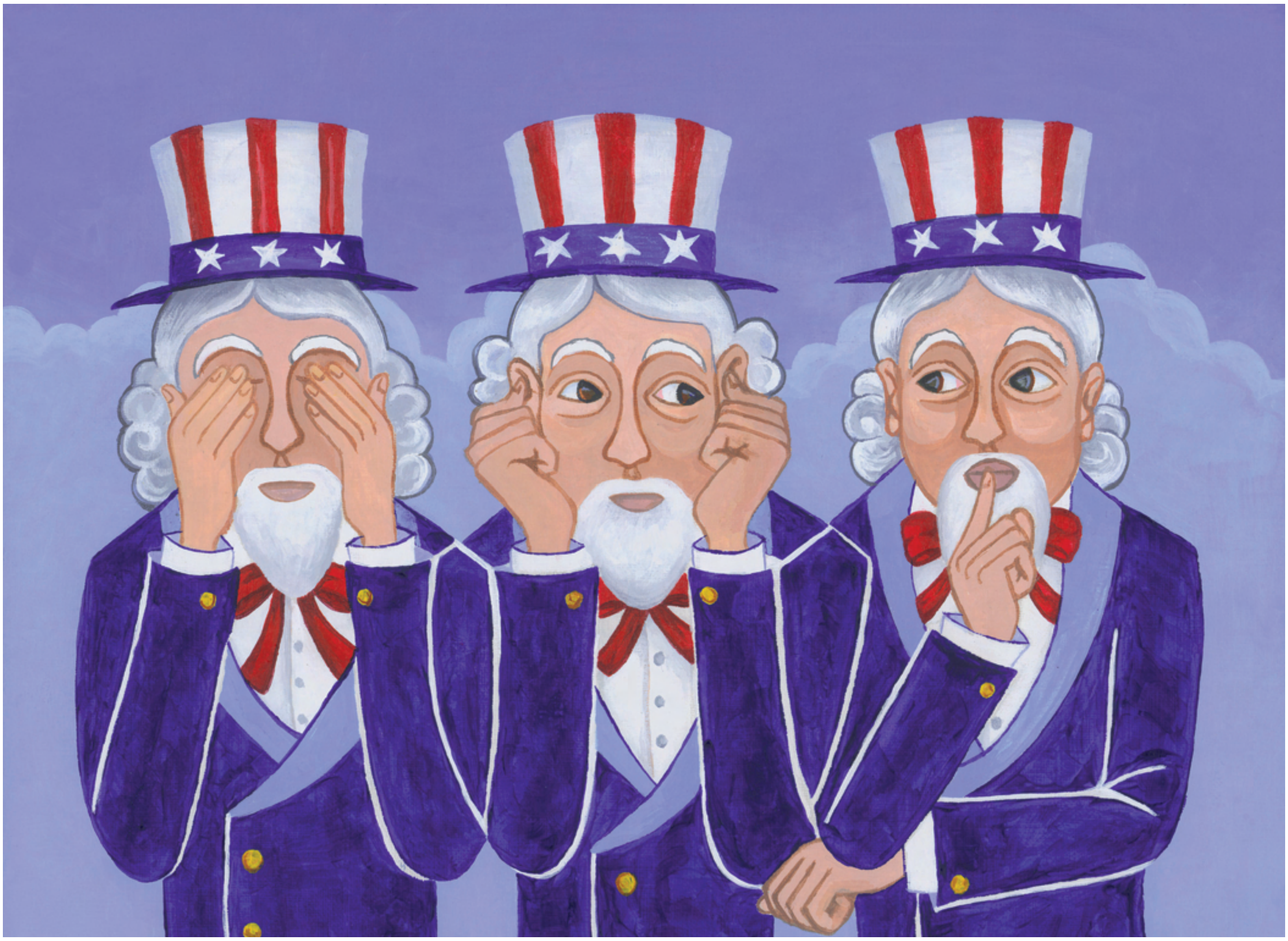


Tax Implications of U.S. Budgetary Pressures

Uncertainty over the Tax Code and the Impetus for Reform

By William M. VanDenburgh and Arthur Hamilton

The accounting profession needs to be actively cognizant of the implications of the U.S. government's recent failed attempts to resolve its budgetary impasses and bring its debt to a sustainable level. The U.S. Treasury's stated debt stood at $15.3 trillion as of February 2012 and is projected to increase by more than $1 trillion in fiscal year 2012. On October 14, 2011, the AICPA sent a letter to the Joint Select Committee on Deficit Reduction (the so-called congressional supercommittee) that observed:

