

U.S. Federal Government & Budget

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Colonial Past



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The Articles of Confederation



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Major challenges to governing through the Articles of Confederation

- Measures passed by Congress had to be approved by 9 of the 13 states.
- Congress was severely limited in its powers.
- The Articles were virtually impossible to amend.

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Closer Union: Constitutional Convention

- Purpose
 - stronger central government
 - make the states subordinate to the federal government
 - make the Constitution easier to amend
- Constitutional amendments are proposed and ratified primarily as follows under Article V:
 - **To propose amendments** two-thirds of both houses of Congress vote to propose an amendment
 - **To ratify amendments** three-fourths of the state legislatures approve it



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U.S. Bill of Rights

1. Freedoms of speech, press, religion, peaceable assembly, and to petition the government.
2. Right to keep and bear arms.
3. Protection from quartering of troops.
4. Protection from unreasonable search and seizure.
5. Due process, double jeopardy, self-incrimination, private property.
6. Trial by jury and other rights of the accused.
7. Civil trial by jury.
8. Prohibition of excessive bail, as well as cruel or unusual punishment.
9. Protection of rights not specifically enumerated in the Bill of Rights.
10. Powers of states and people retained.

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Role of Constitution

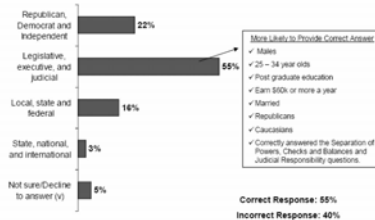
- Separate Powers (this is also known as "Checks & Balances")
 - Legislative
 - Executive
 - Judicial

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Slightly more than half (55%) can correctly identify the three branches of government.

Branches of Government



What are the three branches of government?
Base: All respondents (n=1002)

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Checks and Balances

- The President can veto bills approved by Congress
- The President nominates individuals to serve in the Federal judiciary
- The Supreme Court can declare a law enacted by Congress or an action by the President unconstitutional
- Congress can impeach the President and Federal court justices and judges.

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Other Functions of the Constitution

- **Allocates power to the various levels of government**
 - Federalism
- **Limits Powers**
 - Reserves powers to people or states

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Tenth Amendment Reservations

"Powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people." U.S. Const. amend 10.

Express limits on the power of government to interfere with individual and state rights

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U.S. Constitution in Comparison with the EC Treaty

- Source of Power
- Ability to Withdraw
- Enumerated Powers
- Legislative Process
- Reserved Powers
- Implied Powers
- Supremacy & Preemption
- External Competence
- Anti-Commandeering & State Immunity
- Tax Power

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Compare: Source of Power

- U.S. Constitution

- Preamble:

- *"We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defense, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America."*

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Source of Power

- Articles of the Confederation

- Preamble:

- *"To all to whom these Presents shall come, we the undersigned Delegates of the States affixed to our Names send greeting."*

Articles of Confederation and perpetual Union between the States of New Hampshire, Massachusetts bay, Rhode Island and Providence Plantations, Connecticut, New York, New Jersey, Pennsylvania, Delaware, Maryland, Virginia, North Carolina, South Carolina and Georgia."

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Source of Power

- EC Treaty

- Article 1:

- *"By this Treaty, the HIGH CONTRACTING PARTIES establish among themselves a EUROPEAN COMMUNITY."*

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Ability to Withdraw

- Neither the U.S. Constitution nor the EC Treaty provides the constituent states with a method of withdrawing from the Union. As you know, in the United States, withdrawal, or "secession" has been attempted, to ruinous effect. So in the United States, it is not possible for a state to withdraw.
- No clear method is provided in the EU for withdrawal.

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Enumerated Powers

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Legislative Process

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Reserved Powers: Tenth Amendment vs. Subsidiarity

- Powers Reserved to the U.S. States: Tenth Amendment
 - “Powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.”
- Subsidiarity: Article 5 EC
 - Subsidiarity says that the Community can only exercise powers beyond those enumerated as areas of exclusive competence if the “objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community.”

