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CONGRESS

The Investment Tax Credit, the Capital Gains Tax, and the Repeal of the Estate Tax: The Budget Tango

The budget process determines what Congress does on taxes and the economy. And it is actually more interesting than you would suppose.

So, if you have never heard what you are about to read, it is not because it will not determine whether the estate tax is abolished or the pension rules changed. Rather, it is because no one understands the budget process – not the media – not the congressional staff – and certainly not the senators, even the Budget Committee chairman.

The fact is that congressional Republicans currently are in the center of a parliamentary war with one another.

The fight started with the “rebellion of the Republican moderates” at the end of 2005. For four years – since September 11, 2001 – they had dutifully given the Bush administration just about everything it wanted. But now, with the presidential poll numbers falling below 40% – and the talented, burdened Tom DeLay on his way out – the smoldering resentment began to come to the surface.

The uprising broke out in connection with the once-a-year nonfilibusterable budget-balancing “reconciliation” bill. Under the 1974 Congressional Budget Act, Congress is allowed to circumvent the Senate rules once annually for the ostensible purpose of cutting runaway spending.

The House version of the 2005 (fiscal year 2006) “reconciliation bill” attempted to do this by slashing \$50 billion – largely through cutting entitlements, including Medicare and Medicaid. But part of its “savings” was also from revenues that theoretically would be generated by drilling in the Alaska National Wildlife Refuge (ANWR).

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The combination of slashing entitlements and drilling in ANWR was too much for moderates like Charles Bass (R-N.H.). So they rebelled – and, in the process, forced the House leadership to strip ANWR from the bill. And the media attention heaped on the “moderates” following their ANWR victory turned this ragtag group of moderates into an active force.

Now comes the spring of 2006, when congressional budgeters were preparing a budget – and a blueprint for the annual “reconciliation” bill. On one hand, the newly invigorated moderates in the House and Senate refused to agree to a budget that made any significant cuts. On the other hand, the increasingly slighted conservative wing threatened to bolt from a budget that spent too much. It was a deadlock.

And that’s where it is now. In the end, the Senate Budget Committee chairman, Judd Gregg (R-N.H.), threw up his hands and produced a “reconciliation” blueprint that only dealt with ANWR drilling and effectively made no other cuts.

The House, for its part, sat on its hands until mid-May – a month after the deadline. Finally, fearing that Republican incumbents would be blasted in the upcoming elections for not being

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able to even produce a budget, the House passed a jury-rigged measure – with the understanding that it would never be conferenced and would never become effectual.

But this created a new set of problems: Because Congress had not produced and conferenced a budget in 2006, the previous year's budget continued to apply – for better or worse.

The first consequence was that, while Congress slogged through a supplemental appropriations bill producing between \$92 billion and \$109 billion in red ink, there was no nonfilibusterable mechanism in place for offsetting the supplemental's profligacy. If Congress wanted to offset the costs of the Iraq war through a "meat-ax" cut of other programs, that would have to be attached to the emergency spending bill itself. And, with many Democrats attacking the Iraq war with increasing fervor, there was a limit to what "the legislative market would bear."

But this was the least of the problems.

When Congress created the 2005 (FY 2006) budget, there was little thought to the possibility that there would be no follow-up budget in 2006. As a result, there was only a total of \$93.1 billion for tax cuts in fiscal years 2006, 2007, 2008, 2009, and 2010 combined.

Even if you limited the extension of Bush's investment tax and capital gains cuts to a couple of years, that alone would eat up \$70 billion of the \$93.1 billion kitty – leaving only \$23.1 billion for everything else, including whatever deals Senate Finance Committee Chairman Chuck Grassley (R-Iowa) had to make in order to slash the investment tax credit and the capital gains tax.

Enter the coalition working to permanently repeal the estate tax. Currently, the estate tax is slated to be gradually phased out until 2010 – when it completely disappears – only to recur in full force in 2011. House-passed legislation – H.R. 8 – would make the repeal permanent, beginning in 2011.

In one way, the coalition was blessed by the failure of Congress to reach agreement on a budget. Had there been a budget resolution in 2006, it would have explicitly limited tax cuts in 2007, 2008, 2009, 2010, *and 2011* – unlike the 2005 budget resolution, which explicitly reaches only to 2010. This is significant, of course, because 2011 is the first year when the estate tax repeal fully begins to be felt.

But, following passage of investment tax and capital gains tax cuts, the money left for tax cuts in the 2005 budget resolution was only \$23 billion for both the estate tax repeal and the "pension trailer bill" dealing with both the collapsing pension system and the capital-gains-cut-related "deals."