The appropriate level of federal revenues and spending is a political question. Short-term deficits may be desirable during downturns in the business cycle, especially severe downturns such as the one the nation is currently experiencing. However, the levels of budget deficits currently projected may be unsustainable in the long run. Permitted to continue and to grow, these deficits will limit economic growth, impair the government's ability to finance its debt and provide essential services, and impose an ever-increasing burden on future generations.

(www.aicpa.org/interestareas/tax/resources/taxlegislationpolicy/downloadabledocuments/10-14-11%20letter%20to%20supercommittee%20on%20deficit%20reduction.pdf)

Adding to these debt concerns are the currently scheduled tax changes that CPAs need to incorporate into their clients' financial and tax planning. While Republicans can block almost any proposed increase in tax revenue, there is one major caveat. If no congressional deal is reached beforehand, at the end of 2012, the tax code, in large part, reverts to its pre-2001 and pre-2003 structure. While the exact implications of this reversion are not completely known or predictable, the top marginal rate would increase to 39.6% (in conjunction with the new 3.8% net investment income Medicare contribution tax) and nearly all taxpayers at all income levels will face a tax increase. In addition, the failure of the congressional supercommittee to reach a budgetary plan means equal cuts to both defense and discretionary spending starting in 2013, unless legislation is passed that revises the Budget Control Act of 2011.

The long-sought-after "grand bargain" on federal tax policy is almost universally recognized as requiring a combination of reforms that would raise revenues in conjunction with reducing entitlements that would reduce projected deficits by at least $4 trillion. Prior to its downgrade of U.S. debt, the credit rating agency Standard and Poor's (S&P) called for a budget plan that would result in $4 trillion in deficit reduction over the next decade. During the summer of 2011, President Obama and Speaker of the House Boehner even floated a proposal that called for roughly $3 trillion in budget cuts and $1 trillion in increased tax revenue. Previous bipartisan deficit plans (such as Simpson-Bowles and "Gang of Six" proposals) all called for spending cuts and revenue enhancements.

CPAs should actively monitor any potential changes to U.S. fiscal policy in 2012. Barring any changes, massive across-the-board tax increases will occur for essentially all taxpayers, regardless of income level, in 2013. Currently, many taxpayer-friendly provisions have not been renewed for 2012. Any compromises between Congress and the President will likely be hard fought, as most recently observed in the 11th-hour, initial two-month extension of the payroll tax holiday (which, in February 2012, was extended for the full year). From a professional standpoint, accountants must advocate for tax reforms that not only are well thought out, but also incorporate long-overdue tax simplification.

EXHIBIT 1
Individual Tax Rate Brackets

2012	2013
10%	N/A
15%	15%
25%	28%
28%	31%
33%	36%
35%	39.6%

Expiring 2011 Tax Provisions

Many major tax provisions expired at the end of 2011. Typically, these provisions are eventually extended by Congress, but given the current state of the U.S. budget and the politically charged election-year environment, their extension for 2012 cannot be assured. Major provisions that have not been extended include the following:

- The Alternative Minimum Tax (AMT) patch has not been renewed, and most nonrefundable tax credits cannot offset the AMT in 2012. The AMT exemption level has been increased annually to prevent more than 30 million unsuspecting taxpayers from suddenly coming under its provisions. (Currently, 4 million taxpayers are subject to the AMT.)
- The state and local sales tax deductibility option has expired.
- The $4,000 tuition and fees deduction from adjusted gross income (AGI) has expired.
- The ability to donate amounts from Individual Retirement Accounts (IRA) to charity has not been extended. Previously, up to $100,000 in IRA assets could be donated to charity. While there was not a charitable tax deduction, this donation avoided the inclusion of the IRA distribution in taxpayers' income and counted as part of taxpayers' annual required minimum distributions.
- The Internal Revenue Code (IRC) section 179 expensing election has fallen to $139,000, and the IRC section 168 100% first-year bonus depreciation is no longer available.
- Various tax credits (e.g., the business research, work opportunity, and energy-related credits) have expired.

