From the Editor:

Election Unlikely to Produce Decisive Result

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There is a lot at stake in Tuesday's national election. Whoever controls the White House and Congress will be able to take the lead on tax reform, dealing with the so-called fiscal cliff, and setting the parameters on deficit reduction. The fight between the GOP and President Obama on new taxes and spending cuts is finally in the hands of the voters, and if a party secures a mandate, it could win control of fiscal policy for now.

However, voters don't seem to be in the mood to grant either side much of a victory. If current polls hold, Washington in 2013 will be very similar to Washington in 2012. Obama maintains a slim, but continuing, advantage in most electoral vote forecasts, and Democrats and Republicans look like they will hold on to their respective chambers of Congress. Nothing is set in stone, of course, and Mitt Romney and several Republican Senate candidates remain close enough to win a surprising victory if turnout breaks their way, but the smart money is on the government remaining divided. *Tax Notes* and *Tax Notes Today* will, of course, feature extensive coverage on what this means for tax policy and tax reform as the results become known.

Even in the small world of taxwriters, there aren't likely to be many changes in 2013. Excepting retirements, every Senate taxwriter up for reelection is expected to win easily. On the House side, only F. Pete Stark, D-Calif., is facing a tough fight (although it's against a fellow Democrat, and he's expected to eke it out). If Romney wins, the House will have a new Budget Committee chair, but the odds are that Max Baucus, Dave Camp, Sander Levin, and Orrin Hatch will keep their spots on the Finance and Ways and Means committees. (For coverage, see p. 600.)

Although it would be imprudent to make a strong prediction in a magazine that might be read after the results are known, readers are advised to note one detail in most of the polls this season. All are predicting similar turnout ratios to 2008, when Obama won a decisive victory over Sen. John McCain. If turnout more closely resembles 2004, when George W. Bush prevailed over Sen. John Kerry, then it is very possible that the slight leads Obama enjoys in several key states might turn into slight deficits. That small change could mean very big things for tax policy.

Services PE

The concept of permanent establishment bothers multinational businesses. Most want to avoid it. A PE in a country allows a nexus for taxation. The OECD recently put out a draft on permanent establishment, and the most contentious issue in the document involves services. Lee Sheppard reports on a discussion about the OECD draft at the International Fiscal Association meeting in Boston (p. 583). Multinationals frequently look to the OECD to produce drafts that will allow them to send service providers into a country without creating a PE, according to Sheppard. But even the OECD recognizes that the traditional PE concept needs to be modernized, she writes.

Tax Reform

In a speech to the Tulane Tax Institute, Martin Sullivan argued that we need to get beyond certain preconceptions about tax reform. In an article adapted from the speech, he expounds on his vision for Tax Reform 2.0. Sullivan summarizes most of the major tax reform plans on the table, including Bowles-Simpson, Wyden-Coats, and those offered by Romney and Obama. Sullivan writes that tax reform will be much harder to accomplish now than in 1986 because rates are already low and there is only so much base broadening that can be accomplished. He closes by telling Congress to separate deficit reduction from tax reform, pointing out that tax reform will have a much harder time becoming reality if it can't be revenue neutral. (For his analysis, see p. 591.)

Commentary

Equity-based compensation has been a hot-button tax topic for several years. Romney's tax returns, which highlighted how Bain Capital compensates its partners, brought the issue to the forefront of the presidential campaign during the summer. But the idea that the tax law gives taxpayers too much latitude in crafting equity compensation packages to receive favorable tax treatment is hardly new. James Brown explores the mischaracterization of equity-based compensation in his special report on p. 629. Brown argues that those mischaracterizations actually result in more uniform taxation of equity compensation across different categories of taxpayers. While exploring the sources of the mischaracterizations, he concludes that various proposals to correct mischaracterization of income would aggravate discontinuities between taxpayers and produce a less efficient tax environment.

In *Canal*, the Tax Court held against a taxpayer arguing that a joint venture transaction was not a disguised sale. The decision immediately caused an uproar in the tax community because of the harsh words the court used to describe the advice given by PricewaterhouseCoopers. PwC authored a "should" opinion on the controversial transaction in *Canal*. David Michaels writes that it is a shame that the IRS Office of Professional Responsibility has taken no action, because the "should" opinion in the case flew in the face of all authority in the area (p. 667). Tax professionals should be condemning PwC's actions, according to Michaels, who is disturbed at the level of ire at the court's lack of respect for PwC's opinion. He discusses why the antiabuse rule should have applied in this case and rebuts some of the commentary defending the transaction in *Canal*.

Romney's tax plan is probably very familiar to everyone, particularly voters in swing states who must listen to competing advertisements on the topic around the clock. The Republican candidate wants to cut overall tax rates by 20 percent, and he says he will pay for these reductions by closing loopholes and cutting tax expenditures. Obama argues that Romney's plan would cut taxes for the rich and raise them on lower-income taxpayers, but Romney vigorously denies this (and did quite well defending his plan at the first debate). Calvin Johnson agrees with the president and writes that Romney cannot possibly keep all of his campaign promises (p. 676). Romney cannot cut taxes for everyone without increasing the deficit, and broad rate cuts are likely to overly benefit the wealthy, Johnson writes. He concludes that deficit reduction and tax reform must raise taxes on the rich, who can afford to pay more because wealth in the United States is held unevenly.

In 1989 the IRS issued a notice, followed by proposed regulations in 1992, addressing so-called May Company transactions. The regulations still exist in their proposed form. In August the New York State Bar Association issued a report on the May Company regulations that supported the deemed redemption rule and generally opposed the proposed distribution rule. Monte Jackel addresses both the NYSBA report and the May Company regulations in his column this week (p. 679).

Robert Wood writes about how to get tax-based damages into civil litigation, pointing out that many plaintiffs would like defendants to be responsible for increased taxes (p. 685). He looks at employment and tax shelter cases and how to show when the defendant's act triggers the tax. Although it is tricky to get taxes into civil damages, it is possible with the right facts and foundation, he concludes.

Michael Durst examines the OECD's fight against income shifting on p. 689, focusing on the changing transfer pricing guidelines. According to Durst, the OECD has rocked the tax practice community by saying that some income-shifting deals violate the arm's-length principle and should not be respected. ■