Climate Change Revenue Provisions Emerge With a Whimper

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In 1993 President Clinton allowed Vice President Gore to present a proposed tax on all fuel consumption, to be measured by British thermal units. The tax actually passed the Democrat-controlled House without a single Republican vote in favor, only to fail in the Senate. The opposition of business lobbying groups was a major factor in turning public opinion against the plan, and this swing contributed to the Republican tidal wave that swept the GOP into control of both houses of Congress in the 1994 midterm elections. Democrats complained afterwards that they had been ''Btu'd.''

The failure of the Btu tax effectively killed the prospects for climate change legislation for over a decade (Republican control of Congress and the White House also played a role). Everything old is new again, because the Obama administration's push for a cap-and-trade system has resulted in a bill snaking through Congress that is likely to pass at least in the House by the end of the month. However, the Democrats still seem to be smarting from their 1993 failure. Not only did they decide against the carbon tax — which is easier to implement and more popular with economists — but the House Energy and Commerce Committee also voted to give virtually all the permits away for free. In the end, H.R. 2454, the American Clean Energy and Security Act of 2009, would raise only $165 billion over 10 years and give away $83 billion of that amount in tax rebates. If you're going to give away the permits for free and raise almost no revenue, what is the point? (For coverage of the bill, see p. 1315.)

Any potential climate change legislation is likely to significantly affect current federal energy tax policy. Myriad tax credits are available, most ostensibly promoting the use of clean and alternative energy and fuels (some, however, with seemingly no purpose at all). James Rafferty, Alex Sundakov, and Kevin Richards emphasize the importance of cap-and-trade legislation's interaction with current incentives. Their special report provides a background on energy tax policy and identifies when energy tax provisions and carbon pricing will be complementary or conflicting from an economic efficiency perspective. While Congress has never been much for consistency or efficiency, it would do well to put more thought into how its cap-and-trade bill is likely to interact with the tax code and the economy than is possible by Speaker Nancy Pelosi's June 19 deadline. (For the special report, see p. 1345.)

News Analysis

Lee Sheppard provides her own take on the recent Ninth Circuit decision in *Xilinx v. Commissioner* this week (p. 1295). Sheppard writes that the case presented more of a question of statutory construction than of tax, but that the court apparently understood the issue better than either Xilinx or the government. The Ninth Circuit decision overruled the Tax Court, which concluded that one regulation section trumped another, but Sheppard believes that the majority was right to find that a safe harbor rule should not obscure the purpose of section 482. Sheppard also explores the future of transfer pricing.

Tying together his recent string of articles on international tax reform, Martin Sullivan presents an overview of the four major components of President Obama's plan on p. 1301. Sullivan highlights both the good and the bad components of the administration's proposals, agreeing with the check-the-box and foreign tax credit matching reforms, while opposing the limitation on deductions of deferred profits and the pooling of foreign tax credits. Sullivan concludes that the simpler reform offered by the Clinton administration, which would have eliminated deferral but lowered the corporate tax rate, would be preferable to the Obama plan.

Tax practitioners and observers have big hopes for the Supreme Court's grant of certiorari in *Bilski v. Doll*. Many would like to see the Court eliminate the concept of tax strategy patents, while others would like it to affirm the stringent test laid out by the Federal Circuit. However, some expect the Court to overturn the Federal Circuit's decision and return to the looser test outlined in *State Street*. Jeremiah Coder analyzes the *Bilski* case and presents practitioner reaction on p. 1304.

Commentary

Codification of the economic substance doctrine has been a popular revenue raiser in congressional tax bills since the Joint Committee on Taxation scored an early draft of the provision at $10 billion in additional revenues over a 10-year budget window. The latest JCT estimates on the value of codification are only a fraction of the earlier figure, but the revenue raiser still appears in Obama's 2010 budget proposal. Most of that revenue is attributable to strict liability provisions in the codification's language. Clinton Stretch, Matthew Lay, and John Galotto don't believe that strict liability and the economic substance doctrine mix. In a viewpoint, the authors argue that reasonable cause relief should be added to the penalty provision (p. 1357). They write that imposing a strict liability penalty is at odds with current calls for penalty reform and would penalize taxpayers who act in good faith, as well as those who do not. Congress's stubborn insistence on including this revenue raiser over the objections of the Justice Department, IRS Office of Chief Counsel, and most commentators probably means lawmakers are unlikely to alter codification to produce an even lower score from the JCT.

A recent Shelf Project article by Profs. Gregg Polsky and Brant Hellwig called for a legislative reversal of the *Childs* decision by the Tax Court. (For the article, see *Tax Notes*, June 1, 2009, p. 1141.) Robert Wood disagrees (p. 1363). Although he finds the structure of fee settlements ''arcane and formulaic,'' Wood writes that *Childs* was technically correct and that all that the attorneys in the case had received was an unfunded promise to pay. Wood believes that the Shelf Project proposal ignores basic accrual of income questions and disregards the fact that in *Childs* there was no actual receipt of income. Wood concludes that ''the technical correctness of the *Childs* decision is based on the relationship between the constructive receipt doctrine and section 83.'' Hellwig and Polsky respond to Wood's viewpoint in a letter to the editor on p. 1374.

The Georgia state legislature recently approved a bill allowing the ''adoption'' of embryos. According to Sarah Lawsky and Naomi Cahn, some sources have claimed that taxpayers who adopt an embryo under this state provision are entitled to claim a federal adoption tax credit for their expenses. In their viewpoint, Lawsky and Cahn conclude that embryo adoptions are not eligible for a federal tax credit because they are not legal adoptions of an eligible child under the tax code (p. 1365). They further argue that even a couple who waits to adopt the child after it is born will not be able to claim a federal tax credit. In a tax practice article, Mark Griffin and Alison Peak break down a recent IRS letter ruling on structured settlement payments. Griffin and Peak find that ''the IRS took a very thoughtful and considered approach'' in concluding that payments under a factoring agreement were not subject to information reporting under section 6041(a). The article starts on p. 1341.

Robert Willens defends his recent special report on synthetic consolidations in a letter to the editor this week, responding to criticisms by Paul Rivett in last week's *Tax Notes*. (For Willens's letter, see p. 1373. For the special report, see *Tax Notes*, May 25, 2009, p. 1013.) A letter by John Prusiecki rebuts a recent position by David Cay Johnston. Prusiecki writes that the government's current revenue problems are not caused by undertaxation, but by overspending (p. 1375). ■