2013 Reversions to Prior Tax Laws

While the above list of tax provisions, especially the AMT provisions, would negatively impact many taxpayers, they would pale in comparison to the sunsetting of the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

In 2010, critical provisions of these two acts and subsequent laws that were scheduled to sunset were extended until the end of 2012. Key provisions that benefit taxpayers, who would be negatively impacted upon their expiration, include the following:

- Tax rates for individual taxpayers would rise in 2013 as compared to 2012 (see *Exhibit 1*). The tax brackets for 2013 are shown in *Exhibit 2*. While the new tax brackets will have negative consequences for most taxpayers, taxpayers in the current 15% tax bracket will mostly remain in this same bracket. All taxpayers will lose the benefit of the 10% tax bracket, however.
- Preferential tax rates for dividends would no longer apply, and the long-term capital gains rate would increase from 15% to 20% (for taxpayers in the 15% bracket, the capital gains rate would be 10%). For capital assets sold after five years, the rate would be 18% if the taxpayer is in the 20% or higher tax bracket.
- Gift, estate, and generational-skipping transfer (GST) tax rates revert to 55% (with a 5% surtax), an increase from the current 35% rate. The GST tax exemption of $5 million returns to $1 million in 2013. (This exemption will be slightly higher due to an inflation adjustment.) In 2012, the exemption for gift, estate, and GST tax is adjusted for inflation to $5,120,000.
- In addition, "marriage penalty" relief provisions, educational deductions, AMT refundable tax credits, higher-education provisions, the child tax credit, the earned income tax credit, elimination of the phaseout of personal exemptions, and various itemized deductions will all be negatively impacted.

For a comprehensive list of expiring tax provisions from 2011 to 2022, see the Joint Committee on Taxation list (JCX-1-12, available from www.jct.gov). The multitude of tax provisions that will be affected would result in nearly all individual taxpayers, regardless of income level, being dramatically and negatively impacted if the tax laws revert to their 2001 and 2003 structure.

Adding to the negative changes attributable to the sunset provisions is the new "net investment income" tax of 3.8% that is scheduled to take effect in 2013. This new unearned income Medicare contribution tax applies to income such as dividends, interest, capital gains, annuities, royalties, and rents for single taxpayers with incomes over $200,000 ($250,000 for married taxpayers filing jointly). This new tax applies to the lesser of net investment income or the excess of modified adjusted gross income over the threshold amount. As the law now stands, a high-income taxpayer with dividend income could face a combined marginal tax rate of 43.4% (39.6% regular tax rate plus the 3.8% net investment income tax) on a portion of her dividend income. As noted above, the preferential tax rate on dividends expires at the end of 2012. In addition, in 2013, high-income individuals face an additional 0.9% Medicare hospital insurance (HI) tax on their wages.

Tax Planning Considerations

CPAs and taxpayers need to consider fully exploiting the current favorable tax environment in areas such as accelerating income, deferring deductions, and estate planning. The unsettled nature of U.S. federal tax provisions means that taxpayers are more dependent than ever upon their CPAs' guidance. The

