From the Editor:

Obama Punts Jobs Bill Offsets to Congress

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When President Obama introduced his jobs proposal during an address to a joint session of Congress, he promised to quickly offer revenue offsets to pay for the entire cost of the program. That Obama would feel the need to fully pay for something being touted as stimulus shows how powerful the deficit reduction mantra has become in Washington. Last week, the president kept his promise — in a way — offering $467 billion in new revenue, more than enough to ensure that his jobs program, if enacted, would not add to the deficit. But the components of his revenue proposal make it quite clear that he doesn't actually expect Congress to pay for the jobs bill at all.

The largest component of Obama's pay-fors is a recycled version of his proposal to cap deductions for high-income taxpayers at 28 percent. The president has proposed this revenue raiser every year since taking office, with the $400 billion or so in revenue being used to pay for different proposals. In 2009 Democrats held 60 seats in the Senate and a large majority in the House, yet did not even consider the deduction cap. In fact, many prominent Democratic lawmakers expressly came out against the president's proposal. It is highly unlikely that a Republican House and a narrowly Democratic Senate will be any more receptive to the idea now. It is somewhat surprising that the president would even offer the deduction cap as a possibility, given its complete lack of support on Capitol Hill. It makes him look insincere in his pledge to control deficits while stimulating the economy (a promise he probably shouldn't have bothered to make in the first place).

The other revenue-raising elements of the plan are just as stale. Obama would like to end the section 199 deduction for oil and gas companies and the deduction for corporate jets (together these would raise about $43 billion). The White House again proposed treating carried interest compensation as ordinary income, something that couldn't even make it through a Democratic Congress right after a financial meltdown. Many Democrats support ending tax favors for the oil industry, but Republicans are adamantly opposed and the GOP can always count on the support of Democrats from oil states such as Louisiana and Texas. In fact, Sen. Mary Landrieu, D-La., has already vocally expressed her displeasure that the president continues to press for section 199 repeal. It's pretty clear that if the jobs bill will be even partially offset, the revenue raisers will have to be completely the creation of Congress — there is nothing in the president's proposal likely to pass either chamber. (For coverage, see p. 1202.)

Obama's disapproval ratings are at an all-time high. The Democrats recently lost a special election for Rep. Anthony Weiner's old seat (which had been in their party's hands for generations), something that evokes Scott Brown's shocking upset in Massachusetts. Given these facts, it is surprising that Obama would disrupt the momentum of his jobs proposal by pushing for $467 billion of new taxes (opening him up to classic charges of wanting to raise taxes) that have no chance of passing Congress (exposing him to being labeled as soft on the deficit). The president's package of offsets looks like nothing more than a lose-lose proposition.

Fashion and Financial Transactions

Fashion Week has come and gone and Lee Sheppard offers her guide to this fall's trends. She also analyzes financial transaction taxes vs. financial activity taxes, both of which have been proposed as a means to raise revenue and limit the possibility of another financial sector collapse. A financial transaction tax is preferable to a tax on activities because it would be much easier to administer, Sheppard writes. Such a tax would eliminate high-frequency traders and help restore stability to financial markets, according to Sheppard. She looks at the EU's attempts to create a financial transaction tax and argues that the burden would fall primarily on the United Kingdom. (For her analysis, see p. 1187.)

Commentary

The research credit is probably the most important of the extenders that Congress enacts each year. Proponents argue that it creates high-paying jobs in the United States, and they have repeatedly pushed for the credit to be expanded and made permanent. The credit is generally popular, if somewhat maligned for how it is administered by the IRS. It is the source of many protracted controversies between the IRS and taxpayers, Alex Sadler and Jennifer Ray write (p. 1253). In their special report, they discuss the legislative and administrative climate surrounding the section 41 credit and identify factors that have contributed to disputes. They also discuss several cases and explain the credit's various definitions, requirements, and computational rules.

In a case of first impression, the Tax Court decided that it has jurisdiction to review the IRS's denial of a whistleblower's claim even when the information is not used to collect underpayments of tax. Michelle Kwon writes that the Tax Court was wrong to assert jurisdiction in *Cooper* (p. 1275). She argues that the court should not have equated the denial of a claim with the determination of an award. The case will have important implications because the decision will force the Whistleblower Office to issue a determination sufficient to give the Tax Court jurisdiction over every whistleblower who files an application. She concludes that this is overly burdensome because court oversight is only meaningful for whistleblowers whose information results in the collection of back taxes. (For coverage of a GAO report on the whistleblower program, see p. 1229.)

The financial downturn has created a lot of net operating losses for corporations. In fact, the OECD recently warned that NOL credits threatened to undermine the corporate tax systems of countries that failed to limit the application of the credits. The United States has limits in place on the use of NOLs, particularly after an ownership change. Knowing how to navigate these limitations is critical during turbulent economic times, according to Julie Allen, Richard McManus, and Elizabeth Wivagg (p. 1283). The authors highlight the various means of avoiding the application of section 382, including the choice of method of income allocation. The method of income allocation can be a powerful planning tool, but a loss corporation may find that one method will prove more advantageous than another, they write. In particular, they focus on mid-year section 382 ownership changes.

The healthcare reform act remains as controversial today as when it was passed by a divided Congress in early 2010. Circuit courts have grappled with the constitutionality of the act's individual mandate, while Republicans in Congress continue to search for ways to defund or repeal portions of Obama's signature achievement. If the act is fully implemented in 2014, it will significantly raise the cost of employment, which might exacerbate unemployment, writes Diana Furchtgott-Roth (p. 1289). The tax will encourage businesses to hire part-time workers, she argues. The culprit, according to Furchtgott-Roth, is the $2,000-per-worker tax that will be levied on employers that do not provide the right kind of health insurance. She points out that the shadow of the tax might already be affecting hiring, as no new jobs were created in August and unemployment remains about 9 percent. (For coverage of court challenges to the act, see p. 1224.)

The distinction between capital gains and ordinary income is important. Ordinary income can be taxed at a much higher rate, particularly for high-income taxpayers. Robert Wood writes that the Seventh Circuit's recent decision in *Freda* once again shows that proper planning is critical for obtaining the desired results in close income characterization cases (p. 1293). In *Freda*, the court held that a payment Pizza Hut made to settle a trade secret suit was ordinary income rather than capital gain. Wood writes that some sale or exchange language in the settlement agreement might have been enough to change the case's outcome.

In Of Corporate Interest, Robert Willens analyzes a transaction involving a liquidation coupled with a reincorporation of a portion of the distributed assets (p. 1299). He writes that such transactions cannot usually attain liquidation status for tax purposes and are instead treated as reorganizations. The critical fact is whether reorganization status is unattainable. In these types of cases, the IRS may apply the ''alter ego'' theory, according to Willens. ■