From the Editor:

Mortgage Interest Deduction Might Be Key to Tax Reform Efforts

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The mortgage interest deduction costs the government approximately $85 billion per year. Eliminating it would raise close to $1 trillion over the next decade (which is almost exactly the amount that President Obama's fiscal commission recommended cutting from defense spending). Virtually every tax reform proposal in the last 10 years has recommended trimming, capping, or eliminating this tax expenditure, but none of these proposals has ever really made any progress in Congress.

The reason why is pretty easy to guess. The American dream includes homeownership, and the deduction has become the center of a powerful illusion that without government intervention and assistance, this dream is largely unattainable. Front and center promoting that illusion are the powerful real estate agent, mortgage, and home builder lobbies. But does the mortgage interest deduction actually increase homeownership rates? Not really, according to data comparing the United States with European and other Western nations that lack a tax subsidy. And other research has shown that the primary beneficiaries of the mortgage interest deduction are high-income taxpayers who itemize — people who could probably afford their own home with or without a tax expenditure.

Besides being slanted toward the rich, the mortgage interest deduction is also heavily biased toward certain states. Martin Sullivan finds that states that voted for Obama in 2008 (so-called blue states) benefit much more from the tax subsidy than states that supported Sen. John McCain. Blue states such as Maryland, California, Connecticut, New Jersey, and Massachusetts receive more than three times the per capita benefit from the deduction than red states like Oklahoma, Arkansas, Mississippi, and West Virginia. Sullivan wonders if Republican lawmakers will take advantage of this fact in any tax reform effort. Surely senators from Oklahoma would prefer trimming mortgage subsidies benefiting Maryland over cutting tax expenditures related to oil and natural gas production. (For Sullivan's analysis, see p. 364.)

Sullivan's research, while novel, shouldn't be too surprising. Poor states tend to vote Republican, while the large, urbanized states with high housing prices traditionally support Democrats. What this suggests about voters' ability to discern which party is acting in their interest is a topic best left for another day. Republicans, however, are likely to be just as opposed to trimming the mortgage interest deduction as Democrats. Beyond the GOP's opposition to any form of tax increase, Republicans will also be motivated by the fact that the political donor class benefits significantly from the mortgage deduction. Despite its inefficient design and questionable merit, the mortgage interest deduction in its current form is probably here to stay.

WikiLeaks

Followers of bank secrecy and offshore tax evasion were riveted by WikiLeaks' announcement last week that it had obtained bank account information on more than 2,000 clients of European banks. The provider of the data was Rudolf Elmer, who has already turned over information to various tax administrators (and become a criminal in Switzerland because of it). While it will be some time before WikiLeaks makes its information public, practitioners are already cautioning clients to get ahead of the declaration. The era of bank secrecy appears to be ending, and taxpayers would be well advised to take advantage of whatever voluntary disclosure program the IRS offers. (For coverage, see p. 363.)

Commentary

Collection due process hearings were created in 1998 because Congress sought to grant taxpayers statutory and judicial rights when contesting the collection of federal taxes. Congress probably envisioned that CDP hearings would function as an expedited process for contesting collection matters. In fact, the opposite is true, according to findings by Profs. Carlton Smith and T. Keith Fogg (p. 403). Smith and Fogg surveyed regular and CDP dockets arising from petitions filed in the Tax Court during the first six weeks of 2008. This represented 11 percent of all 2008 petitions. The professors found that CDP cases generally took about a third longer to resolve than non-CDP cases. This is unacceptable, the authors write. They propose several solutions to help expedite CDP cases, including early introduction of the administrative record during Tax Court proceedings. However, other changes are required to fully achieve Congress's intent when it implemented CDP rights, they conclude.

Transfer pricing practices have come under attack as a form of multinational tax avoidance in the last few years. Many articles and organizations have called attention to the low effective rates that many U.S. multinationals are able to achieve through the use of aggressive intangible migration and other transfer pricing practices. This attention might have created an opportunity for substantive transfer pricing reform, writes Michael Durst (p. 443). He attempts to survey the competing positions, finding that there are several possible paths to reform. He recommends that policymakers acknowledge the difficulty in finding comparables, address issues regarding intangibles migration, implement a profit-split method in the future, and push the OECD to take concrete steps to prove its independence from taxpayer and practitioner groups.

The deficit reduction plan introduced by the co-chairs of Obama's fiscal commission received more support than most observers expected. Eleven of the 18 members of the commission voted for the final recommendations. This was not enough to ensure congressional action, but it might have set the stage for true tax reform, according to William VanDenburgh and Nancy Nichols (p. 447). In their opinion, the plan has been an unqualified success in raising the quality of the tax reform debate. They review and critique the elements of the commission's plan and address the outlook for tax reform in 2011.

In the second part of his analysis of tax reform efforts in the last century, Bruce Bartlett isn't quite as optimistic as VanDenburgh and Nichols (p. 473). He writes that conservatives have dominated the tax reform debate in the last few decades. While most experts might believe another 1986-type effort is long overdue, Bartlett concludes that Democrats are unlikely to oppose Republican efforts aimed at lowering the federal tax burden.

In a November 2010 *Tax Notes* article, Claudine Pease-Wingenter wrote that the tax bar should take a bigger interest in how courts are interpreting the privilege granted to federally authorized tax practitioners. She found that courts are not granting sufficient recognition to taxpayer privilege claims in this area. Kip Dellinger believes she might have a point, but wonders why any practitioner would leave a client vulnerable to government challenge in discovery proceedings in order to prove that point. Dellinger disagrees with Pease-Wingenter's conclusion that the tax bar should challenge courts' interpretation of the FATP privilege more often and criticizes her article for omitting references to other works and decisions that might have contradicted her argument. He concludes that the FATP privilege is very limited in scope and that it is not worth risking trapping clients in bad law that arose from bad facts. (For Pease-Wingenter's article, see *Tax Notes*, Nov. 29, 2010, p. 977. For Dellinger's analysis, see p. 475.)

Prof. Bridget Crawford reviews the 10 most popular articles from 2010 related to estate and gift tax practice on p. 469. Crawford chose the articles based on the 10 most downloaded pieces from SSRN that relate in some way to estate and gift taxation. She provides quick summaries of the topics and arguments in each article and concludes that SSRN remains a worthwhile tool for tax analysis.

A civil tax proceeding is likely to follow a criminal conviction in an IRS-investigated case. These proceedings are becoming more common as the IRS becomes more aggressive in its enforcement efforts. Taxpayers might be surprised to learn, however, that a criminal conviction carries with it the effect of full collateral estoppel or limited issue preclusion, writes Steven Harris on p. 438. Harris reviews the origin and nature of this estoppel and concludes that there is a great deal at stake in a civil tax fraud case. Also this week, Robert Wood provides 10 tips to young tax practitioners (p. 463), while Robert Willens reviews the continuity of interest requirement in insolvency reorganizations (p. 459). ■