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Implied Powers

- U.S. Constitution – Necessary & Proper Clause, art. 1 §8, Clause 18
 - “[The Congress shall have Power] To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.”
- EC Treaty – Article 308
 - “If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.”

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Supremacy & Preemption

- Supremacy Clause, U.S. Const. art. 4, Cl. 2
 - “This Constitution, and the laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the authority of the United States, shall be Supreme Law of the land; and the Judges in every state shall be bound thereby, any thing in the Constitution or Laws of any state to the contrary notwithstanding.”
 - All state law (even if it agrees with the federal law) is preempted.
- EU Supremacy Clause?

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External Competence

- U.S. States have no treaty-making powers
 - “No State shall enter into any Treaty, Alliance or Confederation... No State shall, without the Consent of Congress... enter into any Agreement or Compact with another State, or with a foreign Power...” U.S. Const. art. 1, §10
 - “[The President] shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur...” U.S. Const. art. 2, §2, Cl. 2
 - The federal government has the power (?) to preempt state taxes by treaty under the foreign commerce clause, but out of respect for the separate sovereignty of the states, it has chosen not to exercise this power
- EU Member States have External Competence

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Compare: Anti-Commandeering & (Member) State Liability

- U.S. federal government may not impose targeted, affirmative, coercive duties upon state legislatures or executive officials. *Prinz v. U.S.*, 521 U.S. 898 (1997)
- EU initiatives are carried out by the Member States

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(Member) State Liability

Eleventh Amendment

"The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State. "

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Tax Power

- Taxing & Spending Clause, U.S. Const. art. 1, § 8, Cl. 1
 - *"The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States."*

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Constitutional Restraints on the Federal Taxing Power

- Origination in the House of Representatives
- Uniformity
- Apportionment
- Fundamental Rights

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Uniformity

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Tax and Spend

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Apportionment

- The 16th Amendment:
 - *"The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."*

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Fundamental Rights

- Establishment Clause, U.S. Const., amend. 1
 - “Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.”

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Fundamental Rights

- Equal Protection Clause, U.S. Const. amend. 14, § 1
 - “All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the state wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.”
- Incorporation Against the States

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Contrast the EU's Implied Taxing Power

- No express tax power, though Article 94 provides basis for possible future tax enactments
- Article 94 EC
 - “The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market.”

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Role of Constitution

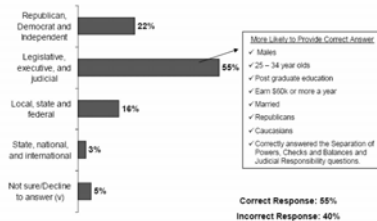
- Separate Powers (this is also known as “Checks & Balances”)
 - Legislative
 - Executive
 - Judicial
- Allocates & Reserves Powers
 - To the Federal Government
 - To the States
 - To the People

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Slightly more than half (55%) can correctly identify the three branches of government.

Branches of Government



What are the three branches of government?
Base: All respondents (n=1002)

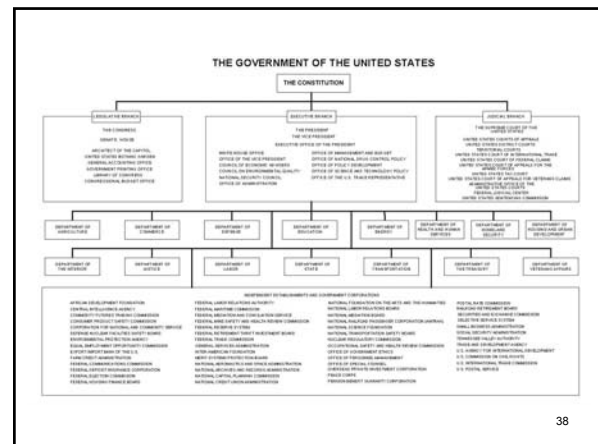
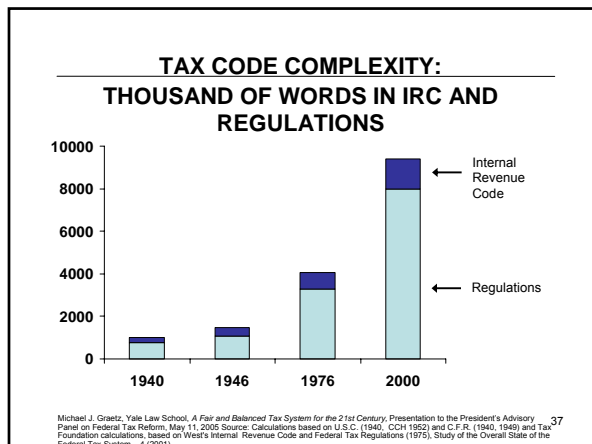
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Sources of U.S. Federal Tax Law

