporation owners is subjective and often comes down to a battle of competing experts, they write. Wood and Karachale conclude that the line between reasonable and unreasonable might become even murkier when the Medicare surtax from the healthcare reform law goes into effect next year.

In their annual look at the public's perception of taxes, Karlyn Bowman and Andrew Rugg find that public attitudes have changed very little, despite the increased attention on the taxation of the wealthy and flat taxes (p. 899). They find that 62 percent of Americans believe that upper-income taxpayers pay too little in taxes, up from 59 percent in 2011. They also review polls that show Republicans have lost ground on the tax issue, with Democrats scoring about the same. That is a stark change from attitudes in late 2010, when Republicans did very well in the midterm elections.

Stewart Karlinsky reviews developments in individual and passthrough taxation in 2011 on p. 887. In the individual area, he looks at audit rates, the updated estimates on the tax gap, inflation adjustments, and attempts to avoid self-employment taxes. For passthroughs, he focuses on adjusted basis claims, section 179, Roth IRAs, and unified business enterprises.

This week's 40th anniversary article is by Kenneth Kies, who served as chief minority counsel for the Ways and Means Committee. In an article first published in 1990, Kies looked at the effects of the 1981 tax act over the last decade and predicted the possible direction of tax policy in the 1990s (p. 853). He correctly anticipated the Clinton administration's focus on increasing marginal income tax rates to raise revenue.

In Of Corporate Interest, Robert Willens writes about the taxation of termination fees in the United States and Canada (p. 905). In the United States, termination fees can escape taxation if they satisfy the origin of the claim doctrine, but in Canada, those fees are usually treated as business income and are fully includable in gross income, according to Willens. ■