And even in the immediate future, the estate tax repeal will fall victim to the biggest "budget process" debate in Washington – the question of how to quantify its cost. This process is called "scoring."

For years, Republicans have whined about the quirks of "scoring," as practiced by the Joint Committee on Taxation, the Congressional Budget Office (CBO), and the Budget Committee. Particularly grating to them is the fact that congressional "scoring" assumes that social spending programs will cost less because they will cure poverty – but not that tax cuts will "cost" less because they will pump up the private sector.

It gets worse, however.

While the Joint Tax Committee refused to consider that abolition of the estate tax would stimulate investment, it was willing to assume that it would make ailing seniors less likely to make gifts in anticipation of death. Therefore, according to congressional "scoring," the estate tax abolition would cost \$9 billion in lost gift tax revenues *before it even took effect*.

This meant that the anti-estate tax lobby would be forced to battle with a variety of other interests in order to gain primacy over the remaining \$23.1 billion tax-cut pot.

And, while at least a dozen senators and Senate staff had the unilateral power to change the "scoring," the staffs of at least four high-ranking

conservative Republican offices (committee chairman and above) reacted with shock when asked to take matters into their own hands and – through their own initiative – eliminate the “static scoring” of the estate tax repeal.

In fact, senior Montana Democrat Max Baucus candidly told lobbyists that he thought Majority Leader Bill Frist (R-Tenn.) was engaging in a perfunctory effort to mollify tax cutters, without taking the draconian steps necessary to prevail.

The bottom line? At press time, the House repeal bill – H.R. 8 – was slated to be laid down on June 6 – immediately following a kamikaze effort to pass a constitutional amendment dealing with same-sex marriages.

Pro-repeal lobbyists felt they were within striking distance in the Senate – with the budget problems being the chief obstacle. And, while it is true that senators sometimes lie about their intentions – and lobbyists sometimes hear “what they want to hear” – pro-repeal advocates were working hard to make sure that Majority Leader Frist took the parliamentary steps necessary to make sure that the bill was not killed by unrelated “killer amendments” dealing with hate crimes against homosexuals, an increase in the minimum wage, prescription drug reimportation, and stem cell research.

Senate Passes Immigration Bill; Showdown with the House in Place

There is no political high-wire act that is higher or more precarious for Republicans in 2006 than the battle over immigration. So perilous is the GOP’s position that this issue – alone – could cost the party control of both the House and Senate.

National polls show that illegal immigration is second only to the war in Iraq in terms of importance to the American people. But the problem is even more serious for Republicans, who must deal with a key element of their base that is absolutely adamant on the subject – and may be willing to abandon the party if it is perceived to embrace “amnesty.”

True, an overnight survey immediately following the May 15 presidential address on immigration showed that almost two-thirds of respondents were sympathetic to the administration’s “amnesty”-like approach that night. But Republicans understand that that was a short-term jump that had a lot to do with the methodology of the poll – the fact that respondents were required to have listened to the

entire Bush speech before rendering an almost instantaneous reaction.

And, like the media’s post-Columbine polls showing that almost exactly two-thirds of the respondents favored gun control, the immigration surveys failed to take into account the overriding importance of the hard-core conservatives that form the base of the Republican Party.

Finally, there is the fact that, unlike most legislative issues, immigration has the potential of fundamentally transforming the electoral map in ways that could ensure one-party dominance for a generation – or more.

As an example, the last “amnesty” bill – the 1986 Simpson-Mazzoli Act – is widely credited with having permanently turned California from a “swing state” into the “bluest of the blue” states. This, in turn, may have taken what would otherwise have been unquestioned GOP electoral dominance and changed it into a competitive system where the last presidential election was determined by 120,000 Ohio votes and the previous, by a few hundred Florida votes.

So, with that in mind, the Senate last month forged ahead with its version of immigration reform legislation. The committee-reported bill – crafted by Judiciary Committee Chairman Arlen Specter – was S. 2611:

Amnesty: First, the Senate bill divided the 12,000,000-man illegal alien population into three groups:

- Group 1 (consisting of those who had resided in the United States for five years prior to April 5, 2006, and who had worked here for at least three years) would be given green cards after six more years of work. This would allow them to apply for citizenship after five additional years.
- Group 2 (consisting of illegals who resided here from two to five years) would be required to register and go home temporarily – which would almost guarantee them temporary “H-2C” (work visa) status and the right to apply for a green card, either at home or in the United States. Although S. 2611 originally provided for 325,000 “H-2C” visas, this number was reduced to 200,000 by a Senate floor amendment.
- Group 3 (those in the United States for less than two years) would essentially continue

to exist under the status quo, which would allow them to be deported.

