

O'MALLEY NEWS & VIEWS

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IN THIS ISSUE...

In Washington Watch, Chuck discusses the recently resolved debt ceiling crisis and its multi-faceted solution. He provides some insight into the various discussions leading up to its approval and some thoughts about how it will evolve going forward.

According to *Bloomberg.com/news*, taxes for the last three years have been below 15% of GDP (Gross Domestic Product), which is the lowest level since the 1950's when it was 18.5% of GDP and below the 18.2% of GDP during the 1980's. The Bloomberg editors further commented that while today's economic crisis is more severe than prior recessions, both spending cuts and revenue increases are required.

Enclosed are four tables at various income levels and fact scenarios, comparing the 2000 tax laws and rates (last year of President Clinton's rules) to the 2010 tax laws and rates (the extension of the 2001 and 2003 President Bush's tax cuts), that are scheduled to expire at the end of 2012. Because recently there has been extensive discussion about the lack of tax revenue and some requests for tax reform, plus the possible expiration of the "Bush Tax Cuts" at the end of an election year, we thought tables showing tax differences at various income levels might be helpful in understanding the tax rates and tax reform debate as it continues over the next fifteen months. It is amazing how much lower taxes are now, with a 35% top tax rate, compared to 2000 (ten years ago), with a 39.6% top tax rate, which was substantially lower than the prior top rates of 70% from 1964 through 1981 and 50% from 1982 through 1986.

Our crystal ball is not powerful enough to forecast what will eventually become tax law, but it's a safe bet that taxes will ultimately become a 2012 election year issue. Because we have 2000 and 2010 tax return preparation software on our computer system, we are able to compare any set of circumstances that might exist for future tax planning purposes.

Washington Watch

SHUT-DOWN CRISIS AVOIDED AGAIN..., but it may only be temporary! See Page 3, **What Did They Pass? - Future Votes**. As predicted in our WINTER 2011 *NEWS & VIEWS* (on the web at www.omalleycpa.com/resource), the GOP does not want to be held responsible for or get blamed for a government shut-down. They avoided it in March on the budget authorization and they avoided it in August on the debt ceiling increase. However, on both occasions it was down to the last hour, possibly the last minute.

It's moments like this, when uncompromising political ideology challenges the constitutional system of checks and balances (executive branch vs. legislative branch), that I am reminded of Benjamin Franklin's comment after the 1787 Constitutional Convention,

"... a republic, madam, if you can keep it..."

The 2010 election sent 78 new GOP members (mostly fiscally conservative Tea – Taxed Enough Already – Party members) to the House of Representatives, switching control of the House to the GOP – 242 to 193. Additionally, the GOP gained 9 seats in the Senate. Because of the Senate's 60 vote rule to stop a filibuster that is preventing legislative debates and votes, Senate minority leader, Mitch McConnell, with 47 loyal GOP Senators, is able to control the agenda even though Democratic majority leader, Harry Reid has 51 Democrats plus 2 Independents. These control issues set the overall tone of the recent debt ceiling debate. In my opinion, minority leader, Mitch McConnell, legislatively, appears to be the most powerful person in Washington.

The President did not embrace the Bowles-Simpson National Commission on Fiscal Responsibility and Reform report at the end of 2010. The 18 member Commission did not approve the report by the required 14 positive votes; they only got 11. Co-chair, and former GOP Wyoming Senator, Alan Simpson made statements that upset the senior citizen community and others in November 2010 when he stated,

"...Social Security is like a milk cow with 310 million tits...",
and referred to Social Security recipients as,
"... the greediest generation ..."

(continued on page 2)

by Charles K. O'Malley, CPA,

The Commission's report suggested deficit reduction and tax reforms. The Senate's "gang of six" recently made similar recommendations, as did the "Grand Bargain".

For weeks there appeared to be multiple, dueling plans and conflicting ideas but the White House negotiations with Vice President Joe Biden were complicated by majority leader, Eric Cantor walking out, and twice by House Speaker John Boehner's departure from negotiations with President Obama. To the horror of both parties, John Boehner and President Obama put sacred programs, tax reform and entitlements, on the negotiation table. While all of the talks were private, with each side only leaking out their own spin, my guess is that the President was attempting to ward off budget director, Paul Ryan's age 55 limitation for changes in Medicare coverage and he wanted tax reform (revenue increases) to help pay the existing prior administration(s) agreed upon expenditures without gutting Social Security, Medicare, Medicaid and a host of other programs such as education, veterans benefits, infrastructure, unemployment, national defense, homeland security, etc. Unfortunately, the "Grand Bargain", as it was named, and the hinted details, did not materialize. It would have been a hard sell to the liberal wing of the Democratic party, which President Obama said he was prepared to,

"...bet his presidency on...",

but because of a dispute over how many dollars of revenue increase via tax reform, John Boehner could not get sufficient GOP support as witnessed by several House voting delays, and the addition of a constitutional amendment to "balance the budget" that could not pass in the Senate. Both the President and the Speaker took their pleas to the public in prime time speeches, the political gamesmanship that took place between July 23rd and August 2nd looked more like a political circus. During that time period, I personally wrote four letters to the President and all of the party leaders in both the House and the Senate, including New Jersey Congressional members, pleading with them to,

"...raise the debt ceiling! America must avoid the possibility of a national default..."