EXHIBIT 2
Joint Committee on Taxation: 2013 Federal Income Tax Rate Brackets

Table 2b.–Federal Individual Income Tax Rates for 2013

If taxable income is:	*Then income tax equals:*
Single Individuals	
Not over $35,500	15% of the taxable income
Over $35,500 but not over $86,000	$5,325 plus 28% of the excess over $35,500
Over $86,000 but not over $179,400	$19,465 plus 31% of the excess over $86,000
Over $179,400 but not over $390,050	$48,419 plus 36% of the excess over $179,400
Over $390,050	$124,253 plus 39.6% of the excess over $390,050
Heads of Households	
Not over $47,600	15% of the taxable income
Over $47,600 but not over $122,850	$7,140 plus 28% of the excess over $47,600
Over $122,850 but not over $198,900	$28,210 plus 31% of the excess over $122,850
Over $198,900 but not over $390,050	$51,785.50 plus 36% of the excess over $198,900
Over $390,050	$120,599.50 plus 39.6% of the excess over $390,050
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over $59,300	15% of the taxable income
Over $59,300 but not over $143,350	$8,895 plus 28% of the excess over $59,300
Over $143,350 but not over $218,450	$32,429 plus 31% of the excess over $143,350
Over $218,450 but not over $390,050	$55,710 plus 36% of the excess over $218,450
Over $390,050	$117,486 plus 39.6% of the excess over $390,050
Married Individuals Filing Separate Returns	
Not over $29,650	15% of the taxable income
Over $29,650 but not over $71,675	$4,447.50 plus 28% of the excess over $29,650
Over $71,675 but not over $109,225	$16,214.50 plus 31% of the excess over $71,675
Over $109,225 but not over $195,025	$27,855 plus 36% of the excess over $109,225
Over $195,025	$58,743 plus 39.6% of the excess over $195,025

Source: Joint Committee on Taxation, "Federal Tax Treatment of Individuals," September 14, 2011, http://www.jct.gov/publications.html?func=startdown&id=4356, p. 9

potential for both favorable and unfavorable last-minute tax changes needs to be proactively monitored. Many of the tax provisions that have expired or will be expiring have historically been extended, but under the current budgetary environment this cannot be taken for granted.

While many might consider tax rate increases as unlikely, given the current Republican control of the House of Representatives, this overlooks the automatic nature of the sunset provisions described above, as well as the 60-vote hurdle required to overcome filibuster and pass legislation in the Senate, among other things. If a tax compromise is not reached in 2012, then tax rates will automatically increase in 2013. This should be a sobering thought for some. Furthermore, midyear tax changes cannot be dismissed.

While the outcome of expiring tax provisions is unknown—and could likely remain unknown throughout the election cycle or later—taxpayers and their advisors should not be surprised if 2013 brings higher tax rates as well as lost tax benefits and deductions. Taxpayers may want to wait until after the elections before taking proactive steps, but the potential for early tax law changes that are effective as of the date the legislation is proposed in the *Congressional Record* is a risk that should be actively monitored throughout the year. Even a retroactive change effective as of the beginning of the year is possible, given the current political environment.

Failure to Reach a Compromise

In November 2011, the congressional supercommittee headed into the last days of the budget negotiations potentially facing a grand bargain, partial resolution, or complete failure. Republicans indicated, to a degree, that they could accept $300 billion in new tax revenue and revenue enhancements (e.g., asset sales), and Democrats indicated a willingness to make cuts to entitlement programs, yet there remained a deep divide that ultimately proved insurmountable. While an agreement was not reached, Senator Joseph Lieberman (I-Conn.) observed that both parties were at least moving from their entrenched positions, in that Republicans were offering some level of tax increases and Democrats some level of entitlement reductions.

In the end, unfortunately, the two sides could not come to the pragmatic compromise needed for the grand bargain of $4 trillion in deficit reductions through spending cuts and revenue enhancements. A reported major sticking point was that Republicans insisted that any deal had to extend the Bush-era tax cuts permanently for all taxpayers, and the Democrats refused to agree. Democrats were willing to extend cuts for taxpayers with incomes under $250,000 (maybe even those with under $1 million in income) at a cost of $3.2 trillion over the next decade, but Republicans held firm with an all-or-none approach. If the Bush-era tax cuts were extended for all taxpayers, the cost would be $4 trillion over the next decade. Upon the supercommittee's demise, some Republicans were vowing to undo the automatic defense cuts; President Obama countered that he would veto such a maneuver. *Exhibit 3* shows a timeline of the budgetary debate from the beginning of 2010 through the end of 2011.