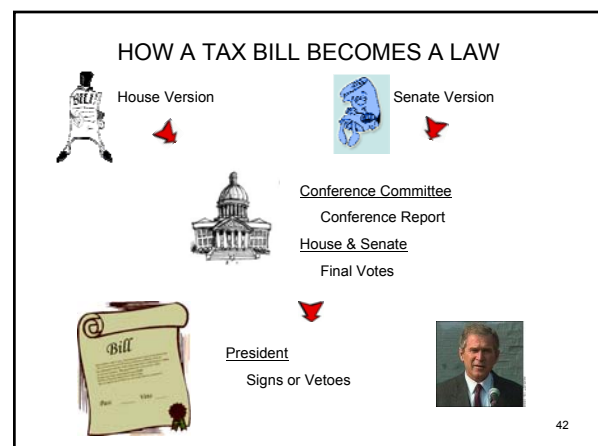
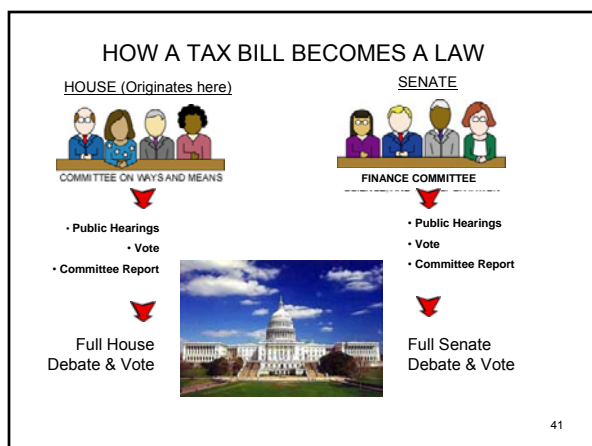
- Tax law is made by all three branches of government:
 - Legislative branch, i.e., the Congress
 - Writes the tax code, defines the tax base
 - Executive branch, i.e., the President and his administration, which includes the Treasury Department and the IRS.
 - Writes regulations that interpret the tax code
 - Enforces the laws
 - Judicial branch, i.e., the court system, reviews both the passage of tax laws to make sure they are constitutional and the IRS's administration of the tax laws.

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Party Affiliations of Senators

| Year | Democrat | Republican | Other |
|-----------|----------|------------|-------|
| 1969-1971 | 57 | 43 | |
| 1979-1981 | 58 | 41 | 1 |
| 1989-1991 | 55 | 45 | |
| 1999-2001 | 45 | 55 | |
| 2001-2003 | 50 | 50 | |
| 2003-2005 | 48 | 51 | 1 |
| 2005-2007 | 44 | 55 | 1 |



Joint Committee on Taxation

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The Executive Branch



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The Executive Branch

- The President plays a role in the legislative process:
 - Tax policy proposals
 - Proposes ideas he would like a House member to introduce
 - Annual budget
 - Makes the annual budget
- The Executive Branch also:
 - writes regulations
 - negotiates tax treaties
 - enforces and collects taxes through audits, litigation, and collection measures.

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Treasury and IRS

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The Executive Branch also includes the Vice President and other officials, such as members of the Cabinet.

