(C) Tax Analysts 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

## *From the Editor:*

# Fixing the Corporate Tax System

*By Jeremy Scott — jscott@tax.org*

The U.S. corporate tax system has few defenders. Even progressive policymakers would like to reduce the corporate tax rate and reform tax incentives. And the tax is anathema to conservatives, who regard it as inefficient and anti-competitive. As businesses have found new and more innovative ways to circumvent the rules, corporate tax receipts as a percentage of federal revenue have dropped continuously. The corporate tax is no longer an important part of the federal budget — in 2010 the tax raised $191 billion, or 9 percent of total revenues.

One of the problems with the U.S. corporate tax regime is that it is neither a territorial nor a worldwide system. Because of the rules on foreign direct investment, the U.S. tax system functions as an ersatz variant on territorial systems, with hidden benefits and costs compared with standard territorial regimes, according to Prof. Edward Kleinbard. In his special report, Kleinbard analyzes the phenomenon of stateless income, which is derived for tax purposes by a multinational group from business activities in a country other than the home of the group's ultimate parent. This type of income is subject to tax only in a jurisdiction that is neither the source of its production factors nor the domicile of a parent company. This allows multinational businesses to achieve very low effective tax rates. Stateless income planning undermines a critical assumption in the capital ownership neutrality model that has been advanced in favor of a territorial system, Kleinbard argues. He concludes that policymakers must choose between a territorial system that confronts stateless income or a worldwide system. He recommends the latter option because its imperfections can be more readily dealt with using the tax rate. (For his report, see p. 1021.)

Michael Durst doesn't believe corporate tax reform can occur without a serious reexamination of the entire tax system. Lower corporate rates must be combined with a more progressive income tax system, he writes. Building on Milton Friedman's arguments in favor of a ''radical center'' approach to tax reform, Durst argues that modern business practices preclude a high corporate rate, but that overall tax receipts must increase to encourage progressivity. Tax reform must address corporate distributions, the use of corporations as tax shelters, income shifting, and the possibility of a territorial system, he writes. (For his article, see p. 1059.)

European governments have largely given up on the corporate tax as a major source of revenue. Even the United Kingdom and Germany have engaged in major corporate rate reductions, and other European states (particularly Ireland) have led a race to the bottom to attract investment (which does little but harm worldwide government tax receipts and enrich multinational companies). Europeans, however, have more progressive tax systems, with much higher rates (on average) on income. They also use very regressive VATs, which burden lower-income taxpayers. The United States shouldn't be so quick to make this bargain, particularly since most Americans are uncomfortable with European state spending levels. Abandoning the corporate tax as a significant source of revenue would further shift receipts away from taxes on capital and toward taxes on income or consumption. It's hard to see how this is a more palpable alternative to even the current system.

**News Analysis**

President Obama would like to allow the Bush tax cuts for upper-income taxpayers to expire. Republicans are opposed to it, ostensibly because the tax increase would affect passthrough business hiring practices by burdening a large percentage of small business income. Using a new Treasury report on small businesses as a guide, Martin Sullivan analyzes who would be affected by a return to Clinton-era tax rates on the rich. He argues that the Bush tax cuts are an inefficient way to encourage hiring because most of the passthrough income goes to businesses that are not employers. Although Democrats are wrong to focus on statistics concerning the number of passthrough businesses, they should be able to make an effective case that targeted tax breaks to employers that increase their hiring is a more effective stimulus policy, Sullivan writes. (For his analysis, see p. 979.)

The new FATCA reporting regime will require foreign banks to report more information than ever on U.S. account holders. But will the United States reciprocate? Treasury would like to and has proposed regulations that would require U.S. banks to report information on nonresident account holders. Naturally, this has Florida and Texas lawmakers

and banks up in arms, according to Lee Sheppard. Comparing the new regulations to those proposed in the waning days of the Clinton administration, Sheppard assesses who is opposed to nonresident reporting and why. The new regulations are the minimum necessary to make FATCA reporting acceptable to U.S. treaty partners, she concludes. (For her analysis, see p. 984.)

**Commentary**

The Eleventh Circuit recently dealt a blow to healthcare reform when it struck down the individual mandate. The opinion severed the mandate from the rest of the act, but it is unclear how Obama's reform package would function effectively without it. Jasper Cummings, Jr., writes that this issue will probably be settled by the Supreme Court and that commerce clause cases over the last 16 years suggest a probable conservative victory (p. 1065). He analyzes the arguments in favor of the individual mandate and wonders why Congress overlooked the taxing power in favor of relying on the commerce clause. Government litigators probably wish the mandate looked more like a tax, Cummings writes. Because of how the mandate was drafted, the Eleventh Circuit did not have to go far outside the lines in holding that the mandate was not a tax, according to Cummings.

The recent ABA tax section debate on the standards of advice and disclosure is not new for tax lawyers. The legal ethics literature shows tax lawyers discussing these same issues in the 1950s, writes Michael Hatfield (p. 1043). Without the burden or benefit of formal ethics opinions, the past debate was more open-ended, with a focus on the ethics of lawyering rather than the law of lawyering, he writes. Contrasting the debate in the 1950s and 1960s with practitioner ire over recent Circular 230 changes, Hatfield finds continuing ambivalence in the tax bar over whether professional ethics should transform into professional regulation.

Congressional Republicans have been pushing for a balanced budget amendment since they retook the House in 2010. Many wanted one as the price for an increase in the debt ceiling, but the final agreement did not even require a vote, much less passage of it (which is very unlikely given Democratic control of the Senate and the cumbersome mechanic of state approval). Prof. Richard Cebula writes that the simplified amendment under consideration in Congress is impractical, and he proposes a more flexible alternative (p. 1046). Cebula criticizes balanced budget amendment proposals that might result in higher federal spending or higher taxes. His proposal would allow temporary deficits of up to 2.5 percent of GDP with approval of two-thirds of the House and Senate in cases when unemployment is more than 8 percent. Cebula supports a balanced budget amendment that mandates government spending being below a set percentage of GDP.

Legal settlements are routinely deducted by businesses with little thought to value. However, in the context of claims against decedents' estates, the need for valuation on the date of death can be at odds with the amount paid later, writes Robert Wood (p. 1051). He analyzes three recent cases that explore valuation and finds that there are few universal principles in this area. Good appraisals are important, but practitioners should be wary of multiple appraisals, he concludes. He also provides other tips for valuation strategies, including advice on how to write letters to auditors for financial statement purposes.

In Of Corporate Interest, Robert Willens discusses a district court decision holding that a closing agreement that addressed the amount of a corporation's NOLs, but did not fix them, did not bar a taxpayer from using the benefits of Notice 2003-65 (p. 1055). The notice allows a corporation to increase the amount of its section 382 limitation and increase the pace at which the NOLs could be used. Willens says that courts closely scrutinize closing agreements and do not make inferences that conflict with the plain terms. ■

© Tax Analysts 2011. 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 2011. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.