U.S. Treasury Rates

The repeated inability to reach a grand bargain can hardly be dismissed as inconsequential. Currently, the United States has a $15 trillion stated debt. The U.S. Treasury is presently borrowing at highly favorable

EXHIBIT 3
Timeline of the Ongoing Budgetary Debate

Date	Event
February 18, 2010	The bipartisan National Commission on Fiscal Responsibility and Reform (better known as the Simpson-Bowles Commission) was created by President Obama through an executive order and was charged with addressing the long-term fiscal imbalance of the U.S. government. A supermajority was needed for their plan to be voted on by Congress (14 out of 18 votes).
November 10, 2010	Prior to a vote of the Simpson-Bowles Commission, the cochairs presented their budget plan. This preemptive move was likely meant to add pressure for the committee to come up with a plan.
December 1, 2010	The final report of the Simpson-Bowles Commission was released. On December 3, 2010, 11 of the 18 members voted for the plan, and thus it was three votes shy of what was needed for the plan to be submitted to Congress. The plan called for roughly $3 trillion in budget cuts and $1 trillion in revenue enhancements.
Mid-July 2011	President Obama and Speaker Boehner floated a proposal that called for roughly $3 trillion in budget cuts and $1 trillion in increased tax revenue. This deal quickly fell apart under pressure from both political parties' bases.
End of July 2011	The "supercommittee" concept became part of a comprehensive deficit-ceiling increase deal. This bipartisan congressional supercommittee was charged with creating a deficit reduction plan of $1.2 trillion that was to be voted on a simple majority basis (both on the committee and the congressional levels). The plan had to be submitted to Congress by the end of November 2011, or automatic cuts to both defense and nondefense outlays would occur (over a 10-year period).
August 5, 2011	S&P downgraded the U.S. debt rating, adding pressure to the supercommittee's work.
Mid-November	Competing plans were leaked by both parties as the supercommittee's talks appeared to be headed for failure.
November 21, 2011	The supercommittee's leaders released a joint statement acknowledging that a deal could not be reached.

interest rates (essentially zero on the short end of the yield curve). This could change quickly and unexpectedly, however; as the old saying goes, "bond markets are with you until the second they are against you." As *Exhibit 4* shows, the U.S. federal government is borrowing at historically low interest rates. Given these low rates, the interest costs to the United States are currently manageable, as the Congressional Budget Office (CBO) observed in December 2010:

> At the same time, a sharp drop in interest rates has held down the amount of interest that the government pays on that debt. In 2010, net interest outlays totaled $197 billion, or 1.4 percent of GDP—a smaller share of GDP than they accounted for during most of the past decade (www.cbo.gov/publication/21960).

Nevertheless, the total interest paid in 2010 was over $400 billion when one includes the amounts owed to other entities of the U.S. government. By 2020, the CBO projects that "gross interest will exceed $1.1 trillion." The bleak budget picture of the U.S. government could turn decidedly worse if and when interest rates rise from their current historic lows.

Given the reality reflected in Exhibit 4, the budget dilemma facing the United States is not only a chronic problem, but also one that could at some unpredictable moment turn even worse whenever interest rates rise (which they almost inevitably will, as the European debt crisis is demonstrating). While the U.S. dollar clearly remains the currency of choice for a whole host of reasons—the relative stability and predictability of the U.S. government, the Federal Reserve's successful quantitative easing policies, and the United States' depth of liquidity—the continuation of deficit spending has its limits. U.S. Treasury debt is currently perceived as one of the safest investments available: on January 11, 2012, 10-year Treasury notes were priced at issuance at a record low yield of 1.9%.

