(C) Tax Analysts 2010. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

From the Editor:

Can Ron Wyden Follow in Reagan's Footsteps?

By Jeremy Scott — jscott@tax.org

The nation's tax system is crumbling. Revenues cannot match expenditures, and the federal government faces a budget deficit that will only get larger as Medicare and Social Security spending explodes over the next decade. But considering Congress cannot even pass extenders legislation or deal with the expiring Bush tax cuts, is tax reform possible in the political climate in Washington?

Sen. Ron Wyden thinks so. Wyden is the coauthor of a major tax reform bill that would create a one-page IRS form for individual income tax filers, eliminate several individual and corporate deductions and incentives, and lower the corporate tax rate to 24 percent. Wyden's proposal is revenue neutral and, more impressively, bipartisan. (His cosponsor is retiring Republican Sen. Judd Gregg.) At a recent Tax Analysts conference in Washington, Wyden said that he believed a serious tax reform effort will take place in 2011. He was encouraged by President Obama's recent indication that the administration is exploring corporate tax reform options. Wyden correctly argued that tax reform can occur only if the president is fully engaged. Sounding a bit like a Republican, the senator also contended that his proposal would solve the nation's budgetary crisis by encouraging economic growth. Wyden pointed to a study that said the Wyden-Gregg bill would create 2.4 million new jobs a year if adopted. (For coverage, see p. 155.)

Other panelists at the conference were not as optimistic, and some even thought that a 1986-style tax reform effort like Wyden was pushing is not enough to fix the nation's tax system. It is true that Wyden's bill faces an uphill climb to passage (or even to become a proposal that Congress deals with seriously). But it is encouraging that at least one policymaker is willing to offer a detailed proposal for tax reform and keep plugging it even as Congress descends into a quagmire of partisan gridlock on virtually all tax legislation.

News Analysis

The codification of the economic substance doctrine and the failure of the IRS to provide an "angel list" of transactions that will not be implicated by section 7701(o) have created serious concerns in the practitioner community. In an article adapted from a speech to state tax court judges, Lee Sheppard asks whether codification was the right move and looks at how the doctrine will affect litigation on state tax issues (p. 157). The codified doctrine is all about penalties, Sheppard writes, adding that penalties usually involve individual tax shelters and not corporate tax planning. She doesn't think the strict liability penalty has much of a chance of being upheld in court, because judges typically recoil at huge penalties when the merits of the transaction are arguable. She concludes by analyzing how states have used their own codifications in court and what effect the doctrine will have on states that conform to the Internal Revenue Code.

Ireland has one of the lowest corporate tax rates in the world at 12.5 percent. The nation also is suffering from a serious recession and faces a budget deficit equal to almost a third of GDP. The Irish government is scrambling to put together an austerity package that will reduce the budget deficit to 3 percent of GDP while still allowing it to bail out the nation's five largest banks. Martin Sullivan asks whether this will require Ireland to raise its corporate tax rate (p. 162). He believes that such a move would be inadvisable because it would actually cost the nation revenue as multinationals shift profits back out of the country. However, Sullivan also finds that mounting pressure from the EU and the likelihood that Ireland will need assistance to avoid a financial collapse means that the 12.5 percent rate might have to be sacrificed.

Commentary

In a new column for *Tax Notes*, Monte Jackel takes aim at the IRS's practice of using guidance to usurp congressional power, focusing on section 108(i) (p. 241). According to Jackel, the IRS has issued regulations that, while taxpayer favorable, have no statutory foundation. Jackel does not believe that the IRS has the power to overrule statutes it finds deficient. He is concerned about the separation of powers issue raised by this use of guidance. Jackel also voices his displeasure with how the government is handling the codification of the economic substance doctrine. He does not believe that practitioners can rely on government statements about how the codified doctrine will be applied in the future when providing tax planning advice.

