From the Editor:

A Call for Action, Bold and Swift

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Political triumph, economic failure. That is the title of Martin Sullivan's article, and as usual he is dead on. This past week saw both.

First, the political triumph: Inauguration Day was a joyous one for the nation. Our first African-American president — the man who promised us change we can believe in — took the oath of office. But President Obama's speech was somber, with a focus on the financial crisis. ''Everywhere we look there is work to be done. The state of the economy calls for action, bold, and swift,'' he said.

Indeed, it does, and Congress was back in session the day after the inauguration, working on an economic rescue plan. But is the legislation proposed by the Ways and Means Committee bold enough? Swift enough?

First, it isn't bold enough. As Sullivan explains, this is no ordinary recession — it has deep roots in financial markets. The proper response to the crisis requires both fiscal policy *and* repair of the financial system. We need major financial repair initiatives, including injections of capital into troubled institutions and government guarantees against losses on troubled assets held by banks. It is time for Congress and the new administration to declare war on credit market turmoil and resist the temptation to punish the financial sector with unfavorable tax treatment.

Second, the proposed stimulus package isn't swift enough. As Sullivan explains, Congress should have passed an economic recovery package four months ago, and all indications are that the tax component of the Ways and Means plan would provide more stimulus in 2010 than in 2009. If Congress and the administration are to put forth effective stimulus, it needs to deliver relief now — not later. For Sullivan's economic analysis, turn to p. 443. More coverage of the proposed stimulus legislation is on p. 458.

The government lost a big case last week. In a win for corporate taxpayers, the U.S. Court of Appeals for the First Circuit held that a public company's tax accrual workpapers are protected by the work product privilege even though the documents were required by financial reporting rules. As a threshold matter, the court determined that tax disputes constitute litigation. The court then stated that the fact that anticipation of such disputes (and corresponding potential litigation) triggered certain business and accounting obligations does not bar the protection of the work product doctrine. In a dissent, Judge Boudin argued that documents independently required, as in the case of tax accrual workpapers created for accounting purposes, are outside the scope of the privilege. I agree with Boudin and hope that the Supreme Court will eventually address the issue. For Jeremiah Coder's news analysis on the case, see p. 446.

In two separate articles, Lee Sheppard takes a close look at bankruptcy of derivative counterparties. In the first, Sheppard looks at the side bets known as credit derivatives, exploring what they are and how they should be treated for tax law purposes (p. 450). In the second, she examines call spread convertibles (p. 455).

Commentary

Many commentators and policymakers are upset about the tax treatment of compensatory transfers of profits interests in partnerships, particularly in the area of hedge fund managers' compensation. Philip Postlewaite disagrees with most of the criticism, writing that the status quo is both logical and consistent with the overall approach of the code. Postlewaite provides a proposal for reform, calling for repeal of the section 83(b) election (p. 503).

Gas prices have fallen considerably (although they may be on their way back up again), and most taxpayers and members of Congress probably beleive that is a good thing. William VanDenburgh isn't so sure. In his opinion, the country faces a choice of either raising gasoline taxes now to induce lower consumption or paying OPEC later during the next price spike. VanDenburgh prefers a substantial increase in the federal gasoline tax, combined with measures to reduce the gas tax's regressive effects. VanDenburgh's case for an increase starts on p. 533.

Robert Wood returns this week to discuss when and how taxpayers should be allowed to take into account deductions when structuring their settlements of restitutions, fines, and penalties (p. 489). Recently many prominent senators have taken aim at companies that paid fines or penalties to the government and then deducted those settlement

amounts. Wood looks at how companies can structure their settlements with the government to ensure deductibility and says a lot depends on the language of the settlement agreement. He concludes by saying that legislative action is unlikely and that this area will remain ''endemically amorphous.''

These are dark economic times, but Michael Durst sees at least a sliver of a silver lining. He writes that the financial crisis might present Congress with the opportunity to completely reform the international provisions of the corporate income tax. Durst's criticisms of the current system and his suggestions for change appear on p. 537. Raymond Wynman and Karen Jacobs provide an overview of the overall foreign loss rules on p. 496, including a look at open issues confronting taxpayers. In Of Corporate Interest, Robert Willens examines leveraged buyouts and the question whether a holding company is unitary with its operating subsidiaries for the purposes of state taxes (p. 541). Specifically, Willens looks at a New York case involving International Banknote, U.S. Banknote, and Citibank.

Jasper Cummings, Jr. isn't pleased with the performance of the IRS Office of Chief Counsel under Donald Korb (p. 545). Cummings, in a letter to the editor, writes that Korb's recent remarks ''are indicative of a problem that should be taken very seriously by the Obama Treasury: a systemic failure to pursue operational and substantive improvement in the tax laws and their administration.'' Cummings also thinks that the new Treasury secretary should take National Taxpayer Advocate Nina Olson's report more seriously. ■