The **House** bill (H.R. 4437)—passed on December 16, 2005, by a vote of 239 to 182—had no counterpart provision.

Green Cards: Second, the Senate bill increased the number of employment-based green cards to 450,000 annually and the number of family-based green cards to 480,000 annually. This provision was further amended on the Senate floor, with, *inter alia*, language offered by a Northeastern high-tech-state senator that would designate two-thirds of the 50,000 green cards issued under the current green card lottery system to high-skilled immigrants with technological degrees. Note that the green card quota would not apply to illegal aliens in Group 1, but this group was, in some respects, treated less favorably with respect to the issuance of “green cards” than illegal aliens in Group 2. Furthermore, under the bill, spouses and children of “green card” holders were treated more favorably than the unmarried sons and daughters of citizens. The HOUSE had no counterpart.

Unskilled and Low-Skilled Workers: Third, the Senate bill took the current 28.6% cap on unskilled and low-skilled workers and raised it to 30% in the case of unskilled workers and 35% in the case of low-skilled workers.

Per Country Quotas: Fourth, the Senate bill carved exceptions in the “per country” quotas in the case of countries expected to provide “numerous workers.”

“H-2C” Visas: Fifth, even immigrants who are not in Group 2 were allowed, under the Senate bill, to receive visas under this temporary worker program if

- they were capable of performing required labor;
- they paid a \$500 fee;
- they had an employment offer;
- they passed a medical exam;
- they passed a background check; and
- they had no intent to abandon their foreign residency.

Enforcement: Sixth, the Senate bill authorized funds and expanded substantive powers to deal with alien smuggling, porous borders, and “work authorization.” These provisions were further beefed up through Senate floor amendments, which included

- an amendment by Alabama Republican Jeff Sessions to construct a border fence;
- an amendment by Oklahoma Republican James Inhofe to make English the “national” (but not “official”) language—a move that was widely viewed as an effort to overturn the bilingual government services requirements of Bill Clinton’s Executive Order 13166;
- an amendment by Finance Committee Chairman Chuck Grassley (R-Iowa) to set up an “employment Instantcheck” system for the federal government to approve every job seeker (American and non-American) applying for a job.

The Senate enforcement provisions did stop short of making illegal aliens felons—an item included in the HOUSE bill but, by now, largely conceded by even the House to be politically unachievable.

But where from here? At press time, rebellious House members—both Democrats and Republicans—were engaging in the obligatory saber rattling. House Republicans, led by the chairman of the Judiciary Committee, were publicly pronouncing their intention to defy George W. Bush and to shoot down any immigration legislation that would create a path to citizenship for aliens illegally within the United States. And the Senate requirement that illegals pay a “fine” in order to get on the track to citizenship seemed to have no effect in assuaging House anger.

The Senate, for its part, was no less intransigent—with key senators such as senior committee Democrat Ted Kennedy (Mass.) and anonymous staff of both parties labeling the House version “dead on arrival.”

All of this would seem to suggest an irresolvable deadlock. But at least two sets of House Republicans have announced their intentions to try to produce a compromise.

House moderates—newly invigorated by their success in stripping Alaska drilling from last year’s

“reconciliation” bill – have declared their intention to try to produce an immigration compromise, shepherded by Delaware moderate Republican Mike Castle.

In addition, normally hard-core-conservative Study Committee Chairman Mike Pence (R-Ind.) has proposed a compromise that would hold open the possibility of citizenship only to illegals who returned to their countries. Pence’s Study Committee, which led the charge for last year’s entitlement cuts, is normally the “gold standard” for House conservatism – but his most recent foray has not, to say the least, met with overwhelming enthusiasm.

Finally, Republicans close to the White House were floating the idea of dropping the “three-tier system” entirely, leaving in place only the guest worker program and the enforcement provisions. While this idea might cut the Republicans’ “Gordian knot,” it is unclear whether there are enough votes in the Senate to shut down a Democratic filibuster of this compromise. And it is, further, not clear whether a bill containing a massive guest worker program would satisfy the hardest-of-the-hard-core in the GOP base.

So – again, at press time – Senate Republicans were whispering the possibility of “slow-walking the bill through conference.” What this means is that the conference would be deliberately allowed to deadlock until after the November elections. Then, in a lame-duck session, when the balloting was over and hapless social conservatives no longer had any leverage, the White House would pressure House conservatives to cave in to Senate demands.

There are, however, a number of significant risks to this strategy. It assumes social conservatives will be stupid and easily pleased. It would also deny the Bush administration a preelection legislative victory – a victory that Bush’s adversaries, at least, are portraying as the hallmark of whether his presidency is a success or a failure.