SILOs and LILOs are large and complicated leveraged leasing transactions involving domestic and foreign infrastructure. They have come under attack by the government in recent years as a form of tax shelter. Sen. Chuck Grassley has called them nothing more than tax fraud. Robert Wood and Steven Hollingworth attempt to break down SILOs and LILOs to show that they are more complicated than they initially appear and may not be fully understood. In their special report on p. 195, the authors explain the mechanics of these complex structures and summarize the state of the administrative and case law. The recent taxpayer victory in *ConEd* shows that not all LILOs and SILOs are shelters, but that should not reassure taxpayers, according to Wood and Hollingworth. They conclude that taxpayers must show a nontax business purpose for any tax-advantaged transaction because courts will usually cut through documentation to look at the essence of a transaction.

The tax system's role in the proper distribution of wealth is a touchy political subject. A recent study, however, found that Americans are remarkably united in what they perceive as an ideal distribution of wealth, but are unable to identify the actual percentages of wealth owned by various income groups. David Cay Johnston looks at the findings of Profs. Daniel Ariely and Michael Norton (p. 251). Ariely and Norton surveyed more than 5,000 people and found that their ideal wealth distribution has the top fifth of Americans owning between 30 and 40 percent of the United States' overall wealth. Johnston asks readers to take a quiz about how wealth is distributed in the United States and concludes that the disconnect between what Americans perceive as ideal and the actual state of the economy will eventually force politicians to radically reform the tax system or risk serious voter ire.

The American College of Trust and Estate Counsel submitted a report to Treasury in June containing proposals to coordinate the foreign corporation antideferral rules with trust taxation provisions. Stephen Vetter reviews ACTEC's proposals and concludes that they would provide much-needed clarity for an area of the code that has received little guidance (p. 222). He writes that ACTEC has outlined workable rules that will help integrate foreign nongrantor trust taxation with the taxation of PFICs.

In an August 16 article, Richard Jacobus criticized an analysis of the decision in *G-I Holdings*, concluding that the district court's opinion on the disguised sale issue was not dicta. The authors of the original analysis, Blake Rubin, Andrea Macintosh Whiteway, and Jon Finkelstein, write in response that under no disguised sale theory proposed by the government was the omission from gross income sufficient to trigger the six-year statute of limitations. Therefore, they continue to maintain that the court did not need to consider the disguised sale issue regarding the statute of limitations. (For Jacobus's article, see *Tax Notes*, Aug. 16, 2010, p. 769. For the response, see p. 232.)

The step transaction doctrine is an important government tool in analyzing the tax implications of certain transactions. In a recent IRS legal memorandum, the Service used it to test the form and substance of a D reorganization. Benjamin Willis believes that this application of the doctrine was inappropriate (p. 207). Willis argues that this use of the doctrine was a departure from a well-established and published Service position.

In Tax Crimes, Scott Schumacher analyzes the circuit split on whether a conviction for filing a false return is an aggravated felony under immigration law (p. 235). He believes this issue implicates serious concerns with statutory construction that may require clarification from the Supreme Court. Leah Durner, Jon Sedon, and Lisa Kothari look at how a U.S. VAT's administration might affect taxpayers, focusing on VAT registration, compliance costs, and refunds (p. 245). They find that VAT compliance costs can be significant, rising to as much as 3 to 5 percent of the revenue collection. In a viewpoint on p. 215, Seth Entin writes about a private letter ruling that provides an important clarification on when stock in a REIT qualifies for the domestic controlled qualified investment entity exception from the FIRPTA rules. ■

© Tax Analysts 2010. All rights reserved. Users are permitted to reproduce small portions of this work for purposes of criticism, comment, news reporting, teaching, scholarship, and research only. Any use of these materials shall contain this copyright notice. We provide our publications for informational purposes, and not as legal advice. Although we believe that our information is accurate, each user must exercise professional judgment, or involve a professional to provide such judgment, when using these materials and assumes the responsibility and risk of use. As an objective, nonpartisan publisher of tax information, analysis, and commentary, we use both our own and outside authors, and the views of such writers do not necessarily reflect our opinion on various topics.

(C) Tax Analysts 2010. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.