From the Editor:

Economic Rescue and the Approaching Election

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Election day approaches, and the talk in Washington centers on two things, the campaigns and economic rescue. Last week the presidential nominees rolled out economic rescue plans — both of which use the tax code. Despite differing approaches, John McCain and Barack Obama agree on two tax-related points. First, unemployment insurance should go temporarily untaxed, and second, penalties for early withdrawals from IRAs and 401(k) accounts should be addressed. Both plans would cost the government billions, and neither campaign has proposed how to pay for them.

McCain's plan would temporarily lower to 10 percent the tax on withdrawals on the first $50,000 from IRAs and 401(k)s. He would also cut the long-term capital gains rate from 15 percent to 7.5 percent for 2009 and 2010. His adviser, Douglas Holtz-Eakin, suggests that reducing the capital gains rate "is a proven way to support asset markets." McCain would also increase from $3,000 to $15,000 the amount of capital loss available to offset ordinary income for the next two years.

The Obama tax proposals include removing tax on unemployment benefits and allowing taxpayers to withdraw 15 percent of their savings in IRAs and 401(k) plans penalty free, up to a maximum amount of $10,000. His main concern is job loss, and in order to create jobs sooner rather than later he proposes a tax credit for companies that create new jobs in the United States between 2009 and 2010. For coverage of the Obama and McCain rescue plans, see p. 239.

Obama's Not-So-New Jobs Tax Credit

But, as Martin Sullivan explains, there are problems with Obama's jobs credit proposal. The first thing we need to know about it is that it isn't new — the proposal is a remake of a near-forgotten credit from the late 1970s. The old credit, in effect in 1978 and 1979, died a quiet death and was replaced by the targeted jobs credit, a tax break for hiring hard-to-employ individuals. Sullivan explains that although Obama's proposal sounds good — it satisfies the political need to pay attention to job creation and appeals to economists who value incentives that can create jobs at a low cost to revenue — it will prove to have limited appeal. Why is Sullivan pessimistic about the proposed credit? It is an incremental credit — and incremental credits are less well liked the more folks learn about them. For Sullivan's full economic analysis of Obama's job credit proposal, turn to p. 241.

Treasury Continues to Issue Bailout Guidance

Last week Treasury announced its latest plan to bolster the financial markets by purchasing up to $250 billion of stock in banks. The plan was issued the same day as guidance outlining how Treasury will limit compensation paid to executives of companies that participate in the Troubled Assets Relief Program and the Capital Purchase Program. Under the guidance, companies will be allowed to deduct only up to $500,000 (as opposed to the current $1 million) of salary paid to top executives. The guidance also removes the exception in section 162 for performance-based compensation. How effective will this be? Not very, if you ask practitioners in the know. For their opinions and more information on the executive compensation guidance, see p. 243.

But that isn't the only guidance issued recently in Treasury's bailout work, and people are bound to have questions about it all. Hence Treasury and IRS officials explained the recent guidance issued in response to the financial meltdown at a Practising Law Institute conference in New York last week. Discussed were Notice 2008-100, which addresses transactions that include Treasury acquisitions of bank stock under the Capital Purchase Program; Notice 2008-83, which addresses the proper treatment under section 382(h) of items of deduction or loss allowed after an ownership change to a bank; and Notice 2008-78, which provides guidance on capital contributions under section 382(l)(1). This guidance has been coming in fast.

But I try not to rush because that is when I make mistakes. So I'm concerned about what Treasury's doing here. And the more I think about it, the deeper my concerns go about Treasury's authority to issue guidance in this manner. I'm not alone in worrying about Treasury's authority. Treasury itself is concerned. At the PLI conference, Clarissa Potter, IRS deputy chief counsel (technical), said that whether Treasury has the authority to issue all of the recent guidance "is something we take extremely seriously." Let's all take it extremely seriously, and give it a lot of thought. For the article on the PLI conference, see p. 246. For more on recently issued guidance, see Joseph DiSciullo's Guidance column on p. 263.

News for Bicycle Commuters

Do you ride your bike to work? If so, you can look forward to investing some pretax earnings in your bike under a new transportation fringe benefit — but you will have to forgo pretax benefits for parking and transit. Under the new bicycle commuting provision in the bailout bill, a business can designate $20 per month of workers' pretax earnings toward defraying expenses relating to riding their bikes to work. There is, however, a catch. If commuters take advantage of the bike benefit, they are prohibited from claiming vanpool or parking benefits. You qualify for the benefit only if you regularly use a bicycle for a substantial portion of travel between home and work (p. 257).

Commentary

Our coverage of the economic crisis continues in this week's commentary. Martin Lobel thinks that we are in deep trouble because thinly capitalized banks and other financial institutions took too many risks on derivatives. How do we pay for this mistake? He suggests (1) going to a flat tax on the profits that corporations declare to the SEC, or to a formulary apportionment to eliminate shifting profits to low-tax countries and (2) simplifying the tax code by eliminating most subsidies and lowering rates for the middle class. He also tells us that the "sooner we make the system transparent again by forcing the banks to recognize their losses, by requiring higher capital rations, by injecting needed capital into the banks under terms that protect taxpayers, and by reforming our regulatory agencies, the better off we will be" (see p. 313). Thomas R. May, in a practice article, has help for the practitioner who has to deal with the recent bailout-associated guidance. He provides information on notices 2008-76, 2008-83, and 2008-78 (p. 277). We have more lessons from the 1930s this week from our tax historian, Joseph Thorndike. He looks at the rhetoric of redistribution employed by Franklin Delano Roosevelt (p. 333).

We have our second edition of On the Margin this week. Alex Brill and Alan D. Viard conclude their series on effective marginal tax rates and the individual income tax system. The first article reviewed the theoretical issues regarding the potential impact of tax policy on effective marginal rates, and this week's article examines particular items within the current system that cause effective marginal rates to deviate from the statutory rate structure (p. 327).

We have a special report this week from Phillip N. Jones that I, as a former litigator, find fascinating and helpful. It explains the burden of proof issues present in tax cases in a very thorough way that I have never seen before. I wish I'd had a copy of it when I was a trial attorney at the Tax Division. Jones provides an overview of the burden of proof rules and then examines the impact of section 7491, issued 10 years ago, which specifies conditions under which taxpayers can shift the burden of proof to the government in tax litigation. He concludes that the legislation has had almost no impact because almost all cases are decided on the preponderance of the evidence without regard to the burden of proof (p. 287).

In another tax practice article, Robert Wood looks at the tax treatment of settlement and damages payments for emotional distress under section 104 (p. 281). Do we need a simplified health savings account system? David E. Libman thinks so. In a viewpoint, he offers his suggestions for a better, simpler future in this area (p. 315). In other viewpoints, Stanley Veliotis presents a call for a progressive taxation on home energy use (p. 319), and B. Cary Tolley III examines the proper treatment of leveraged leasing structures (p. 324). Finally, in a letter to the editor, Donald Samelson gives kudos to Sullivan for his article on "the unholy relationship between debt and taxes" (p. 339). ■