

*From the Editor:*

## Fiscal Cliff Negotiations Collapse as GOP Fractures

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John Boehner has lost control of the Republican caucus, and House Republicans have misread the results of the last election. There seems to be no other explanation for last week's events in Washington. After edging so close to a deal with President Obama on Monday that Wall Street started to react with euphoria, the speaker drew back and produced his own solution to the fiscal cliff, dubbed "Plan B." But Boehner's fallback plan couldn't even garner enough Republican support to come to a vote, and the House and Senate left town with no deal in sight.

Early in the week the outline of a fiscal cliff deal seemed to be in place. Just like during the debt ceiling negotiations, Boehner and Obama swapped proposals that were only different on the margins. Boehner wanted to restrict a rate increase to incomes over \$1 million, while Obama offered to move up to \$400,000 from his long-held \$250,000 position. Both agreed to change how the CPI is calculated for Social Security, a reform that seemed to satisfy the GOP's demands that entitlement spending be addressed. But just like during the summer of 2011, Boehner either lost his nerve or lost the support of his House colleagues. The latter seems much more likely.

While claiming that his Plan B proposal did not forestall further negotiations with the White House, Boehner spent most of the week pushing the House toward a vote on the bill, which would raise taxes only on incomes over \$1 million. Plan B did not address the sequester, the payroll tax cut, unemployment insurance, or a host of other items that were on the table during the talks with Obama. Boehner did not seem to have enough support to pursue a grand bargain. It turned out he didn't even have enough support for Plan B. After a companion measure that dealt with the sequester passed on a narrow 215-206 vote, Boehner pulled Plan B from the floor without a vote. Republicans later conceded that Boehner didn't have the votes to pass the bill, despite House leaders saying all week that they did. House Republicans seem to have wasted the entire

week, which is just what Obama and Senate Majority Leader Harry Reid claimed. (For coverage, see p. 1371.)

Where does Obama go from here? It seems almost pointless to negotiate with Boehner, who doesn't speak for enough Republicans to pass anything in the House. This is the second time that Obama seemed close to a grand bargain to deal with deficit-related issues, only to see Boehner pull out of the talks. Perhaps Boehner will be more secure after January 3, when he (presumably) will be reelected speaker. But that won't change the basic calculus that not enough Republicans are willing to vote for a tax increase to avert the fiscal cliff. At some point, if anything is to pass, Boehner will have to abandon the so-called Hastert rule (that a majority of Republicans must be in favor of anything brought up for a vote) and pass a compromise with a mix of GOP and Democratic votes. It doesn't seem like any deal is possible otherwise.

### Asset Protection Schemes

Do asset protection schemes work? Yes, according to Lee Sheppard, who takes another look at how complicated arrangements involving tax havens can exhaust creditors and their attorneys. Sheppard discusses two recovery cases involving asset protection measures. A corrupt Brazilian mayor attempted to use Jersey, a British Crown dependency, to hide over \$10 million in kickbacks. In *Maluf*, the Brazilian government was ultimately able to recover some proceeds because of British law. The Norwegian government wasn't quite so lucky in a case involving a wealthy shipping magnate and the Cayman Islands. Even when creditors can successfully convince a court to freeze assets, most of the procedures recovered are eaten up by legal fees, according to Sheppard. That makes any asset recovery case a war of attrition and any "win" merely a Pyrrhic victory, she writes. (For her analysis, see p. 1363.)

### Commentary

As tax extenders have come under scrutiny in recent years, there has been a decline in support for credits for renewable energy. Energy-related tax incentives were very popular throughout the 2000s and in the first years of the Obama presidency, but the nation's fiscal woes have made many policymakers question whether the United States can afford these tax expenditures and others to ask whether they are effective. The decline in political support for renewable energy credits has caused

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some to consider how REITs might be used to invest in renewable energy assets, according to Patrick Dowdall (p. 1409). He discusses whether solar and wind energy assets can qualify as real property for REIT purposes, and he looks at business matters related to renewable REITs. Dowdall concludes that the IRS could issue a favorable ruling on these types of REITs.

One of the few Supreme Court tax cases this term concerned the intersection of bankruptcy and tax law. The Court considered whether post-petition taxes incurred on a sale of farm assets under chapter 12 of the Bankruptcy Code are eligible for a discharge, with a majority finding that deductibility is determined by whether the taxes are incurred by the estate or the individual debtor. David Burton and Olivier De Moor write that the Court's analysis in *Hall* hinges on the meaning of "incurred by the estate" and that the import of the case is not limited to family farms (p. 1425). Because bankruptcy filings under chapters 7, 11, and 13 do not create separate taxable estates, *Hall* must also be taken into account by businesses and individuals filing under those chapters, Burton and De Moor conclude.

Republicans believe that taxpayers in the United States are taxed too much and that government spending is too high. Democrats sometimes disagree, particularly on the latter point. Neither party is an enthusiastic supporter of higher taxes. That is because of voters' general antipathy to higher taxes, even when the taxes might support higher benefits. Bruce Bartlett explains that the United States' anti-tax attitude might be explained by the relatively few benefits provided by the government (p. 1429). He looks at OECD data showing that the United States is relatively lightly taxed, but also spends a higher percentage of its GDP on healthcare than most other nations in the survey. Although taxpayers believe that a state-run healthcare system would

be too costly, the reality is that the United States pays more for its private-run system than European countries pay for their single-payer regimes, Bartlett writes. The United States is not necessarily better off for having low taxes because of how taxes in the United States and Europe are used, he argues.

Most corporate defendants that are forced to defend legal claims do not consider the possibility that settlements and defense costs might be nondeductible, writes Robert Wood (p. 1433). In his column, he explores how in the world of closely held companies, the possibility of nondeductibility is very real. Wood looks at *Cavanaugh*, a Tax Court case involving a closely held corporation and expenses that were found to be personal to the taxpayer. *Cavanaugh* is a warning that when the facts are egregious and there is no business connection, the fact that the company is named as a defendant is not enough to ensure deductibility of legal expenses, Wood concludes.

A recent IRS memo advised field offices on how to audit domestic consolidated group returns that claim a worthless stock deduction or involve a cross-chain asset transfer not disclosed on the return. Jasper Cummings, Jr., discusses who should read the memo, which may end up causing a lot of mischief in accelerating the final liquidation of corporations (p. 1437). Cummings writes that the memo seems to be aimed at making a finite accounting method point within a consolidated group. The memo should be of interest to corporations that occasionally commit tax fraud, whose subsidiaries sometimes ignore cross-transfers, or companies that have deferred intercompany transactions for years. The memo's audit procedures might apply to inadvertent cross-chain transfers for nothing, which can sometimes be explained as D reorganizations, Cummings argues. ■

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