S&P Downgrade

On August 5, 2011, S&P downgraded the U.S. debt and placed the U.S. government on a negative long-term outlook based on the prospects of a greater "debt trajectory." As S&P observed in announcing its downgrade:

> The political brinksmanship of recent months highlights what we see as America's governance and policymaking becoming less stable, less effective, and less predictable than what we previously believed. The statutory debt ceiling and the threat of default have become political bargaining chips in the debate over fiscal policy. ("Research Update: United States of America Long-Term Rating Lowered to 'AA+' on Political Risks and Rising Debt Burden; Outlook Negative," Nikola G. Swann)

Three conditions were seen as central to the S&P's negative outlook—spending reductions less than agreed upon, the potential for higher interest rates, and new fiscal pressures. Both Moody's and Fitch Ratings have indicated that they too have concerns over the long-term U.S. debt outlook. On December 22, 2011, Fitch indicated that failure by the United States to adopt a credible plan by 2013 would result in Fitch downgrading the U.S. sovereign debt rating ("Fitch Publishes Update to its Fiscal Projections for the United States," Business Wire, December 21, 2011, www.businesswire.com/news/home/20111221006243/en/Fitch-Publishes-Update-Fiscal-Projections-United-States).

Competing Forces

On November 2, 2011, 100 members of the House of Representatives (40 Republicans and 60 Democrats), led by Congressmen Mike Simpson (R-Idaho) and Heath Shuler (D-N.C.), pushed for a meaningful bipartisan solution. They signed a letter to the supercommittee that observed:

> To succeed, all options for mandatory and discretionary spending and revenues must be on the table. In addition, we know from other bipartisan frameworks that a target of some $4 trillion in deficit reduction is necessary to stabilize our debt as a share of the economy and assure America's fiscal well-being. (http://simpson.house.gov/news/email/show.aspx?ID=3HTCCDL2ILY4MS6W5TD4I27BPA)

Senator Mike Crapo (R-Idaho) observed on November 16, 2011, that over 40 senators would embrace a $4 trillion plan.

Against this support for a grand bargain—that is, one that would encompass both spending and revenue changes—a group of 72 Republican members of the House, led by Rep. Patrick McHenry (R-N.C.), on November 17, 2011, wrote to the supercommittee:

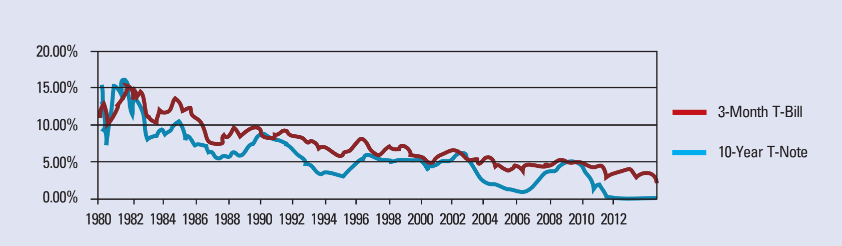
> It is evident that America has a fiscal crisis because Washington spends too much, not because it taxes too little. According to the non-partisan Congressional Budget Office, tax revenues will reach or exceed the historical average of 18 percent of economic output by the end of this decade, even as spending continues to increase at an unsustainable rate. (http://mchenry.house.gov/News/DocumentSingle.aspx?DocumentID=269380)

One indicator of this no-compromise position is the no tax pledge that Grover Norquist, the president of Americans for Tax Reform, has vocally campaigned to have politicians sign and abide by. The U.S. Senate's "Taxpayer Protection Pledge" is shown in *Exhibit 5*. The objective of this inflexible tax position was summed up by Norquist in the *Washington Post*: "We'll run against their tax increase and we'll crush them."

Social Security and Medicare

Countering those who take uncompromising positions on taxes are those who insist on few or no changes to entitlement

EXHIBIT 4
U.S. Treasury Rates



programs. The American Association of Retired Persons' (AARP) nationwide campaign directed at the supercommittee called for lawmakers to "cut waste and tax loopholes, not Social Security and Medicare" (www.aarp.org/politics-society/advocacy/info-04-2011/AARP-fights-against-threats-to-medicare-and-social-security.html). This argument against any changes to Social Security and Medicare ignores the reality that these programs represented 36% of the federal budget in fiscal year 2010. In addition, overall, the United States is currently borrowing around 40¢ for every $1 it spends. Quite simply, these two items cannot be sustained in the long term.