But perhaps the most preeminent risk as far as Congress is concerned is that, should Democrats make significant gains in the upcoming elections, they may be less than willing to swallow the Republicans’ bill. And, in the Senate, the 45 Democrats have more than enough strength to successfully filibuster the conference report.

The Executive Branch

SEC Steers a Middle Course; Justice Gets Tough on White-Collar Violators

It’s not as though Wall Street is hoping for a return of former Securities & Exchange Commission (SEC) Chairman William Donaldson – who made alliances with the Commission’s two Democrats in order to expand federal jurisdiction over issues like corporate governance.

But anyone who thought the confirmation of current SEC Chairman Chris Cox signaled some sort of pro-business apotheosis was sadly disabused of that notion last month – when the SEC refused to exempt small business from the reporting requirements of the 2002 Sarbanes-Oxley Act.

Rejecting the advice of its own small business advisory panel specifically created by the SEC for the purpose of studying this particular issue, the Commission declined to exempt companies with a market value of less than \$128 million from the Sarbanes-Oxley requirement that corporations prove they have adequate safeguards to catch accounting errors and fraud.

Also rejected were suggestions that firms with market values of up to \$787 million be exempted from current requirements that an auditor approve those safeguards.

Small business was given three olive branches:

- The SEC agreed to a five-month compliance extension for every business with a market value of less than \$75 million.
- The SEC also promised to provide “additional guidance” concerning how corporations are to assess the adequacy of their accounting controls.
- Finally, the Public Company Accounting Oversight Board indicated that it would amend its own rules on auditor oversight of internal corporate controls.

Advocates for a small business exemption – including members of the repudiated panel – tried to put the best face on their rejection. They argued that what the SEC had done was to give small business a respite while it tried to “sort things out” – which, apologists argued, was exactly the outcome they were pressing for.

But, with Congressman Ron Paul (R-Tex.) and others standing by with legislation to do away with the Sarbanes-Oxley reporting requirement entirely, it is more likely that what the SEC has done is to merely take the steam out of the opposition until the program can become fully ensconced.

Clearly, however, the time to whine about Sarbanes-Oxley was in 2002 when it was being considered in the Senate and when senators could have filibustered it and pelted it with amendments, rather than cowering in fear at the media-generated barrage.

Enron Convictions Presage Tougher Justice Department Stance Toward Business: When the current federal sentencing structure was put in place in 1984, the conservative negotiator for the Senate insisted on striking language (left over from an earlier Kennedy draft) that would have emphasized harsh sentences for “white-collar criminals.”

And, for nearly two decades on the heels of that compromise, white-collar offenders were generally treated differently from street criminals and organized crime figures.

But no more.

Newspapers detailed how corporate wrongdoers – previously allowed to surrender privately out of the public view – are now routinely handcuffed and paraded before the public in humiliating “perp walks.” Furthermore, long sentences such as those slated for Enron’s Kenneth L. Lay and Jeffrey K. Skilling may preclude consideration for minimum security facilities. And, under Justice Department guidelines, corporations are frequently pressured to waive all legal rights – including attorney-client privilege – in order to avoid threats that the corporations themselves will be made defendants.

The Justice Department appears emboldened in getting its way with corporate and political defendants – who are increasingly treated in many ways like Mafia defendants (or worse). Meanwhile, late-night FBI raid on the congressional offices of Louisiana Congressman William Jefferson – the first in U.S. history – has further polarized the legislative and executive branches.

Although Jefferson is a liberal Democrat, the peculiar bipartisan reaction – at least in the House – to allegations of Jefferson’s flagrantly illegal conduct results from a belief that this is a “dry run” for searches and arrests arising from the activities of D.C. lobbyist Jack Abramoff.

Potential exculpating witnesses will be named “unindicted coconspirators” – securing their cooperation by putting their lives in permanent limbo. And House members facing the possibility of being investigated themselves want to ensure that they are not subjected to the “Enron treatment” when that time comes.

FTC Finds Lack of Gasoline-Related “Price Gouging”; House Moves To Build a Political Fire Wall

Echoing every other major study that has looked into the issue, the Federal Trade Commission (FTC) last month found that price gouging had played no significant role in the price of gasoline.

This was not well received by the press. But it was even worse news for House Republicans, who desperately need someone to detract attention from Congress’s failure to address the cost of gasoline.

They had tried to do this with last year’s hodge-podge of tax credits, exotic energy incentives, and special interest provisions (particularly for ethanol producers). But it is becoming increasingly apparent that that bill is widely viewed as “pork” and is producing little political traction.