- | | |
|---|--------------------------------|
| •The Secretary of Agriculture | •The Secretary of State |
| •The Secretary of the Interior | •The Secretary of Labor |
| •The Secretary of Commerce | •The Secretary of the Treasury |
| •The Secretary of Education | •The Secretary of Energy |
| •The Secretary of Health and Human Services | •The Secretary of Defense |
| •The Secretary of Homeland Security | •The Attorney General |
| •The Secretary of Housing and Urban Development | |
| •The Secretary of Transportation | |
| •The Secretary of Veterans' Affairs | |



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Treasury Department

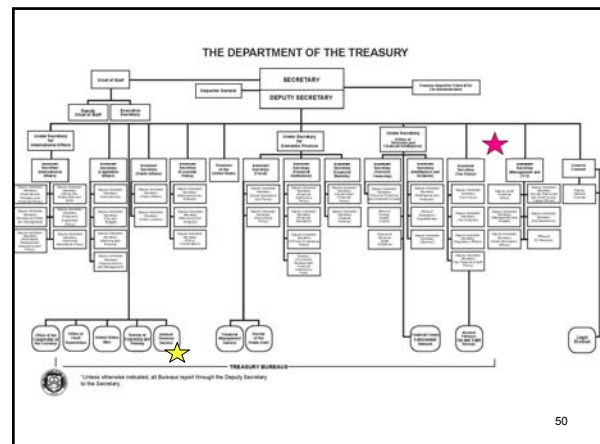
- Consults with Congress
- Writes Regulations
- Negotiates tax treaties
 - Recall that Article II, section 2, of the Constitution states that the President "*shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two-thirds of the Senators present concur.*"

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Article 9(4) of the old U.S.-UK Treaty

Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision, or local authority shall not take into account the income, deductions, receipts, or out-goings of a related enterprise of the other Contracting State or of an enterprise of any third State related to an enterprise of the other Contracting State.

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Internal Revenue Service

- Its unofficial mottoes include
 - “Working to put service first.”
 - “Service plus enforcement equals compliance.”
 - Written across the IRS building in Washington DC is: “Taxes are what we pay for a civilized society” (Oliver Wendell Holmes, Jr.)

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Internal Revenue Service

Collects the taxes and enforces the laws

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Executive Branch

- The executive branch gives us a variety of sources of tax law
 - Treasury
 - Regulations
 - Treaties
 - IRS
 - Revenue Rulings
 - Litigated Cases
 - Other published guidance

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The Judicial Branch



Judicial Branch

- Reviews tax laws for constitutionality
- Interprets tax laws and regulations
- Decides cases in controversy

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Colonial Past



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Second Circuit

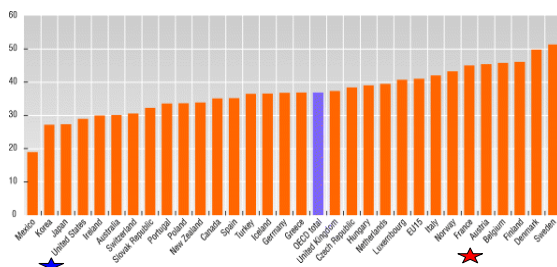


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Substance of the U.S. Federal Tax System

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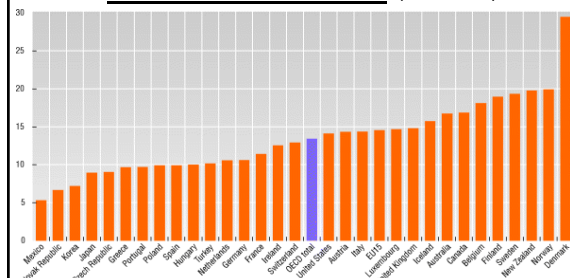
Total Tax 2001 (% of GDP)

