From the Editor:

Apple Pushes Tax Avoidance To the Limits

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Many corporations are concerned about their reputations. No one wants to be called a tax cheat by a reputable government. That is why Starbucks made a voluntary payment to the U.K. treasury after it was publicly shamed by Prime Minister David Cameron. There doesn't seem to be any such sentimentality at Apple. At a congressional hearing last week, the technology giant admitted that much of its profits aren't taxed anywhere and some are taxed at a rate as low as 2 percent. Before an irritated Carl Levin and John McCain, Apple's CEO defended the company's tax avoidance strategies as being legal and laid the blame on Congress, calling on lawmakers to enact dramatic tax reform.

Apple's tax avoidance strategy depends on cost-sharing agreements between its U.S. and Irish subsidiaries and affiliates. Lee Sheppard breaks down how the company is able to claim that a portion of its profits isn't subject to tax in either Ireland or the United States (p. 967). Apple is exploiting cost-sharing regulations from 1980, which can still apply to agreements made at that time, Sheppard writes. She also blames the United States' use of an incorporation test rather than a management and control test. Ireland is effectively a tax haven because of how its laws operate, Sheppard writes, pointing out that Apple was using an overly generous income calculation permitted by Ireland to lower its rate to 2 percent. She looks at how the Permanent Subcommittee on Investigations hearing relates to the OECD's BEPS project and how check-the-box rules need to be repealed if the United States is serious about capturing some offshore profits for tax. In a separate article, Sheppard presents a hypothetical memorandum from Treasury to U.S. multinationals, explaining why the days of paying no tax anywhere are coming to an end (p. 979).

The PSI hearing highlighted the complete breakdown of U.S. international tax rules and the brazenness of companies like Apple. Almost all of Apple's research and development occurs in the United States, and its Irish subsidiaries are largely managed and controlled from California (many of the directors are even U.S. citizens). Let's not even talk about where Apple's customer base is located. But somehow, U.S. taxpayers and lawmakers are supposed to believe that income earned from those R&D efforts is properly allocated to Ireland, where the corporation conveniently has to pay little or no tax. The Senate will miss Levin, who has chaired the PSI for years, when he retires. Who else can be counted on to call attention to the cheap tax gimmicks used by Apple and others? Let's hope that Levin and the PSI can stir up enough outrage to change the rules before he retires at the end of this Congress.

Cost-Sharing Agreements

Apple is not alone in its aggressive use of cost-sharing arrangements. Martin Sullivan looks at how cost-sharing agreements are similar to licensing arrangements, but can produce dramatically different tax results under U.S. rules (p. 973). He presents several examples of how cost-sharing arrangements can result in perfectly legal profit shifting. Sullivan concludes that Congress should enact rules that treat cost-sharing and licensing agreements the same.

IRS Scandal

The IRS exempt organization scandal claimed another victim last week. Lois Lerner, who caused the furor by admitting and apologizing for the inappropriate targeting of conservative organizations, was forced to take administrative leave. She was reportedly asked to resign, but refused (p. 990). Lerner's assertion of her Fifth Amendment rights at a House hearing contributed to a bad week for the Service and made the Obama administration's damage control efforts more difficult (p. 992). The administration wasn't helped by former acting Commissioner Steven Miller's evasive and contradictory testimony at several congressional hearings. Miller also caused controversy when he admitted that the IRS planted the question at the May 10 ABA conference that elicited Lerner's apology. Lawmakers were upset that the Service would choose that forum to admit wrongdoing, rather than notifying the numerous committees that felt misled by officials' assurances that no such conduct was taking place in 2011 and 2012 (p. 988).

Commentary

The net investment income tax was enacted as part of the healthcare reform effort. It was essentially just a pay-for, a way to offset some of the costs of Obamacare. Section 1411 has come under criticism from Republicans and others. The 3.8 percent tax is flawed and overly complicated, according to Jon Brose (p. 1035). He points out that the tax has several unfair results and has added more administrative burdens to an already complex statute. Section 1411 is a parallel tax universe that is only similar to chapter 1, which causes economic distortions, he writes. He concludes that Treasury has some ability to simplify the application of the tax through final regulations, but that the proposed regulations already issued don't do enough.

House Ways and Means Chair Dave Camp has proposed substantial changes to passthrough taxation. His discussion draft would either implement significant changes to existing subchapters K and S, or it would do away with them entirely and create a new unified passthrough regime. Willard Taylor argues that option 2 in the Camp draft properly requires commentators to focus on whether there should be different rules for S corporations and partnerships (p. 1051). He says that the reforms in option 1 are not new. Option 2 would be economically significant and would greatly change the structure of passthrough taxation, which might allow Congress to determine whether passthroughs and corporations should be taxed differently. Taylor concludes that option 2 should allow policymakers to explore the simplification of partnership taxation and the effect LLCs have had on choice-of-entity decisions.

In an April article in *Tax Notes*, Jasper Cummings, Jr., analyzed AM 2012-007, which said that a consolidated group could not rent its way into affiliation with a subsidiary (*Tax Notes*, Apr. 15, 2013, p. 313). In a second look at the recurring issue of property ownership for federal income tax purposes, Cummings writes that ownership for tax purposes is primarily a state law question (p. 1059). He criticizes the courts and the IRS for seldom using nontax law. He argues that an error is being made by courts and commentators who disrespect established common law property precedents.

Many taxpayers assume that relying on the advice of a tax professional will excuse them from possible penalties. They couldn't be more wrong. Robert Wood writes that whether you can rely on a tax adviser to avoid penalties depends on the nature of the advice you were given (p. 1069). It matters if the advice was technical or substantive, Wood says. He reviews how the Ninth Circuit's decision in *Knappe* has affected the assumptions in the taxpayer penalty area.

In Estate and Gift Rap, Wendy Gerzog discusses the valuation of fractional interests in art (p. 1073). She specifically talks about the holding in *Estate of Elkins*. The Tax Court valued the decedent's fractional interest in many artworks. Gerzog reflects on the court's willingness to consider the intentions of the parties to hold on to the pieces as part its FMV valuation. ■