As the Social Security and Medicare 2011 Trustee Annual Report observes, program expenditures exceeded revenues by $49 billion in 2010 (projected to be a $46 billion deficit in 2011) and in its summary it concludes:

> Projected long-run program costs for both Medicare and Social Security are not sustainable under currently scheduled financing, and will require legislative corrections if disruptive consequences for beneficiaries and taxpayers are to be avoided. (www.ssa.gov/OACT/TRSUM/index.html)

Currently, Social Security provides benefits to 55 million people; by 2035, a projected 91 million will receive benefits. Adding to the strain on Social Security is that more Americans are living past age 90. The percentage of older Americans (those 65 and older) who are over 90 is increasing. In 1980, it was only 2.8%; now it is 4.7%, and by 2020, it is projected to reach 10%, according to the U.S. Census Bureau ("Census Bureau Releases Comprehensive Analysis of Fast-Growing 90-and-Older Population," November 17, 2011).

Both Senate Majority Leader Harry Reid (D-Nev.) and House Minority Leader Nancy Pelosi (D-Calif.) have indicated a strong reluctance for changes in Social Security and Medicare. Although some Democrats have indicated that they would be receptive to entitlement changes in exchange for tax increases, the exact level of changes that would be acceptable is far from certain.

One indicator of the inability of either political party to shore up Social Security and Medicare is the temporary employee payroll tax cut of 2011, which was initially extended for the first two months of 2012 and which has now been extended for the full year. The resultant revenue losses in 2011 were offset by transfers from the general fund and not by any meaningful structural changes. The seemingly inevitable changes to cost-of-living adjustments (COLA), means-testing, retirement ages, copayments, and tax structures are better done sooner rather than later. Relatively minor changes in these areas could have a meaningful long-term impact, but the longer Congress waits, the harder the cuts and the greater the increased costs will be.

EXHIBIT 5
Taxpayer Protection Pledge

AMERICANS FOR TAX REFORM

United States Senate candidates

Taxpayer Protection Pledge

I, ____________________, pledge to the taxpayers of the state of ____________________, and to the American people that I will:

ONE, oppose any and all efforts to increase the marginal income tax rates for individuals and/or businesses; and

TWO, oppose any net reduction or elimination of deductions and credits, unless matched dollar for dollar by further reducing tax rates.

Signature ____________________ Date ____________________

Witness ____________________ Witness ____________________

Pledges must be signed, dated, witnessed and returned to:
AMERICANS FOR TAX REFORM
722 12th Street, Washington, DC 20005
PHONE (202) 785-0266 FAX (202) 330-5224

Automatic Sequestration

The Budget Control Act of 2011 (BCA) requires the Office of Management and Budget (OMB) to estimate if the U.S. budget will exceed mandated budget cuts. If budgets are in excess, then "across-the-board reductions (or sequestration)" will occur. As OMB stated:

> The BCA tasked a new Joint Select Committee on Deficit Reduction to produce legislation to reduce deficits by more than $1.2 trillion over the 2012-2021 period. If such legislation is not enacted by January 15, 2012, the BCA specifies additional procedures for reducing deficits, starting in 2013. These procedures include a redefinition of the discretionary security and nonsecurity categories based on budget function 050 and non-050 (defense and non-defense) and reductions to those discretionary caps, as well as a sequestration of certain mandatory spending, in order to achieve the $1.2 trillion deficit reduction goal. (Sequestration Update Report to the President and Congress for Fiscal Year 2012, www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/sequestration/sequestration_update_august2011.pdf)

Included in the OMB's report is a table on discretionary spending caps. *Exhibit 6* reveals that, despite mandated budget cuts of $1.2 trillion over the next decade, total discretionary spending will increase nearly $200 billion by 2021. Only in Washington political circles would a $200 billion budget *increase* be portrayed as part of a $1.2 trillion budget cut.