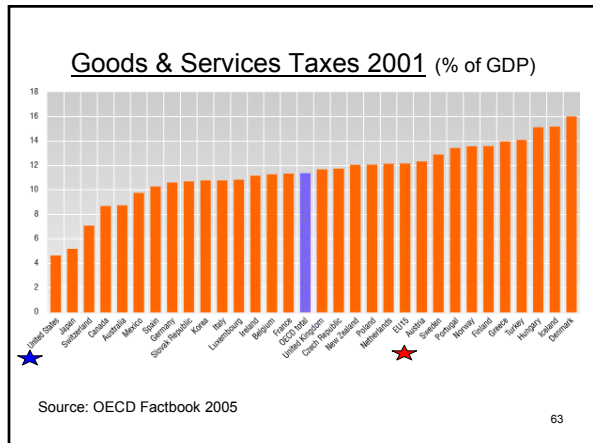
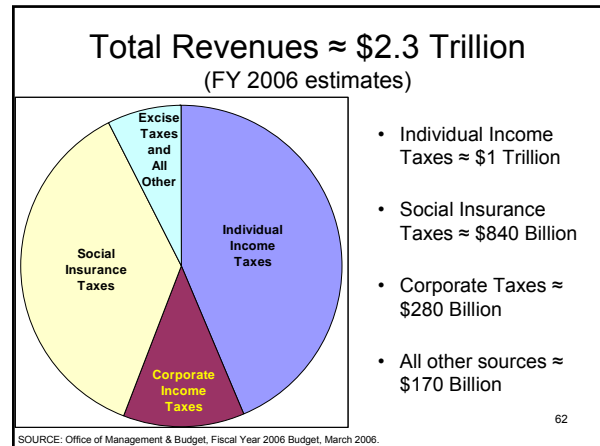
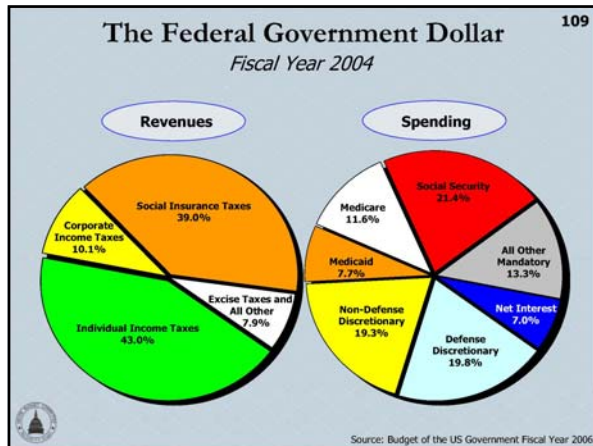


Source: OECD Factbook 2005

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Income Tax 2001 (% of GDP)





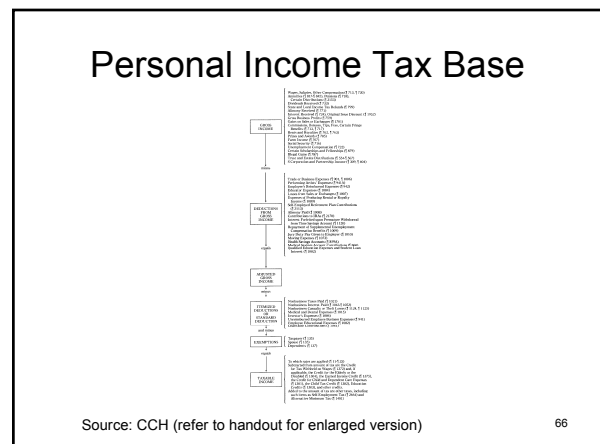
The Tax Base is Broad

- The Internal Revenue Code includes "all income from whatever source derived, including (but not limited to) the following items:
 - 61(a)(1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
 - 61(a)(2) Gross income derived from business;
 - 61(a)(3) Gains derived from dealings in property;
 - 61(a)(4) Interest;
 - 61(a)(5) Rents;
 - 61(a)(6) Royalties;
 - 61(a)(7) Dividends;
 - 61(a)(8) Alimony and separate maintenance payments;
 - 61(a)(9) Annuities;
 - 61(a)(10) Income from life insurance and endowment contracts;
 - 61(a)(11) Pensions;
 - 61(a)(12) Income from discharge of indebtedness;
 - 61(a)(13) Distributive share of partnership gross income;
 - 61(a)(14) Income in respect of a decedent; and
 - 61(a)(15) Income from an interest in an estate or trust.

