From the Editor:

Tax Ramifications of the Bailout

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Desperate times call for desperate measures. Intense negotiations over a $700 billion bailout of Wall Street continue as I write, with both President Bush and Senate Democrats looking to get things done, while Republican House members call for Wall Street — instead of taxpayers — to inject capital into the financial system. Treasury Secretary Henry Paulson, Federal Reserve Chair Ben Bernanke, and Congressional Budget Office Director Peter Orszag have all made the case before Congress for a bailout, with Orszag specifically discussing the impact it could have on the federal budget and future tax policy.

But what about *past* tax policy? Did the tax system bring us to the brink of financial ruin?

My answer to that question is a qualified no. No, but it sure didn't help. And I think Martin Sullivan agrees with me. As he explains, excess leverage is at the core of the financial crisis, and two features of the tax system encouraged the types of borrowing that played a prominent role in it. The first is the deductibility of home mortgage interest, and the second is the deductibility of interest by corporations. According to Sullivan, those provisions ''greased the skids for our downward slide.'' For Sullivan's analysis, see p. 1241.

David Cay Johnston is thinking about the bailout, too. He asks if we really want to ''put out $700 billion of our money to rescue domestic and foreign banks,'' and looks at some of the tax issues he says belong on the front burner, such as the repatriation of all untaxed offshore profits held by banks that get a bailout, and extending the statute of limitations on tax cheating by executives who get the bailout. Oh, and he discusses Jane Austen's *Pride and Prejudice*, too (p. 1323).

What do the bailout talks mean for Congress's unfinished business on how to pay for the tax ''extenders''? The Senate took the first step last week, passing a partially offset tax-cut package that included a one-year AMT patch and renewals of more than three dozen expired or expiring tax breaks. But House Democrats refused to accept the Senate version, instead proposing four separate tax bills of their own, including a fully offset extenders package. Because Congress is busy debating the language of the bailout bill, there may not be time to bring an amended extenders bill back to the Senate floor. For coverage, see p. 1239.

Withholding on Securities Loans and Swaps

The Senate Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations held a hearing about withholding tax avoidance by means of total return equity swaps and securities loans, which the subcommittee called ''dividend enhancement'' strategies. Although subcommittee Chair Carl Levin, D-Mich., grilled IRS Commissioner Douglas Shulman, there was no discussion of how the problem might be fixed technically. Perhaps they should ask Lee Sheppard what to do. In news analysis, Sheppard explains how the tax administrator could go about stopping this particular kind of withholding tax avoidance (p. 1248).

Commentary

In Tax History we have an article from Sullivan on gas tax politics. He traces the recent history of the gas tax from Presidents Nixon and Ford up through the Carter, Reagan, Bush, and Clinton administrations to the present. What does this history teach us? Turn to p. 1331 to find out.

In this week's practice article, Robert Wood looks at the confusion surrounding the tax treatment of class action attorney fees. He explains that the big tax question is whether amounts paid to tax counsel are income to class members p. (code). In a special report, Matthew Chen examines the Treasury's proposed contract manufacturing guidance, which is supposed to modernize subpart F to protect the competitiveness of U.S. multinationals. He concludes that revisions are necessary to prevent the effort from being undermined by a potential creation of subpart F income under the revised ''branch rule'' for multinationals that have no subpart F income without relying on the manufacturing exception (p. 1287).

In *McWilliams v. Commissioner* (1947), the Supreme Court held that a loss would be suspended when a husband sold stock at a loss and simultaneously ordered his broker to buy the same stock in his wife's account. Under current law, the related party gets the loss added to basis. In our Shelf Project this week, Calvin Johnson proposes an automatic suspension of the loss if a closely related party replaces the sold loss property within 30 days

before or after the loss sale. Johnson would preserve the loss, however, for the original seller (p. 1325).

In a viewpoint, Ruth Mason looks at a report written by the Joint Committee on Taxation about the taxation of sovereign wealth funds. The report considers whether Congress should amend section 892 to tax those funds like any other foreign private party investing in the United States (p. 1321). In Of Corporate Interest, Robert Willens explains that the expansion doctrine may have facilitated the spinoff of SunPower (p. 1341). In What Were They Thinking? Jasper L. Cummings, Jr. looks at the ''new'' more likely than not standard (p. 1345).

Finally, we have three letters to the editor this week. The first two, from the Dellingers and Tom Daley, respectively, take on David Cay Johnston's recent article comparing the United States with Sweden. See p. 1349 and p. 1350. The last is from Prof. Reuven S. Avi-Yonah, who defends his recent testimony before the Permanent Subcommittee on Investigations, in response to David Hariton's recent article, ''Taxing Equity Swaps: Don't Throw Out the Baby With the Bath Water'' (p. 1351). ■