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'Death Tax' Hopes to Survive Near-Death Experience

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The estate tax was so close to going away that Republicans could almost taste it. Earlier this decade, a GOP-dominated Congress passed a bill that raised the exemption amounts and lowered the rate. One of the strange provisions in the bill called for the tax to disappear in 2010 and then return to Clinton administration levels in 2011. The Republicans considered that provision, which was largely a budgetary gimmick, a poison pill that would force Congress to revisit the issue in 2009. At the time, conservatives probably were confident that Republicans would still control Congress and could permanently eliminate the tax.

The plan didn't go quite as expected. Democrats took control of Congress in 2006 and expanded their majorities in 2008. While the Republican Party overwhelmingly opposes the estate tax, Democrats have a much more complicated relationship with it. Moderate Democrats, such as Sen. Blanche Lincoln of Arkansas, would like to see the exemption levels raised from the 2009 levels. That is also the viewpoint of several Blue Dog representatives in the House from conservative or western districts. Liberal Democrats, however, view the tax as one of the few progressive taxes in the code and are uncomfortable with even the 2009 exemption and rate levels, much less those touted by Lincoln and Republicans. The result of this GOP unity and Democratic waffling has been a year of confusion for estate tax professionals.

The uncertainty might be lifting. The House last week passed its version of estate tax reform, making the 2009 exemption and rate levels permanent. The bill passed by a 225-200 vote and, in a familiar refrain, not a single Republican member voted in favor of it. Business groups, particularly those representing farmers and ranchers, will now take their fight to the Senate, where the House bill faces an uphill battle. Lincoln is working on a compromise bill with Republicans that the minority leader says will garner the support of all 40 Republican senators. If Lincoln sides with them, Democrats won't be able to break a filibuster of an estate tax bill. Senate leadership is also split on whether to permanently enact the 2009 rates or extend them for one or two years. The stage is set for another showdown and, like with healthcare reform, extended gridlock both within the Senate and between the upper chamber and the House. (For coverage of the estate tax vote, see p. 1047. For coverage of lobbying efforts, see p. 1063.)

Republicans and conservatives won the debate over the estate tax's place in the public consciousness long ago. The tax is extraordinarily unpopular, even among those who will never pay it. The fact that the supposedly left-leaning Democratic Party is split over a tax that affects only the wealthiest taxpayers and the largest estates shows the extent to which the debate has shifted over the last decade. Despite this amazing rhetorical success, however, Republicans seemed to have missed their chance to kill the ''death tax'' permanently. Such an opportunity is unlikely to arise again soon, regardless of the outcome of the 2010 election.

Tax Reform and War Taxes

The corporate tax is probably second only to the estate tax in terms of maligned revenue raisers. Unlike the estate tax, however, the corporate tax is under fire from all sides. Even liberals have called for some kind of a reform of how businesses in general and profits in particular are taxed. Martin Sullivan writes about four major options for corporate tax reform. According to Sullivan, reform options run the gamut from simply lowering the rate and broadening the base to replacing the tax with some form of consumption tax. Sullivan concludes that in the near future, the only reform that seems possible is minor tweaking of the corporate tax rate and base, but that policymakers might later have to consider more radical reforms, as a way both to raise revenue and promote economic efficiency. (For Sullivan's analysis, see p. 1043.)

The war tax generated a great deal of debate in Washington last week. After Rep. David Obey, D-Wis., proposed a surtax to offset increased costs related to President Obama's Afghanistan plan, there was no shortage of opinions on whether it was time for Americans to sacrifice some of their income to pay for our national defense commitments. House leaders quickly denounced Obey's plan, but Joseph Thorndike writes that simply debating the issue is real progress. Thorndike traces the history of war taxes in the United States, concluding that Americans are much more supportive of tax increases during wars they support (World War II) than those they are lukewarm about (the War of

1812 and the Vietnam War). (For Thorndike's analysis, see p. 1050. For war tax coverage, see p. 1049.)

Commentary

Energy tax subsidies have multiplied over the last two decades as successive Congresses, both Republican and Democratic, have used tax expenditures in an attempt to encourage the development of alternative fuels and, more questionably, to increase domestic oil and gas production. The latter tax credits are the target of David Cay Johnston's latest column (p. 1119). ''No industry is more tax favored than energy,'' Johnston writes, and he backs up that assertion by listing the various energy tax expenditures. Johnston praises the Obama administration's efforts to end most tax expenditures favoring oil and gas companies, pointing to the testimony of Alan Krueger, the Treasury assistant secretary for economic policy and chief economist. Krueger told a Finance subcommittee that these tax subsidies distort the economy, grant drilling a negative federal tax rate, and favor investment in nonintegrated firms. Johnston concludes that it's time for corporate socialism to end and for oil companies to return to practicing capitalism. In the end, higher market prices that hold down consumption of oil, and especially coal, would be desirable, according to Johnston.

Bethany Record looks at a specific energy tax incentive in her article on the enhanced oil recovery credit. Her viewpoint outlines the credit and its strengths and weaknesses (p. 1107). Record notes that despite the good intentions behind the creation of the credit, the legislative design of the incentive precluded efficient implementation and administration. She proposes several options for future energy tax incentives that would improve the oil recovery credit's design.

The United States' approach to international taxation has been under fire all year. The United States is one of the only countries in the world that still cling to a worldwide taxation system, and some observers would like to see the nation move to the territorial regimes that predominate in other nations. J. Clifton Fleming, Robert Peroni, and Stephen Shay argue in their special report that the U.S. approach more closely resembles a hybrid worldwide system in form. The authors write, however, that the U.S. system's generous exemptions produce a better-than-exemption format and create more complexity without generating greater revenue. Their report outlines the two major debates in the area of international tax reform, and the authors find that the proper question is not whether a well-designed hybrid system is superior to the U.S. worldwide system, but whether a well-designed hybrid exemption system is superior to a well-designed worldwide system. The authors conclude that the United States' flawed approach simply distorts the debate and that a well-designed worldwide system is superior to an exemption regime. (For their report, see p. 1079.)

One of the most popular programs in the stimulus bill passed earlier this year was the so-called cash for clunkers rebate, which allowed consumers to trade in older automobiles for a tax credit on the purchase of a newer and more fuel-efficient design. George White thinks that much of the hoopla over the credit's stimulus of car sales might be overstated (p. 1111). According to White, some observers believe that at least 80 percent of the 700,000 sales eligible for the credit would have taken place anyway. Despite this skepticism, White presents an analysis of the tax angles of the credit, including the unique positions of the buyer and the auto dealer.

Divorce is considered by the courts to be a personal matter, and the legal fees arising from a divorce proceeding are not usually deductible. But what about when the business-related transactions caused by the divorce occur many years later? Robert Wood tries to answer this question in his latest Woodcraft column (p. 1115), using the long, complicated divorce of Terence Melcher (the son of Doris Day) as an example. Wood questions the conclusions of the Tax Court in *Melcher* and says that the taint of divorce should disappear after an appropriate length of time. According to Wood, the origin of the claim doctrine should be a bit more malleable than it is under the interpretation of many courts. ■

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