From the Editor:

Recession Might Not Be the Best Time for Cap and Trade

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Having successfully passed healthcare reform, President Obama would like to turn to his next major policy initiative. The administration and Congress have hinted for some time that goal will involve comprehensive energy legislation. We have known since early last year that Obama's preferred form of climate change legislation and energy reform is a cap-and-trade system, rather than a simpler carbon tax, and Sens. John Kerry and Joe Lieberman recently introduced a modified version of the 2009 House-passed bill in the Senate.

But is the timing right for the United States to set up a cap-and-trade system and begin lowering its carbon emission levels? The BP oil spill might seem like it would call attention to U.S. energy policy and the country's dependence on antiquated fossil fuels for so much of its energy needs. But on the other hand, a contentious midterm election year in the middle of a major economic downturn might not be the best time to propose a package that would jeopardize America's standard of living by taxing and capping the cheapest way to satiate the country's voracious energy appetite. At least that's the opinion of Diana Furchtgott-Roth, who writes that cap-and-trade legislation as passed in the House and Senate would reduce economic activity and reduce employment. She also argues that it would not slow global warming unless developing nations such as India and China implement a similar program, which neither has any intention of pursuing soon. Furchtgott-Roth concludes that with unemployment hovering around 9.5 percent and Americans already dealing with a reduction in their standard of living related to the recession, Congress should pass on attempting to deal with climate change legislation. (For her analysis, see p. 211.)

And she has a point. Despite a great deal of rhetoric about how much they care about jobs and the state of the economy, Obama and congressional Democrats have seemed remarkably out of touch when presenting their legislative agenda. Even though most of his campaign platform was drafted before the financial and economic crisis struck in 2008, the president has stuck to it almost like he is reading from a script. Now he seems to be turning the pages of that script to the climate change section without regard for the state of the economy or federal revenues. Democrats would do well to consider whether a bill that imposes $846 billion in new taxes over a 10-year period is appropriate during the early months of a very fragile (even tepid) recovery.

News Analysis

Republicans have been slowly declaring their intention to oppose Obama's nomination of Elena Kagan to the Supreme Court. This is no surprise, of course, because Kagan holds many viewpoints at odds with conservatives and has an odd background for a Supreme Court justice. Kagan has never served as a judge, prosecutor, or administrator, so it might be assumed that there is little in her record to interest the tax community. Not so, writes Lee Sheppard. She finds that Kagan's views on administrative law, and particularly executive privilege and *Chevron* deference, should give tax practitioners and policymakers pause. In particular, Sheppard believes that Kagan's legal writings indicate that the nominee would base the level of deference given to guidance on the rank of the decision-maker who signs off on it. Sheppard takes this to mean that Kagan would prefer that the secretary of the Treasury or the IRS commissioner sign off on every piece of regulatory authority issued by the Service. This would be unworkable and indicates a lack of understanding of how the executive branch functions, writes Sheppard. Kagan's views on how involved the president should be in the making of regulations also clashes with Congress's usual preference of having gaps in statutes filled in by bureaucratic experts, according to Sheppard. Sheppard concludes that Kagan would encourage further politicizing of the process of drafting and issuing guidance, something that few in the tax world would likely support. (For Sheppard's analysis, see p. 131.)

The United States and Japan have very similar tax systems. Both nations rely on income and corporate taxes. Both have high statutory corporate tax rates. And both nations minimize the role of consumption taxes (the United States leaves consumption taxes to the states, while Japan has a subtraction method VAT with a low rate). Those similarities may be coming to an end, writes Martin Sullivan. Sullivan points to the new Japanese prime minister's desire to raise Japan's VAT and decrease its corporate tax rate. If Japan follows through on that plan, its tax system will have more in common with Europe's than with America's, writes Sullivan. Although it is by no means certain what direction Japanese tax reform will take, Sullivan concludes that at least Japan has put fundamental reform and serious revenue-raising proposals on the table. The United States has yet to even begin to address its own revenue crisis or its increasingly out-of-touch corporate tax regime. (For Sullivan's analysis, see p. 136.)

Commentary

Healthcare reform dominated the legislative calendar last year, and the passage of Obama's controversial reform package did not occur until earlier this year (and required more than a little legislative trickery). The plan seemed to satisfy no one, with progressives disappointed in the lack of a public option and conservatives angry over the cost and the government's increased role in the healthcare industry. Despite their legislative defeat, many Republicans have not given up the fight against reforms, and the law has been challenged by numerous state attorneys general on constitutional grounds. Prof. Steven Willis and Nakku Chung support those challenges and argue in a special report that the penalty for failure to maintain minimum coverage in new section 5000A is an unapportioned capitation or direct tax and is unconstitutional. The penalty is neither an excise tax nor a proportional direct tax, write the authors. Their analysis relies heavily on the Supreme Court decision in *Macomber* and rejects the ideas that slavery taints the apportionment requirement in the Constitution and that apportionment was repealed by the 13th Amendment. ''No credible argument supports the constitutionality of the healthcare act penalty,'' the authors conclude. (For the special report, see p. 169.)

Although the direction of tax reform is largely unsettled in Congress, one thing does seem clear: Income tax rates for upper-income earners will rise in 2011. Republicans simply lack the votes to extend the top two rates. Many believe that even tax increases on the wealthy will be self-defeating from a revenue perspective or will hinder future economic growth. Profs. Marvin Chirelstein and Lawrence Zelenak disagree. In a viewpoint on p. 197, they write that the expiration of the Bush tax cuts will entail little, if any, loss of labor and output. They also focus on the inequality in the income tax system and conclude that even a restoration of the Clinton-era top rates will do little to promote tax equality. The authors propose changing the income tax system to index tax rates for changes in pretax income distribution. They conclude that something along these lines is necessary because ''it is by no means clear that voters understand the issue in general terms and certainly do not understand the complex role that taxation plays'' in determining the appropriate relationship between the rich and poor.

Noted tax professor, lawyer, and scholar Martin Ginsburg died June 27. Ginsburg was highly respected in the field of mergers and acquisitions (where he was a coauthor of the principal treatise) and corporate tax. Ginsburg's death prompted a torrent of tributes to his life and achievements. *Tax Notes* presents a compilation of remembrances from the TaxProf Blog on p. 215. A separate memoriam to Ginsburg by Jay Starkman appears as a letter to the editor on p. 223.

Tax Notes columnist Robert Wood frequently advocates the use of qualified settlement funds and touts their advantages. This week Wood focuses on the deductibility of payments to QSFs even if the defendant appeals the verdict (p. 207). Wood believes that defendants should still be able to deduct payments to the fund even if they contest the decision that requires the payment. In his opinion, the appellate process puts the funds beyond the defendant's control and does not spoil the deduction. Wood points to the regulations under section 468B(g) and a decision by the Tenth Circuit to support his argument. Robert Willens's article on p. 205 looks at the tax consequences of reorganization transactions in which the target shareholders do not receive pro rata shares. According to Willens, these transactions are bifurcated and considered two separate steps for tax purposes. ■