

### *From the Editor:*

## Hoyer Hints at Middle-Income Tax Increase

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The American public doesn't trust President Obama (and, perhaps, by extension the Democratic Party) on taxes. Republicans have succeeded in planting the idea in the back of the public's mind that Democrats are all tax-and-spend liberals. This idea is so firmly established that an astounding poll done earlier this year revealed that most Americans believe that Obama has already substantially raised their taxes, which flies in the face of all the tax trimming the administration and Congress have done at the edges of the code. This attitude largely explains Obama's refrain that he will not raise taxes on households making less than \$250,000 a year.

One could quibble with whether the president and Congress have already broken that vow, but so far no broad-based tax increases have been proposed. However, Democrats are taking a beating on the deficit issue, and last week House Majority Leader Steny Hoyer seemed to take the first steps toward preparing the public for a possible tax increase. Hoyer said that an extension of the Bush tax cuts for middle-income earners was not guaranteed and would be closely tied to long-term tax and fiscal reform. He wants to link the Bush tax cuts to a possible plan from the president's fiscal commission, which is supposed to help guide the federal government to fiscal sustainability. Before Hoyer's remarks, Democratic leaders frequently stressed that they intended to permanently extend the Bush tax cuts, except for the rates on the highest income levels. In fact, congressional Democrats have frequently found themselves on the defensive when questioned about plans for a federal VAT and the possible revenue-raising components of a deficit reduction plan. On the surface, Hoyer seems to have played into Republicans' hands leading into the midterm elections this fall. (For coverage, see p. 1415.)

If Democrats fail to extend the Bush tax cuts before the November election, Republicans will likely highlight the issue in virtually every contested race. So it is unclear whether Hoyer's approach will be endorsed by the full House or Senate. The Maryland congressman, however, was

probably just being honest. It is hard to figure out how the deficit can be closed without some kind of broad tax increase — especially because neither party is truly serious about trimming spending.

### Extenders

A third substitute amendment to the extenders legislation in the Senate stalled last week, as Democrats failed to garner the necessary votes to invoke cloture. Calling the political situation dismal, Senate Majority Leader Harry Reid indicated that the Senate would be tabling extenders and moving on to a small-business tax bill. The latest amendment was once again offered by Finance Committee Chair Max Baucus and included more revenue raisers, an even further watered-down carried interest proposal, and an extension of increased unemployment benefits. Although 57 senators supported the bill, Baucus could not win over some conservatives in his own party who are concerned about the deficit. As is typical in the Senate these days, not a single Republican broke ranks and voted for cloture. If Republicans and certain Democrats are against both increasing the deficit and higher taxes, perhaps they will get what they wish by simply letting the extenders expire permanently. That probably isn't quite what Republicans are hoping for, but one wonders whether they are overplaying their hand on extenders and the estate tax. (For coverage of extenders, see p. 1416 and p. 1418. For coverage of the estate tax, see p. 1419.)

### Commentary

The Foreign Account Tax Compliance Act of 2009 is likely to have a profound effect on international tax compliance. While not as expansive as the Stop Tax Haven Abuse Act that floated around Congress for several years, FATCA does contain several increased reporting requirements for U.S. businesses and taxpayers. Mike Gaffney writes that FATCA will alter the equity finance business regarding U.S. equities and increase the burden on the IRS, Treasury, and market participants. In his special report on p. 1453, Gaffney questions whether it is time to scrap the outbound dividend withholding tax. He also examines the Tier I examination process, in which the IRS attempts to determine whether a nonresident should be deemed to own stock that it does not nominally hold. Gaffney concludes that the new law goes against longstanding congressional attempts to encourage foreign investment in the United States. He believes that the United States

should (and will) ultimately consider repealing the withholding tax on portfolio dividends.

The *Schering-Plough* decision by a district court in New Jersey has upset many practitioners. In fact, a sharp critique of the court's holding by Phil Stoffregen and Lynne Edelstein appeared in *Tax Notes*, alleging that the court made several serious fact-finding errors and misrepresented the economic substance of the underlying transaction. Richard Jacobus disagrees and defends the district court. He believes that the court opinion adequately addresses the criticisms by Stoffregen and Edelstein, but he does provide a few clarifications of the court record. Jacobus writes that the two authors missed the mark in analyzing the details of the *Schering-Plough* transaction and that the court undertook the proper analysis of the STRIPS deal. He also believes that like most critics of the economic substance analysis by the court, the two overreacted to Judge Hayden's "well-taken remarks on the big picture." (For the earlier *Schering-Plough* analysis, see *Tax Notes*, Mar. 29, 2010, p. 1599. For Jacobus's viewpoint, see p. 1469.)

The Supreme Court recently held that campaign finance limits on corporations were unconstitutional. The decision in *Citizens United* disappointed advocates of campaign finance reform and has many worried that corporations will soon play a disproportionate role in influencing candidates for public office. Theodore Seto also believes that this may give corporations an even larger role in dominating the area of tax expenditures because congressmen who fail to support targeted tax breaks might find themselves the targets of corporate campaign interventions (p. 1476). He believes that the problem must be dealt with quickly and suggests several legislative solutions. He concludes, however, that many legislative solutions will face a filibuster in the Senate unless they are enacted using the reconciliation process.

Financial derivatives are under attack. They are a target of financial reform legislation passed by the Senate, and many analysts believe they increase leverage in the financial system while providing no real economic benefit. Scott Semer disagrees. In his opinion, derivatives provide valuable information about market conditions (p. 1478). In particular,

derivatives can show how some investors view market trends, writes Semer. If an investor is betting against the housing market in a derivatives product, he probably believes that the market is overvalued. Semer concludes that the IRS's plans to tax derivatives in a punitive fashion are misguided.

Tax litigation is becoming more and more complex, with court opinions often seeming like a labyrinthine mix of alternative rationales. This trend toward long (and often indecipherable) opinions is the fault of the government's frequent assertion of the economic substance doctrine and the courts' willingness to rely on it, according to Jasper Cummings, Jr. The government's goal in asserting the doctrine seems to be to frighten litigants away, according to Cummings (p. 1483). Cummings looks at the 357-page opinion in *Fidelity International v. United States* and cautions that once unleashed, the government cannot control where the doctrine will go.

Restitution payments create frequent conflicts between the IRS and taxpayers. The difficulty arises because many taxpayers believe that restitution payments are above-the-line deductions, a position that the IRS usually opposes. Robert Wood examines this issue in the context of the *Cavaretta* decision, in which the Tax Court sided with the taxpayer (p. 1489).

Comments on the IRS's uncertain tax position proposal were almost universally negative. In fact, some bordered on hyperbole. The Service probably expected the criticism and recently said that although there would be some changes, there would be no second draft for public comment. (For coverage, see p. 1423.) Most of the criticisms of the proposal, and the tone of the commentary, are overblown and exaggerated, writes Kip Dellinger. Dellinger reasserts his position that the UTP proposal will affect only a small percentage of taxpayers and primarily those that use different firms to audit and prepare their tax returns (something smaller businesses cannot afford). Dellinger concludes that tax professionals should reconcile themselves to the UTP proposal and focus on limiting its expansion, not calling into question its existence. (For Dellinger's article, see p. 1495.) ■

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