U.S. Federal Income Tax Rates 2005
For Married Persons Filing Jointly

| Taxable Income | | Tax (before credits) | | |
|----------------|--------------|----------------------|-----|----------------|
| Over | But not over | Flat amount | +% | Of excess over |
| 0 | \$14,600 | 0 | 10% | 0 |
| \$14,600 | 59,400 | \$1,460 | 15% | \$14,600 |
| 59,400 | 119,950 | 8,180 | 25% | 59,400 |
| 119,950 | 182,800 | 23,318 | 28% | 119,950 |
| 182,800 | 326,450 | 40,916 | 33% | 182,800 |
| 326,450 | -- | 88,320 | 35% | 326,450 |

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| | |
|---|--------|
| Exclusion of employer contributions for medical insurance premiums and medical care | 79,780 |
| Deductibility of mortgage interest on owner-occupied homes | 46,860 |
| Accelerated depreciation of machinery and equipment (normal tax method) | 52,230 |
| Capital gains exclusion on home sales | 43,900 |
| 401(k) plans | 39,800 |
| Employer plans | 52,470 |
| Exclusion of net imputed rental income | 34,320 |
| Child care | 42,120 |
| Deductibility of charitable contributions, other than education and health | 33,210 |
| Step-up in basis of capital gains at death | 27,260 |
| Exclusion of interest on public-pension State and local bonds | 29,840 |
| Deductibility of nonbusiness state and local taxes other than on owner-occupied homes | 32,460 |
| Exclusion of interest on life insurance savings | 20,770 |
| Capital gains (except appreciation, timber, iron, ore, and coal) | 20,760 |
| State Security benefits for retired workers | 19,750 |
| Deduction for loss of dependent child | 16,760 |
| Deductibility of State and local property tax on owner-occupied homes | 12,810 |
| Deferral of income from controlled foreign corporations (normal tax method) | 10,670 |
| Keogh plans | 11,840 |
| Deductibility of medical expenses | 6,130 |
| Individual Retirement Accounts | 5,970 |
| Exclusion of workers' compensation benefits | 5,310 |
| Exemption from passive loss rules for \$25,000 of rental loss | 5,230 |
| Expensing of research and development expenditures (normal tax method) | 6,120 |
| Earned income tax credits | 6,130 |
| Self-employed medical insurance premiums | 4,630 |
| Credit for low-income housing investments | 4,250 |
| State Security benefits for disabled | 4,210 |
| Deductibility of charitable contributions (education) | 4,030 |
| Deductibility of charitable contributions (health) | 3,860 |
| State Security benefits for dependents and survivors | 4,040 |
| Residualized corporate income tax rate (normal tax method) | 3,860 |

Source: Analytical Perspectives on the Budget of the United States Government, Fiscal Year 2007, Table 19-3.

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- Capital gains are preferentially taxed to individuals in the U.S., with the gain on most assets held for longer than a year taxed at 15%, rather than at the individual's marginal rate of up to 35%.
- There is no corporate capital gains preference.

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- A classical, or double tax system
- Most corporations are subject to tax at a flat 35% rate
- Right now, the dividend tax is 15%, the same as the capital gains rate, but historically, dividends have been taxed at the shareholder's marginal rate
 - "Qualified dividends"
- Corporate shareholders are entitled to a dividends received deduction

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[illegible]

Source: CCH (refer to handout for enlarged version)