So, in a largely symbolic gesture, the House, before Memorial Day, once again passed legislation to open the Alaska National Wildlife Refuge (ANWR) to oil exploration and drilling.

The Senate had earlier used its once-a-year opportunity to produce a nonfilibusterable budget-balancing “reconciliation” bill for the almost exclusive purpose of shoving through ANWR drilling without requiring the unattainable 60 votes it would normally need to shut down debate. Unfortunately, that effort collapsed with the collapse of efforts to produce a House-Senate agreement on a budget.

The Courts

The Supreme Court

Scalia Lashes Out at Congressional Conservatives

It wasn’t as though the Court hadn’t invited the public to snoop into its business. In an almost unprecedented “debate,” three Justices had participated in a public panel discussion to explore the extent to which foreign law should be considered by American courts.

So when congressmen such as Florida Republican Tom Feeney chimed in with “sense of Congress” resolutions condemning, *inter alia*, the use of foreign law in American jurisprudence, they reasonably expected they did so with the gratitude of Associate Justice Antonin Scalia—whose position they championed.

They were wrong.

In a scathing address to the National Italian American Foundation attended by some congressmen, Scalia told Congress that “[i]t’s none of your business.” Talking down to a group of politicians not used to being talked down to, Scalia went on to say: “I’m darned if I think it’s up to Congress to direct the Court how to make its decisions.”

Congressmen who had erroneously thought they were accepting the Court’s invitation to join in a national debate on the issue were more gracious about the Scalia rebuke than anyone had a right to expect. And no Court-watcher can have failed to notice that Scalia, as he ages, has become less and less reticent in responding to challenges with sharp retorts and even an expressive Italian gesture.

But you have to wonder what level of behind-the-scenes irritation at the Court it took to produce this public explosion. And you also have to wonder whether some members of the Court are having second thoughts about the Court’s recent level of openness.

The Inferior Courts

Senate Once Again Eases Toward the Brink of “Nuclear” Showdown

To review the bidding: Last spring, Senate Republicans threatened, by a simple nondebateable majority vote, to overturn a written Standing Rule of the Senate allowing debate on judicial nominations to be ended only by a procedure called “cloture.” Their gambit, called the “nuclear option,” would have created the precedent that the written rules of the Senate are meaningless if 51 senators, at any time, without debate, vote to end them.

The Senate narrowly avoided the actual exercise of the nuclear option when a group of seven Republican senators and seven Democrats—the so-called Gang of 14—agreed to a two-part compromise:

- judicial nominations would be filibustered, with the support of the group, only under “extraordinary” circumstances; and

- no member of the group would vote to exercise the nuclear option so long as—effectively—the first part of the compromise was honored.

With the agreement in place—and the threat of the nuclear option hanging over the Senate—the nominations of John Roberts, Samuel Alito, and a number of appeals court nominees were confirmed without significant difficulty. Ironically, however, the shallowness of the conservatives’ commitment to the proposition that every judicial nominee deserves an up-or-down vote on the Senate floor was revealed when a nominee unacceptable to them—White House counsel Harriet Miers—was sent to the Senate.

But consistency has never been a particular hallmark of the Senate. And over the past two months, the Republican leadership has once again raised the possibility of invoking the nuclear option to confirm the nominations of presidential adviser Brett M. Kavanaugh (to the D.C. Circuit Court of Appeals) and Terrence W. Boyle (for the Fourth Circuit).

Democrat Patrick Leahy (Vt.) had argued that Kavanaugh lacked the capacity to be independent of the Bush administration. And the American Bar Association had downgraded him from “well qualified” to “qualified.”

But the Senate was spared a constitutional crisis over Kavanaugh when the Senate voted, 67 to 30, to take up his nomination—far more than the 60 votes needed to shut down a filibuster.

The battle over Boyle may be the last gasp for those Republicans eager to politicize the Senate rules. Last year, there were exactly 50 senators (plus the Vice President) in favor of the nuclear option—and exactly 50 opposed. Assuming, as expected, Senate Republicans lose at least one seat, there will no longer be the votes to invoke the nuclear option.

Should, on the other hand, Republicans lose control of the Senate, they can only hope Senate Democrats don’t have the strength and the will to abolish the legislative filibuster using the same text that has served as the Republican Bible for the nuclear option over the last year—former Senate aide Martin Gold’s article in the *Harvard Journal of Law and Public Policy* [Volume 28, Issue 1] laying down a blueprint to abolish the filibuster of legislation (not, incidentally, the filibuster of nominations).

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