

Tax Letter

Debt Ceiling and Fiscal Deficit

Dear Clients and Friends,

We purposely held back our July letter until the end of the “Debt Ceiling and Deficit” fiasco in Washington, hoping that we may be able to include certain new tax changes. Finally, it was over on August 3, 2011 with a new law, “Budget Control Act of 2011 (S-365) “. In real term, the new law S-365 offered no substantive solution to our National problem other than a temporary relief from certain “Acute Anxiety Syndrome”. Let us look at this political fiasco and our national problem from, at least, three different directions.

Firstly, our national Government is not an open Government like what we all wanted to believe. If you have any doubt, just look at the recent fiasco concerning our national debt and ever increasing fiscal deficit. Currently, our national debt is about 14 Trillion dollars which is about the size of our annual gross national product (GNP). To make up this GNP, everyone of us, old or young, rich or poor, man or woman, must work very hard for one whole year. The total value of this combined effort will be about 14 Trillion dollars. Put it another way, the 14 Trillion dollars national debt means everyone of us, old or young, rich or poor, man or woman will be responsible to pay back about \$47,000 each. Further, every year our national Government will continue to borrow to finance our deficit spending. According to the most conservative estimate, if we continue spending the way we are, 4 to 5 years later, our national debt will be 2 to 3 times of our annual GNP. For a matter as serious and as important as this, one would think that there will be many serious National debates involving every senator and every representative. No, Washington decided to have an invitation only, 2-month close door discussions among very few members of Congress. This is our Government, like it or not !

Secondly, we all wanted to believe that our elected officials in our national Government are responsible and honorable persons. Facing such a monumental task, after nearly 2 months, our honorable senators and representatives together with our President can only manage to come up with a new law – Budget Control Act of 2011 (S-365). The result could have been expected, because it is typically Washington style. Perhaps, it is also typical for a Country ran by lawyers. Any national crisis, lawyers usually believe, can be solved by passing and signing a new law. If this new law can effectively install serious spending discipline and genuine national borrowing limits, it could be a good new law. However, it did not. It is nothing more than another deferral, another trade-off. It deferred the moment of reckoning until the end of this year. It traded-off some token cut-backs for an additional 2 Trillion dollars borrowing increase. This is our future, our fate, like it or not !

Finally, what is the new law (S-365) all about ? In general, the new law increased the Federal borrowing limit to keep our Government running as usual. On the other hand,

it will start the motion of an initial round of deficit reduction for 1 Trillion dollars which will be completed in 10 years (from 2012 to 2021). During the same 10 years, there will be another round of deficit reduction for 1.5 Trillion dollars. However, this 2nd round of reduction will not be implemented until some sort of special committee (**JSC**) had a chance to study, to debate, before any plan of reduction will be recommended, adopted.

This **JSC** committee will consist of 12 specially selected members from both Houses, 6 democrats and 6 republicans. To reduce our annual fiscal deficit, it could be a combination of spending cuts and tax increases. Collectively, they may propose and recommend both spending cuts and tax increases. All this are fine, but it failed to address the real issue - our National debt crisis. Even both rounds of deficit reduction will somehow be magically succeeded, at best what we can achieve is not piling up as much new borrowing on our National debt. However, we will continue to have annual fiscal deficits, perhaps smaller. The total reduction (or savings) will only be 2.5 Trillion dollars in 10 years, an average of 250 Billion dollars per year. As such, our National debt will continue to be increased from the current 1 GNP to 1.5 GNP or to 2 GNP in a slower pace, say 10 plus years. Is this new law a problem solver or a crisis deferment ? Your answer is just as good as mine.

For further discussion, please give us your response.

Sincerely,

Cho F Chan CPA, Inc.
An Accountancy Corporation