The final approval was 269 to 161 – 62.5% of the House - 174 GOP plus 95 Democrats; and 74 to 26 – 74% of the Senate - 28 GOP, 45 Democrats, plus 1 Independent. Vermont Independent Bernie Sanders voted no. Generally, the extreme right, Tea Party members and the extreme left, liberal Democrats voted against the legislation. All of the leaders from both parties cast a YES vote.

This debt ceiling increase was very difficult to approve, and may be the only one of 75 increases since 1960 with deficit restrictions. The Paul Ryan, GOP budget that passed the House, plus the Tea Party inspired deficit reduction desires, coupled with Grover Norquist's Americans for Tax Reform pledge (signed by 274 GOP members of the House and Senate, but only 3 Democrats) became the driving forces in this debate. While Social Security and Medicare benefits are currently safe, many, particularly those under age 55 have expressed concerns. Recently I heard the following,

**"... I started working when I was 20 and for 28 years I have been required to contribute to the system ...
I hope its there when it's my turn to collect ..."**

Through the years all employers, employees and self-employed people have paid more into the system than was paid out in benefits, but the government used this excess tax revenue for current expenditures rather than saving and investing the excess revenue. Do you remember the "lock box" argument of the 2000 election?

Congress has a disapproval rating of over 80% and the President's approval rating is below 50%, it's no wonder that the S & P stated,

"...The downgrade reflects our opinion that the ... plan that Congress and the Administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term debt dynamics ... 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..."

Recently, House majority leader, Eric Cantor, in a memo to his Republican colleagues, warned that S & P's analysis put the party under "pressure to compromise on tax increases" on the ground that there is "no other way forward". His response:

"I respectfully disagree."

It appears to me that any compromise on deficit reduction and revenue increases will continue to be the main debate.

On page 10 of our WINTER 2011 *NEWS & VIEWS* (see www.omalleycpa.com/resources), we detailed the government's 2009 problems and showed how they paid out 67% more than they received. There's some good news for 2010, revenue received was up and paid expenditures were down. Unfortunately, the government still paid out 60% more than they received, but that is an improvement. As most of us know, in our business and/or personal life, there is a limit to how much can be accomplished with budget restraints and deficit controls. At some point in time, we need more revenue. *(continued on page 4)*

WHAT DID THEY PASS? - FUTURE VOTES

Seventy-four pages titled *The Budget Control Act of 2011*. It raises the debt ceiling in three installments; \$400 billion immediately; \$500 billion in September; and \$1.2 to \$1.5 trillion by the end of 2011; and sets up future votes in September on appropriations for every government agency and a Super-committee report due in late November for a December up or down vote. Congress has two more opportunities (deadlines) to play the government shut-down game.

Raising the Debt Ceiling

- The bill raises the debt ceiling by a minimum of \$2.1 trillion and a maximum of \$2.4 trillion.
- By the end of the year, the U.S. national debt limit would be somewhere between \$16.4 and \$16.7 trillion.
- Both parties estimate that amount will give the government the borrowing power it needs through 2012.
- Under this deal, the debt is increased in two phases.

Phase one

- This bill would cut \$917 billion in spending over 10 years.
- And it would raise the debt ceiling by \$900 billion; \$400 billion now and \$500 billion in September.
- Lawmakers involved say they believe the first phase provided borrowing power through early 2012.

Phase two

- The debt limit could increase \$1.2 trillion to \$1.5 trillion, attached to deficit cuts of the same magnitude.
- The debt deal sets up one of three ways that Congress could trigger the next debt increase.
 - **Trigger one:** A balanced-budget amendment – The debt ceiling would increase another \$1.5 trillion if Congress passes a balanced-budget amendment to the Constitution. That requires a two-thirds vote in each chamber.
 - **Trigger two:** Super-committee – The debt ceiling would increase up to \$1.5 trillion if Congress passes broad deficit reform measures as recommended by a new joint committee. The ceiling would increase only by the amount of deficit cuts passed by the committee and Congress. Thus, if the committee passes \$1.3 trillion in deficit cuts, the president could ask for only a \$1.3 trillion increase in the debt ceiling.
 - **Trigger three:** Automatic cuts – If neither of the above options happens, the lack of action triggers automatic across-the-board cuts in government. Those cuts would be up to \$1.2 trillion and would trigger an increase in the debt ceiling of the same amount. Cuts would be up to 2% for Medicare, but the bill dictates they should not affect beneficiaries.

