From the Editor:

Why Is the United States Reluctant to Tax Banks?

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In 2008 the global financial sector nearly collapsed, causing a deep recession that resulted in a spike in U.S. unemployment and serious sovereign debt problems worldwide. At the time, governments were forced to intervene to save the banking industry, with most of the world's largest financial institutions receiving some form of direct assistance (those that didn't have greatly benefited from the interest rate policies of U.S. and European central banks). Three years later, some of the banking sector has recovered, but there are renewed fears that another too-big-to-fail crisis is just around the corner. Unlike some of its European allies, however, the United States has taken no steps to either rein in the size of banks or to set up a revenue stream to pay for a future bailout.

Bank taxes enjoy widespread public support. Wall Street and the banking industry remain unpopular, and that unpopularity is not just restricted to those camping out as part of the various Occupy movements. Republican presidential candidate Jon Huntsman has tried to capitalize on voters' distrust of banks by proposing a tax on bank assets. It doesn't hurt Huntsman's campaign that the two Republican front-runners, Mitt Romney and Newt Gingrich, have questionable ties to the financial sector. Huntsman's plan would force banks whose size exceeds a set percentage of GDP to pay a fee covering the cost they would impose on taxpayers in a bailout, writes Martin Sullivan. Sullivan points out that a special tax on banks has solid economic justifications because of the negative externalities that bank bailouts represent. He also argues that banks receive a subsidy because of the implicit promise that governments will bail them out if they are ever on the verge of failure. A bank tax would help offset that subsidy and shield taxpayers from the full cost of another near financial collapse. Sullivan concludes by criticizing President Obama's failure to push an expansive bank tax. (For his analysis, see p. 1443.)

A financial transactions tax is an alternative to a tax on bank assets or liabilities. A transactions tax has been heavily discussed in Europe, but progress has been slow because of British resistance and a reluctance to impose such a tax unilaterally. There are proposals in Congress, put forward by Democrats, to enact a U.S. financial transactions tax. Bruce Bartlett writes that this kind of tax is a bad idea. He reviews the history of transactions taxes as a means to curb speculation and summarizes the arguments against the tax. He concludes that Republicans are unlikely to allow such a tax to pass and that if the United States does explore a financial tax of that kind, it is likely to target activities rather than transactions. (For his analysis, see p. 1535).

The financial sector escaped the Great Recession with comparatively little permanent damage. In the United States, no bank tax has been enacted and the regulatory reform that was passed by Congress (Dodd-Frank) was extremely weak. Once banks and investment firms were able to tap all the low-interest money being pumped into the economy by the Federal Reserve, they essentially resumed business as usual. There is still an overleveraging issue, and risky financial products continue to threaten the U.S. (and worldwide) economy. Republican opposition to a bank tax is to be expected. The GOP is not open to any kind of tax increase and is dependent on Wall Street for both political and financial support. It is the failure of Democrats to push more vigorously for a European-style bank tax or transactions fee that has been surprising. Even when Obama's party controlled both chambers of Congress, the idea of a new tax on the financial sector received only lukewarm support. It is hard to believe that an obvious source of new revenue will be left on the table during a period of extreme budget distress, but a U.S. bank or transactions tax remains only a remote possibility.

Commentary

Foreign tax credits are governed by complicated rules. In recent years, Congress and the IRS have tried to force a matching principle on foreign tax credits. The goal is to match deductions with the year that foreign tax is actually paid. However, tax year splitters still exist today and provide planning opportunities for the well informed, according to F. Scott Farmer (p. 1491). In his special report, Farmer explores the accrual method accounting rules governing the year in which a foreign tax credit is reported. The situation is made complex when the U.S. and foreign tax years overlap. Farmer writes that those situations can create a mismatch between the U.S. tax years in which the income is reported and the year the foreign tax is imposed. He hopes that his report will provide a useful guide in understanding tax year splitters and will help shape future guidance in this increasingly important area of the law.

For months Congress has tantalized the business community with bipartisan talk of a reduction in the corporate tax rate. Obama and Republicans agree that the U.S. rate is too high and must come down, and there is even some consensus that any corporate reform should be revenue neutral. However, corporate reform is probably not imminent. Jana Raedy, Jeri Seidman, and Douglas Shackelford write that there are some tax consequences to a corporate rate reduction that might not be welcome by U.S. corporations, particularly changes to deferred tax assets that will result from a lower rate (p. 1515). If the corporate rate were reduced from 35 to 30 percent, the 18 publicly traded *Fortune* 50 companies with a net deferred tax asset position would suffer a $12 billion drop in total accounting earnings. The 31 publicly traded companies with a net deferred tax liability position would experience a $28 billion jump in earnings. The authors argue that Congress and businesses should take deferred tax assets into account when considering corporate tax reform.

The centerpiece of Obama's jobs plan is almost certain to be extended by the time this issue goes to press. Republicans and Democrats are both united in supporting a payroll tax cut extension, and an agreement in the Senate looked imminent late last week. Richard Cebula, Robert Boylan, and Christopher Coombs write that the American Jobs Act proposed by Obama, including the payroll tax cut, is defective and will fail to stimulate employment and will certainly increase the federal deficit (p. 1527). The authors write that instead of a payroll tax cut and the other components of the Jobs Act, Congress should make all the Bush tax cuts permanent, eliminate the alternative minimum tax, repeal all corporate tax expenditures, and cut federal salaries by at least 2 to 3 percent. Cebula, Boylan, and Coombs analyze each provision of Obama's plan and conclude that only a few provisions should be included in their own recommendations to stimulate the economy.

The IRS recently released its revamped Audit Guide for Lawsuits, Awards and Settlements for 2011. In his review of the guide, Robert Wood notes that many of the changes are predictable because of changed economic conditions and the development of case law (p. 1543). The new guide suggests auditors will give increasing scrutiny to the wage versus non-wage distinction in employment cases, according to Wood, who adds that this portends an even closer examination of settlement agreements and the background that produced them. He also concludes that attorney fees will be subjected to increased examination and compensatory versus punitive damages will remain a hot button issue.

In Tax Accounting Developments, George White looks at how subchapter C can be used to the advantage of well-advised taxpayers (p. 1539). Specifically, White writes about *Bausch & Lomb* fact patterns and how rule-based definitions can be a double-edged sword that can be used to avoid tax-free treatment.

In an adaptation of his testimony before a joint session of the congressional taxwriting committees, Prof. Alex Raskolnikov outlines the options for fundamentally reforming the taxation of financial products, urging Congress to properly evaluate the effects of any type of reform (p. 1549). ■