From the Editor:

Aggressive Income Shifting Undermines the Tax System

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Corporate tax reform means different things to different people. To some, it means lowering U.S. corporate rates, adopting a territorial system, and boosting U.S. multinationals' competitiveness overseas. To others, it means closing the holes in the U.S. transfer pricing system, eliminating incentives for offshore investment, and lowering the corporate rate only after broadening the tax base. The differences between President Obama's quest for revenue-neutral corporate reform and U.S. businesses' push for a less burdensome tax regime will likely mean that nothing will come from tax reform efforts this year.

Multinationals are wrong to de-emphasize the role that income shifting plays in the U.S. corporate tax system, writes Martin Sullivan. Sullivan analyzes a recent set of papers by Edward Kleinbard, in which the former JCT chief of staff defined ''stateless income'' and pointed out the harm that aggressive profit shifting is doing to the U.S. economy and tax regime. Sullivan agrees with Kleinbard and argues that stateless income discussions should assume a prominent place in the corporate tax reform debate. Sullivan outlines four different possibilities for corporate tax reform, including three different approaches to territoriality. Although he believes that a worldwide tax system with a low rate would probably be the best plan, Sullivan concludes that such a reform is probably impossible in the current political environment. Instead, he proposes a plan built around territoriality with teeth, including limitations on earnings stripping and limits on excess deductions for indebtedness. He hopes such a plan could be a starting point for Treasury and congressional staff and that policymakers will have the courage to stand up to the lobbying efforts of multinationals trying to retain the best-of-both-worlds system in place now. (For Sullivan's analysis, see p. 1315.)

Mayo

Many commentators have interpreted the Supreme Court's holding in *Mayo* as a major win for the government and the IRS. Some believe that the Court opened the door for increased deference to regulations and guidance. However, Tax Court Judge Mark V. Holmes does not agree. At a recent forum, Holmes said that he thought *Mayo* might actually give taxpayers a greater chance of challenging guidance because the holding opens up a number of administrative law challenges to Treasury regulations. The judge advised tax practitioners to start inserting administrative rationales in their briefs and footnotes. He also commented on the IRS's string of victories in overstated basis cases and on why he has dissented in the 6015(f) cases before the Tax Court, most of which have been reversed on appeal. (For coverage, see p. 1319.)

Commentary

One of the more controversial tax reform ideas circulating around Capitol Hill is the potential Treasury proposal to tax some large passthrough entities as corporations. While it is only a rumor, the plan has received support from some powerful Democrats (including the Senate majority leader) and tepid opposition from a few Republican lawmakers (such as the chair of the Ways and Means Committee). Passthrough taxation is the proper regime for many business arrangements, according to Bradley Borden (p. 1353). In his special report, Borden argues that an entity-level tax would treat members of passthroughs differently from individuals, which would violate notions of equity. This type of tax reform would also shift more of the tax burden to the middle class, he writes. Instead of raising revenue by increasing middle-income taxes, the government should look at surtaxes on the superwealthy, Borden concludes.

In *Canal Corp.*, the Tax Court held that the taxpayer could not rely on the advice of its regular tax adviser to avoid penalties because the adviser was involved in planning the transaction at issue. The adviser also had a financial interest in the outcome of the advice. Needless to say, the decision has caused quite a stir in the practitioner community. James Browne writes that the Tax Court should not have held that relying on adviser's opinion in such a situation is per se unreasonable, but instead should have applied a facts and circumstances test (p. 1363). He argues that the court should have looked at the facts in greater detail and that the case support for the holding is weak. Although he does not agree with the decision, Browne does write that it would be prudent for taxpayers to seek a second, disinterested opinion on transactions until Treasury or the courts resolve this issue.

The healthcare reform bill signed into law by Obama in March 2010 contained myriad changes to tax laws. Many of those changes specifically altered the code, while others were hidden in other sections of the legislation. Anne Batter, Christopher Condeluci, and Garrett Fenton provide a list of the top five tax changes under the healthcare law on p. 1371. The authors write that in-house counsel for businesses should be aware of the changes to taxation of benefits and compensation as the law starts to take effect. Their article targets the excise tax on high-premium plans, the nondiscrimination rules for fully insured group health plans, changes to Forms W-2, and a new Medicare payroll tax rate, among other healthcare reforms.

The IRS has pushed corporate boards to become more involved in tax questions. The Service's emphasis on corporate governance caused many to question its motives, but the effect of the policy has been to bring tax issues to the forefront of shareholders' and board members' minds. Rosemary Schlank writes that straight talk about tax risks has been added to investors' demands in today's uncertain tax environment (p. 1377). She identifies key questions that management should be prepared to address to demonstrate the effectiveness of their companies' oversight of tax risks, including questions about low effective rates and how tax avoidance strategies will be treated by the tax administrator in the future. Schlank also examines a recent pension fund's efforts to place tax questions on proxy statements for shareholder votes.

Many countries use tax incentives to allow for the purchase of artwork. These incentives usually reduce estate and other tax liabilities and have the effect of keeping valuable works of art from migrating to other countries as the result of estate sales. Focusing on the program that led to the creation of the Picasso Museum in France, George Guttman analyzes how these tax credits work and how the United States might adopt such a general tax program (p. 1381). He also points out an example of tax credits being used to aid the Smithsonian and argues that rules with general applicability might address a major disconnect in the United States' charitable contribution programs.

In her second column, Caroline Harris of the U.S. Chamber of Commerce writes about how the United States is on the edge of glory but will require significant tax reforms to renew its potential (p. 1387). In her quest to avoid dwelling on deficit doldrums, Harris focuses on how tweaks to the U.S. corporate tax system and the research credit could boost the economy and competitiveness. The United States needs "to get on the globalization train and give American businesses a tax code that lets them achieve their potential," Harris concludes.

SILOs and LILOs seem like old news. The government has been incredibly successful in winning court cases and shutting down these transactions and has turned its attention to offering a general settlement program. Robert Wood revisits SILO and LILO deals and looks at the latest case in the Federal Circuit, *Wells Fargo* (p. 1389). He finds that there is little life left in classic LILO and SILO deals, despite the fact-specific *Con Ed* exception.

The latest Shelf Project proposes repealing graduated corporate tax rates (p. 1395). In his proposal, Jeffrey Kwall argues that section 11(b) should be amended to repeal lower marginal rates that apply to the first $10 million of corporate income, resulting in all corporate income being taxed at the 35 percent rate. ■