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| | | |
|---|---------------------------------------|---|
| 8832 (Rev. 10-1-80) U.S. DEPARTMENT OF THE TREASURY Internal Revenue Service | Entity Classification Election | DATED <u>10-1-80</u> FILED <u>10-1-80</u> BY <u> </u> |
| Name, address, and state of taxpayer, and P.O. box, and location | | EIN # <u> </u> |
| City, state, and ZIP code, and ZIP code for a foreign address, where not permitted to which address care and correspondence | | |
| Type of election (see instructions): | | |
| <input type="checkbox"/> Initial classification by a newly formed entity | | |
| <input type="checkbox"/> Change of current classification | | |
| Form of entity classification | | |
| <input type="checkbox"/> A domestic eligible entity electing to be classified as an association taxable as a corporation | | |
| <input type="checkbox"/> A domestic eligible entity electing to be classified as a partnership | | |
| <input type="checkbox"/> A domestic eligible entity with a single owner electing to be disregarded as a separate entity | | |
| <input type="checkbox"/> A foreign eligible entity electing to be classified as an association taxable as a corporation | | |
| <input type="checkbox"/> A foreign eligible entity electing to be classified as a partnership | | |
| <input type="checkbox"/> A foreign eligible entity with a single owner electing to be disregarded as a separate entity | | |
| Disregarded entity information (see instructions): | | |
| Name of owner | | |
| Identifying number of owner | | |
| Country of organization of entity electing to be disregarded (if foreign) | | |
| Date is to be effective beginning month, day, and year (see instructions) | | |
| Name and title of person whose TIN may be used for information | | |
| <input type="checkbox"/> This person's telephone number | | <u> </u> |

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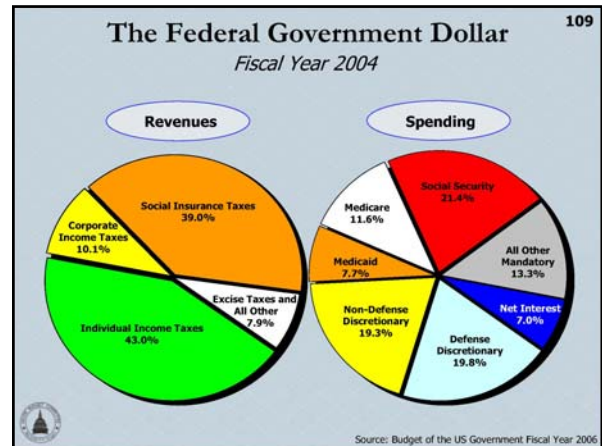
- The federal government also levies gift and estate taxes, but these taxes generally only hit very large gifts and estates.

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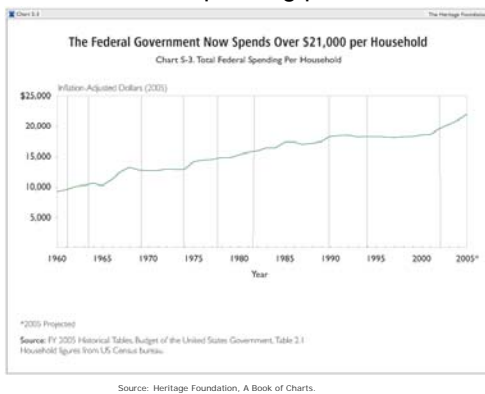
How the Estate Tax Will Fade Away

| Year | Estate tax exemption | Gift tax exemption | Highest estate and gift tax rate |
|------|----------------------|--------------------|--|
| 2005 | \$1.5 million | \$1 million | 47% |
| 2006 | \$2 million | \$1 million | 46% |
| 2007 | \$2 million | \$1 million | 45% |
| 2008 | \$2 million | \$1 million | 45% |
| 2009 | \$3.5 million | \$1 million | 45% |
| 2010 | Estate tax repealed | \$1 million | top individual income tax rate (gift tax only) |
| 2012 | \$1 million | \$1 million | 50% |

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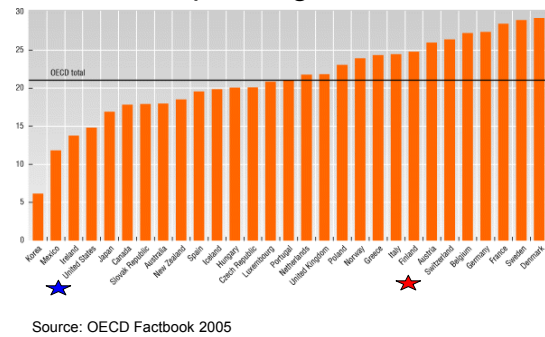


Total Federal Spending per Household



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Social Spending 2001 (% of GDP)



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On Budget vs. Off-Budget

As of April 3, 2006 the federal debt was

\$8,377,471,102,607.82

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