Pragmatic Solutions

Barring major congressional changes in the 2012 elections, any congressional debt deal will require both parties to give and take. In particular, the 60-vote hurdle that most legislation effectively needs to pass the U.S. Senate means that it is unlikely that any one party can dictate the terms of a comprehensive budget deal. Within this context, the presidential election is less of a factor than the makeup of the U.S. Senate in any future budget deals. In addition, delaying a deal means the costs of any plan may be significantly greater if U.S. borrowing costs spike. Currently, despite a $15 trillion stated debt, only 6% of federal outlays are needed to cover interest payments. This "debt service holiday" will not continue.

In the authors' opinion, both sides must give. Entitlement programs must be reformed. On the revenue side, the elimination or scaling back of tax deductions and loopholes is long overdue, if for no other reason than tax simplification. The Simpson-Bowles Commission's 2010 plan to eliminate key tax expenditures (such as the child tax credit, itemized deductions, etc.) as a means to both lower taxpayers' tax rates and increase revenue could be a basis to restart negotiations. Supercommittee member Senator Pat Toomey (R-Pa.) has proposed changes, including limited itemized deductions, a top marginal rate of 28% on ordinary income, and maintaining the 15% preferential rate on dividends and capital gains; these could be a basis for restarting negotiations. Another compromise might be to eliminate certain tax deductions, and institute a top marginal rate of 30% on ordinary income and a 20% preferential rate on dividends and capital gains, in conjunction with meaningful entitlement reforms. The key is not the exact proposals, but the parties' ability and willingness to compromise in order to pass tax reforms. While tax benefits would be lost, lower tax rates could offset their impact to a partial or even large degree for most taxpayers over the long term.

In addition, the elimination of certain key tax provisions would make the tax code cleaner. Is it really worth the financial risk to the overall U.S. economy not to reach a deal? The current inaction by politicians is an ill-conceived gamble that the U.S. government's borrowing costs will remain low.

The Need for Reform

In the authors' opinion, the solution to the ongoing U.S. federal budgetary crisis, with its unsustainable debt trajectory, is painfully simple: increase tax revenue, mainly through curtailment of tax deductions and loopholes, and reduce entitlements, through structural changes to Social Security and Medicare that reduce their costs. One can only hope that a long-term viable budget solution is adopted before the U.S. government's borrowing costs begin their nearly inevitable rise. Even a $4 trillion deal would only stabilize the current debt trajectory of the U.S. government. If the financial crisis of 2008 and 2009 taught us anything, it is that it is high time for Americans to make the hard choices today to mitigate the long-term impact of unsustainable debt levels.

The accounting profession should be advocating that the United States adopt a sound long-term fiscal policy. While advocates in the profession should be careful not to take a political stance, tax advisors can probably agree that any potential tax reforms need to be structured to simplify the needlessly complex and bloated tax code. Tax simplification would inevitably benefit some taxpayers at the expense of others within the context of any single provision; however, reform would benefit most taxpayers, and the American economy, from an overall long-term perspective. CPAs need to guide clients to prepare for the seemingly inevitable changes to the tax structure and entitlement programs. Barring new law, the tax system will revert to its pre-2001 structure with a 39.6% marginal tax rate, along with many other taxpayer-unfriendly provisions, at the end of 2012. The past year saw a great deal of discussion about the federal deficit and tax policy, but politicians were unable to compromise on a long-term plan to address these issues. At the very least, the debate should continue in 2012; whether progress will be made, and how the profession will contribute to the discussion, remain to be seen. ❑

William M. VanDenburgh, PhD, *is the Robinson, Farmer, Cox Faculty Scholar and assistant professor of accounting at James Madison University, Harrisonburg, Va.* ***Arthur Hamilton, JD,*** *is a professor of business law at James Madison University, Harrisonburg, Va.*

EXHIBIT 6
Automatic Sequestration

Table 1. Discretionary Spending Limits Enacted in the Budget Control Act of 2011
(In billions of dollars)

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
SECURITY CATEGORY:										
Budget Authority	684	686	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
NONSECURITY CATEGORY:										
Budget Authority	359	361	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DISCRETIONARY CATEGORY:										
Budget Authority	N/A	N/A	1,066	1,086	1,107	1,131	1,156	1,182	1,208	1,234

N/A = Not Applicable