From the Editor:

Romney and Ryan Have a Chance To Control Tax Reform Debate

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The Republican convention has come and gone, and Mitt Romney is now the party's formal nominee for president. Romney and his running mate, Paul Ryan, are hoping that the GOP convention has pushed the reset button on their campaign, giving them a chance to turn voters' attention to President Obama's economic record and their own calls for smaller government and lower taxes. The president is vulnerable on both fronts. In particular, Obama's lack of leadership on tax reform gives the Romney-Ryan ticket the opportunity to define the debate.

Obama's campaign has emphasized few tax reform proposals, and all have been small. According to Marie Sapirie, the ''Buffett rule'' and the elimination of several targeted tax expenditures would do little to solve the nation's fiscal problems. The Buffett rule is simply a guideline, while plans to eliminate tax preferences for oil and gas companies and change the compensation of carried interest would raise very little revenue, she writes. Obama's lack of leadership on tax policy means that Romney and Ryan have an opportunity to push their own vision of tax reform, she argues. The GOP candidates should embrace House Ways and Means Chair Dave Camp's plan for a territorial tax system, she says. They should also provide details on what tax expenditures can be scaled back to pay for broader reform, she writes. The groundwork for business tax reform has been laid by Republicans in Congress, and Romney should take advantage of that foundation, Sapirie concludes. (For her article, see p. 1095.)

Tax reform requires strong presidential leadership and a commitment of political capital. Obama has provided neither. His corporate tax reform plan is even less detailed than most GOP proposals, and Treasury failed to release a rumored white paper that might have included a plan to tax large passthroughs as C corporations. So far, Romney hasn't done much better. His plan to cut taxes by 20 percent while eliminating tax expenditures is also very vague. But Romney is the challenger, and that gives him the opportunity to present a bolder vision than the president's. As George Will pointed out in *The Washington Post*, many more Americans identify themselves as conservatives than liberals. Romney might be able to tap into that conservatism with a bold tax and fiscal reform plan.

Interest Allocation

Corporate tax reform is an important part of both Romney's and Obama's tax policy proposals. Romney would like to move the country to a territorial tax system, while Obama has consistently proposed rules that would strengthen the current worldwide rules. Despite Obama's position, a move to a territorial system might be inevitable — it enjoys significant support from both parties in Congress. But the devil is in the details. One of those details will be how to keep a territorial proposal revenue neutral, according to Martin Sullivan. He argues that interest allocation rules will be a part of any territorial tax proposal and that allocation rules are important because they avoid eroding the domestic tax base. Using numerous examples, Sullivan shows how a lack of interest allocation rules can result in U.S. multinationals paying a negative tax rate in the United States. (For his analysis, see p. 1098.)

Commentary

Back when the Obama administration seemed likely to release a detailed corporate tax reform plan, there were rumors that Treasury would issue a white paper containing a proposal to tax large passthrough entities as corporations. The theory was that it would raise revenue and discourage tax abuses related to partnerships. Such a proposal is a bad idea, grounded solely in a desire to raise revenue, according to Philip Postlewaite (p. 1177). In his special report, he writes that taxing large passthroughs as C corporations would reverse 30 years of steady movement toward business tax neutrality. If large passthroughs are taxed as C corporations, it will encourage businesses to engage in planning to stay below the corporate tax threshold, he argues. There is also evidence that the revenue impact could be minimal, he concludes.

The healthcare reform laws are designed to expand the reach of health insurance. Obama's stated goal was to reduce or eliminate the number of uninsured Americans. The compromise nature of the reform law makes it unclear whether that goal will be achieved, but there are mechanisms in place to penalize employers that do not offer health insurance to their employees. The question is whether it will be cheaper to simply pay the penalty. Donald Susswein and Bill O'Malley analyze the cost to employers of insuring or paying a penalty under the new healthcare law (p. 1189). They find that the healthcare act may not redistribute income or directly burden taxpayers, but it might result in increased costs to some employees, who could see reduced wages and benefits. The $2,000 penalty might directly reduce the cash compensation paid to workers at companies with more than 50 employees, they write.

Ryan has a long record on tax issues. He is most famous for his 2010 Roadmap for American's Future, in which he outlined a number of reforms to Medicare and other government programs to reduce their costs. Many on the right lauded the plan as a serious attempt to address the government's long-term fiscal future, while critics attacked its lack of detail and its focus on decreasing taxes on the wealthy. Edward Kleinbard writes that Ryan's roadmap would operate in a similar manner to Herman Cain's 999 plan (p. 1195). The plan would convert personal and corporate income taxes into two consumption taxes and repeal the estate and gift tax. In effect, it would create a large new payroll tax, according to Kleinbard. That would be highly regressive because it would immunize old capital from taxation, he writes. Kleinbard concludes that the roadmap might increase the tax burden on middle-income families on the order of 50 percent, while also implementing regressive government spending cuts.

In the second part of his analysis of the history of the Laffer curve, Bruce Bartlett traces the development of supply-side economic theory before the 1970s (p. 1207). He looks at the writings of 14th-century Muslim philosopher Ibn Khaldun, who influenced Nobel Memorial Prize-winning economist Robert Mundell. Bartlett also relates a passage from Jonathan Swift that had an enormous influence on Adam Smith, David Hume, James Madison, and Alexander Hamilton. The idea that raising taxes beyond a certain point raised less revenue than a lower tax rate is far from new, Bartlett concludes.

The scope of the section 104 personal physical injury exclusion is controversial. Courts and the IRS have become more lenient in recent years, but the Service still frequently challenges claims related to physical sickness. Robert Wood addresses damages for exacerbating depression in his column this week, finding that depression might not be enough to cause damages to qualify for the exclusion (p. 1211). Wood looks at the decision in *Domeny*, *Parkinson*, and *Blackwood*. *Blackwood* involved a court's denial of depression-related deductions and made it clear that documentation matters, Wood writes. He also advises practitioners and taxpayers to be reasonable in their allocations and explicit in any settlement agreement.

2009 was the 25th anniversary of the expanded straddle rules. As part of *Tax Notes*'s 40th anniversary, the detailed analysis of the rules that ran that year has been republished on p. 1135. The article was the result of a collaboration among the top practitioners in the field and includes thoughts on the pros and cons of the straddle regulations. Also in 2009, Lee Sheppard published a two-part analysis of derivatives regulation and the Big Bang project to formalize credit default swap documentation and trading conventions (p. 1159). Both parts have been combined into a single article for readers. A third 40th-anniversary article by Jasper Cummings, Jr., is on p. 1172. In it Cummings discussed the history of section 338, focusing on a number of important court decisions, including *Court Holding*. ■