From the Editor:

Endgame Looms for Bush Tax Cuts

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Lawmakers spent only one week in Washington before adjourning for the Thanksgiving holiday. So far the lame-duck session has produced little intrigue during the Democratic leadership elections, but when Congress returns this week, it must begin to make actual progress on tax legislation — or admit that taxes will go up substantially for most taxpayers on January 1.

In the wake of their devastating defeat at the hands of Republicans in the midterm elections, Democrats have actually appeared slightly more unified. The House in particular seems resistant to suggestions that the Bush tax cuts be extended for all income levels even temporarily. Outgoing Speaker Nancy Pelosi and her lieutenants have pledged to hold a vote on a permanent extension of only the middle-income tax cuts before the end of the year. And last week, the third ranking member of the House Democratic team, James Clyburn, hinted that he wouldn't be particularly disappointed if all of the Bush tax cuts expired. According to Clyburn, this could be considered serious deficit reduction. (For coverage, see p. 955. For analysis of the lame-duck session, see p. 1027.)

Clyburn's position is not surprising (although perhaps his frankness is). Many Democrats probably share his belief that any extension of the Bush tax cuts is unnecessary. But President Obama and many vulnerable Democratic senators probably can't risk seeming responsible for a huge tax increase in the middle of tough economic times. And it isn't remotely clear that Obama would be successful in painting the failure to extend the tax cuts as the fault of Republicans. The president usually receives most of the blame or credit for tax cuts and hikes. (If Obama has any doubts about this, perhaps he should ask his predecessor's father about the 1992 election.)

In the end, both parties are engaged in a game of chicken. Republicans believe that they can force the White House to accept at least a temporary extension of all the rates. Their goal is to avoid a decoupling of the upper-income tax cuts so they can try for a permanent extension if they win the 2012 presidential and Senate elections. Some Democrats don't think the GOP will actually vote against a permanent extension of the tax cuts for the vast majority of taxpayers, which is why Pelosi and Senate Majority Leader Harry Reid are attempting to force a vote in each chamber on just the middle-income tax rates. Which side will blink first? The answer is probably the White House (which is not a surprise). It would be easy for Obama to justify a temporary extension of the entire tax cut package given the state of the economy. And considering how many members of his own party (particularly in the Senate) support this type of compromise, a two-year extension of the Bush tax cuts remains the most likely outcome. However, in these hyperpartisan times, nothing is ever certain.

Cisco and Repatriation

Cisco Systems is one of the most vocal supporters of a second repatriation holiday for profits invested offshore. In fact, its CEO, a staunch Republican, even endorsed Democratic Sen. Barbara Boxer because of her support for a revival of section 965. Martin Sullivan writes that Cisco's support of a repatriation holiday has a lot to do with the company having nearly $40 billion in cash offshore. Sullivan details Cisco's use of aggressive transfer pricing practices to reduce its marginal tax rate. The company has been very successful in using tax rules to increase profitability. Unlike Microsoft, however, Cisco refuses to borrow cash to pay for shareholder dividends which is the main reason the company would like a second opportunity to repatriate tens of billions of dollars stored offshore, according to Sullivan. (For his analysis, see p. 951.)

Commentary

Attorney-client privilege issues are at the heart of many disputes between the IRS and practitioners. Tax accrual workpapers are only part of this simmering feud between the government and taxpayers. Privilege, however, doesn't only apply to attorneys. In 1998 Congress enacted section 7525, which extended to specified non-lawyers some of the benefits of the attorney-client privilege. However, courts interpreting the section have misunderstood some of the underlying principles of privilege and have significantly curtailed the scope of the protection available, according to Claudine V. Pease-Wingenter (p. 977). She writes that the federally authorized tax practitioner privilege has been overly affected by the earliest court decisions that inappropriately curtailed the statutory protection. Even though lawyers might prefer a status quo in which they are protected more than non-lawyers, Pease-Wingenter believes that a curtailed privilege protection can put some attorney communications at risk when lawyers and authorized tax practitioners share clients. She concludes that unless courts begin to correctly interpret section 7525, the scope of attorney-client privilege will gradually be eroded in the area of tax practice.

The alternative minimum tax is not popular with either taxpayers or lawmakers. The tax is complex, fails in its original purpose to ensure the wealthy pay an acceptable level of tax, and increasingly affects middle-income taxpayers with numerous deductions (including tax credits for children). Every year Congress goes out of its way to make sure that the tax applies to as few taxpayers as possible, regardless of its technical reach. This AMT patch has become an annual feature of tax policy debates. Benjamin Harris and Daniel Baneman write that the AMT is not all bad, however (p. 1001). They point out that the tax remains progressive through most of the income distribution and raises a great deal of revenue. They argue that it should be reformed to improve progressivity and promote greater efficiency, while still raising the same amount of revenue. They propose two alternatives: an AMT with a minimum tax rate of 20 percent and one with a rate of 17 percent, but a lower threshold. They conclude that either of those alternatives is preferable to the existing tax.

In his 2000 and 2001 budgets, President Clinton proposed an amendment to sections 351 and 721 that would treat a transfer of less than all the substantial rights in intangible property as a transfer of property. Congress failed to adopt the proposal. Monte Jackel and Audrey Ellis write that the amendments should be revisited if lawmakers take up tax reform soon (p. 1011). This area of law has been expansively interpreted by the IRS, according to Jackel and Ellis. However, they believe that the Clinton proposal would clarify the status of intangibles as property and would require consistent treatment by transferors and transferees, which is an improvement over current law.

In Estate and Gift Rap, Prof. Wendy Gerzog looks at the Tax Court decision in *Le Caer*, in which the court analyzed and rejected the taxpayers' arguments regarding the credit for prior transfers under section 2013 (p. 1023). She questions the need for the section 2013 credit in the first place and agrees with the court's rejection of the taxpayers' computation. She doesn't believe that two estate tax inclusions because of proximate deaths always create a hardship.

Robert Wood writes that qualified settlement funds can be used when cases are resolved by a judgment (p. 1017). Although this might seem counterintuitive, Wood believes that QSFs are flexible vehicles for resolving litigation and that practitioners frequently overlook their viability for cases that receive a final judgment. Using a QSF post-judgment is not an abuse, he concludes. ■