Initial spending cuts

- The \$917 trillion in cuts in phase one come as spending caps over the next 10 years.
- The bill does not delineate which agencies would have cuts. Instead it would limit appropriators in future years to spending caps. Where the cuts hit would be up to future committees and Congresses.
- The caps do not cut total government spending year to year but instead shrink how much that spending grows. Put another way, under this plan discretionary government spending would still increase year to year but would increase by significantly less than under current policy.
- These are cuts in future spending.

Super-committee

- **Who:** Twelve members of Congress;
 - GOP Senators; John Kyl ** - Assistant minority leader – Finance Committee member
Rob Portman – First Term – Budget Committee member – Bush budget director
Pat Toomey – First Term – Budget & Banking Committees member
 - GOP Representatives; Dave Camp * – Chairman of the Ways & Means Committee
Fred Upton – Chairman of the Energy & Commerce Committee
Jeb Hensarling * – Financial Services member; Super-committee Co-chair
 - Democratic Senators; Patty Murray – Budget & Appropriations member; Super-committee Co-chair
Max Baucus * – Chairman of the Finance Committee
John Kerry – Finance Committee member; Foreign policy experience
 - Democratic Representatives; James Clyburn ** – Ass't. minority leader; formerly on the Appropriations Committee
Xavier Becerra * – Ways & Means Committee member – caucus vice chair
Chris Van Hollen ** – Budget Committee member
- **When:** The committee has until Thanksgiving to come up with a plan to cut up to \$1.5 trillion from future deficits. Congress must vote by December 23.
- **Vote:** The reform package would require a simple majority (not 60 votes) – to pass the Senate.
- **What:** The committee can recommend any reforms to the federal budget. Its goal is, find \$1.5 trillion in cuts.

* Was a member of the Bowles-Simpson National Commission on Fiscal Responsibility and Reform, but voted NO.

** Participated in the Vice President Joe Biden debt reduction talks.

Washington Watch

continued from page 2

The best help for a struggling business is an increase in profitable sales. Personally, sometimes it is a second or third income from overtime pay, an additional part time job, a better paying job, a spouse returning to work, or a better return on investments. Increased revenue can solve a lot of budget problems. That's what the Bowles-Simpson National Commission on Fiscal Responsibility and Reform said, that's what the Senate "gang of six" said and if the Super-committee is honest and willing to compromise, that is probably what they will say.

We have heard and read a lot about the \$14.3 plus trillion U.S. government debt but very little about government assets. We know they own land and buildings, highways, bridges and other infrastructure items; there are vast amounts of military assets (bases, ships, airplanes, schools, etc.); mineral deposits on government land and other assets that should have a dollar value. The best I could find in my *Google* searches is, the government has more than \$1.6 trillion in liquid assets (cash or cash equivalents) as of July 2011. The reason is, asset purchases are expensed in the year they are acquired. I could not find a government balance sheet that shows assets, liabilities (debt) and a net value. Businesses and individuals have debt but they also have assets that generally exceed the debt. We need to know how much our government is really worth, not just it's debt.

The stock market has been negatively affected (15.7% drop in value between July 5th's high of 12,719 and August 10th's low of 10,720) by both the U.S. government's handling of their debt and deficit problems and the overall world financial dilemma. However, Warren Buffett says he's buying and if the market goes lower, he will buy more. The Independent Advisor, Dan Weiner of Advisor Investments in his weekly e-mail said,

"...The volatility we've seen in the markets over the past week has been exceptional. Looking back at more than a decade's worth of data on swings in the Dow, the moves on Monday and Tuesday rank within the top 50 most erratic or volatile days we've seen. They, of course, don't compare with the swings we saw in 2008 during the height of the financial crisis, and the current situation is nothing close – this is not a financial crisis, but a crisis of confidence in our political leadership, in the state of our economic health, and the broader economic health of many countries around the globe. That said, consumer health has improved dramatically since the mortgage crisis days, corporate health is astounding given the amount of cash on balance sheets and growth in profits, and once investors focus on this, the stock market's health will improve. This is not a replay of 2008 except in the minds of investors who, once again, are shooting first, and asking questions later, if at all..."