From the Editor:

Prospects Brighten for Full Extension of Bush Tax Cuts

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President Obama has made his position on the Bush tax cuts very clear. In the 2008 campaign, he promised that he would hold the line on middle-income tax rates and begin to make the wealthy pay their fair share. The Obama administration has consistently supported a permanent extension of the rates for taxpayers earning less than $200,000 ($250,000 for joint filers) and an expiration of the top two rates on high-income taxpayers. Democratic leaders in the House and Senate have backed Obama on this issue. But rank-and-file Democrats, including a few prominent senators, have slowly and steadily retreated from the administration's position. As the midterm elections approach and a Republican takeover of at least one house of Congress becomes more likely, many Democrats in the House and Senate are beginning to endorse an extension of all current tax rates.

Senate Budget Committee Chair Kent Conrad and outgoing Sen. Evan Bayh have already announced their support for at least a short-term extension of the 2001 and 2003 tax cuts. Last week Rep. Chris Van Hollen became the first key House Democrat to suggest that such an extension is not off the table. While saying he opposed the Republicans' plan for a permanent extension of the upper-income tax rates, Van Hollen wouldn't rule out a temporary extension, at least for next year. Several freshman Democratic lawmakers (many destined to lose their seats or at least face tough campaigns in the fall) have announced their support for the current tax rates, arguing that a tax increase is not appropriate with the economy still struggling. ''In my view, this is no time to do anything that could be jarring to a fragile recovery,'' Rep. Gerry Connolly (who holds Tom Davis's old seat) said at a town hall event. (For coverage, see p. 1019 and p. 1021.)

By now, everyone knows the situation. If Congress does nothing, taxes will rise for almost all taxpayers. The expiration of the Bush cuts could cost taxpayers making between $40,000 and $75,000 around $1,000 a year in extra taxes. Republicans have announced that they will oppose any measure that doesn't fully extend all tax rates. It is no surprise that many Democrats don't want to face voters with this issue unsettled. It is becoming increasingly likely that enough members of the majority party will join with the GOP to attempt to extend all the Bush tax cuts. The question is whether Democratic leaders will allow such a proposal a fair chance on the floor (and considering that the majority leader in the Senate is in danger of losing his seat to a tea party-backed conservative, observers shouldn't be surprised if a full extension gets a vote in at least the upper chamber). If such an extension passes, what will the president do? Despite his promise to make the wealthy contribute more in taxes, it seems next to impossible that Obama will use this particular issue to stand up to Congress for the first time. After all, he has his own election to worry about in 2012.

Commentary

The recession and the brief, massive dip in stock prices highlighted a problem with defined benefit and defined contribution retirement plans. The nightly news was filled with stories about workers who expected to retire, only to have their 401(k) plan balances drop drastically. The stock market, of course, has recovered from its 2008 low, but that hasn't caused many taxpayers and policymakers to become less wary of the viability of the U.S. retirement system, which is based in large part on supplementing Social Security with investments in stocks and other volatile assets (primarily through employer-provided contribution plans). Although the United States must take steps to ensure the adequacy of benefits in retirement plans, it should build on the voluntary system in place and not create new untried institutions, argues Mark Warshawsky in a special report on p. 1041. Warshawsky proposes a new plan type, called a flexible structured plan, that would have the basic features of a defined benefit plan, but the plan sponsor could cut back benefits if plan funding falls sharply. Sponsors would also be required to increase benefits if plan funding rises significantly. He believes that such a plan would share the investment risk and return reasonably between employees and employers. Warshawsky also advocates a reform of the reversion tax for defined benefit plans.

Another consequence of the economic downturn has been the dissolution or liquidation of corporations and businesses. This, of course, usually causes shareholders to lose at least a portion of their investment. But shareholders of failing corporations do get a federal tax benefit: worthless stock deductions. The tax code forces taxpayers to receive the benefit of the deduction at a later point in time than when the losses are realized, according to Robert Jackson and William Weatherford (p. 1059). The authors point out, however, that there are methods available to taxpayers who wish to accelerate the recognition of losses or attempt to obtain ordinary loss characterization. They discuss the pennies-per-share exception, worthless stock deductions, and a 2003 revenue ruling. The authors conclude that significant technical questions remain unanswered and that taxpayers and tax advisers should keep in mind the preparer-penalty rules under section 6694 when taking an aggressive position.

The amount of deference that should be given to Treasury regulations has become an area of heated dispute between the government and taxpayers. Courts are often caught in the middle as the judiciary is called to interpret broad, and sometimes conflicting, Supreme Court decisions. The *Intermountain* decision by the Tax Court invalidated Treasury regulations related to the six-year statute of limitations and basis overstatements. Irving Salem writes that *Chevron* did not provide much guidance to the Tax Court and that there are open questions about whether legislative history can be used in a *Chevron* step one analysis and whether the test for step one is ''clear'' or ''unambiguous.'' He concludes by wondering whether these issues will ever be clarified and with an imaginary moot court debate between the legislative, judicial, and executive branches (p. 1065).

The judge in the *Canal Corp.* decision was not pleased with the opinion letter written by an attorney that designed a transaction and then blessed it. In fact, the court opinion was so vitriolic in its treatment of the practitioner that OPR Director Karen Hawkins recently said her office was considering whether to impose sanctions on him. *Canal Corp.* and the recent string of pro-government opinions in shelter cases raises the question whether opinion letters have much value anymore, at least in the area of aggressive tax planning. Robert Wood thinks they are still important (p. 1071). The idea that opinion letters are only valuable as penalty protection is incorrect, Wood writes. Opinion letters obtained early can help shape a transaction or position on a return, help with information return issues, direct the return preparer, and mitigate the effect of tax controversies, according to Wood. He advises taxpayers to seek opinion letters before the deeds are done and the government attacks the transaction.

Reps. Earl Pomeroy and Patrick Tiberi have proposed bailing out underfunded collectively bargained multiemployer pension plans. According to Moody's, these plans are underfunded by at least $165 billion. The Pension Benefit Guaranty Corporation has already stepped in to isolate troubled plans, but that isn't enough for Pomeroy and Tiberi. The federal government cannot afford to add $165 billion to the deficit, writes Diana Furchtgott-Roth (p. 1079). She argues that a bailout would create adverse incentives for funding these pension plans. She also points out that union worker demographics (too few young workers, too many older ones) suggest that these plans may never be able to fund themselves, leading to a permanent taxpayer subsidy to keep them afloat if the Pomeroy-Tiberi bill becomes law. She concludes that the government cannot afford to shift this liability to the taxpayer and that such a plan also would undermine the Pension Protection Act of 2006.

Family limited partnerships are the subject of this week's Estate and Gift Rap (p. 1075). Prof. Wendy Gerzog analyzes the Tax Court decision in *Price*, in which the court held for the government, finding that some transferred interests were future interests because the agreement precluded transfers to third parties and didn't grant the FLP limited partners a present right to income. Gerzog believes the opinion correctly finds no difference between *Price*'s fact pattern and the earlier *Hackl* decision, and she argues that the opinion is a logical result. ■