From the Editor:

Offshore Tax Evasion: Front and Center Again

By Petya V. Kirilova — pkirilov@tax.org

Offshore tax evasion is in the public eye again as Congress tries to close loopholes that might allow for offshore tax abuse. On p. 827, Martin Sullivan provides extensive analysis of the recently proposed Foreign Account Tax Compliance Act of 2009 (FATCA). (For prior analysis of the bill, see *Tax Notes*, Nov. 2, 2009, p. 493.) FATCA requires all non-U.S. financial institutions to annually report comprehensive information on U.S. account holders to the IRS, or risk having a new withholding tax imposed on all their income from U.S. securities and on all of their customers' accounts. Sullivan examines the impact of the bill on large and small financial institutions and questions whether FATCA can really curb offshore evasion. He is skeptical about the effectiveness of the bill and argues that foreign financial institutions would have little incentive to comply with the disclosure requirements because, among other factors, doing so would mean incurring additional costs. Sullivan concludes that the bill lacks key provisions included in previously proposed offshore tax evasion bills.

Even if larger financial institutions comply, smaller ones might step up and attract U.S.-tax-evading customers. The result would not reduce offshore evasion but would merely reshuffle its accommodating parties. And if enacted, FATCA might harm the U.S. economy by causing foreign financial institutions to withdraw from U.S. capital markets, exacerbating the credit crunch.

FATCA is also the focus of an article by Cleary Gottlieb Steen & Hamilton LLP. The firm analyzes the bill's principal provisions and identifies key issues raised by the expansive new reporting and withholding regimes. The article also offers preliminary observations on how various banks, financial intermediaries, and securities firms might be affected by the legislation if it becomes law. With FATCA almost certain to pass (possibly with changes on the Senate floor if Sen. Carl Levin, D-Mich., has his way), individuals and financial institutions would be well served by preparing their response to a new era of transparency and information sharing, even if FATCA is not as stringent as some would like. (For the article, see p. 892.)

Just in time, it seems, the IRS released a previously undisclosed annex defining the limits of Swiss bank secrecy in the context of the recent agreement in the UBS case between the Swiss and U.S. authorities. The annex lays out the criteria for account disclosure to be carried out in accordance with the Switzerland-U.S. income tax treaty procedure. Essentially, the criteria aim to uncover accounts that involve ''egregious behavior,'' that would be difficult for the IRS to identify, and that have a high asset value. For coverage, see p. 832.

Continuing with the theme of international tax cooperation, Lee Sheppard examines whether Latin American countries have incentives to enter into OECD model-type treaties (see p. 854). She argues that the OECD model is suited to European countries, but not to South America because the latter might not even be able to comply with its provisions. In this regard, Sheppard looks at the broader question whether the OECD model is compatible with South American countries' domestic laws and concludes that it is not.

New Column Debuts

Tax Notes is pleased to introduce a new column, Woodcraft, by frequent contributor Robert Wood. The column will continue to present Wood's expert views on the taxation of litigation recoveries, and it will also address topics such as qualified settlement funds, employee classification, and the use of tax experts in litigation, among many others. In his first column, Wood discusses settlement allocations involving wages, front pay, and back pay. He examines the wage versus nonwage dichotomy and the incentives to the parties. For the column, see p. 925.

Commentary

David Cay Johnston's latest column again offers suggestions for Congress in its hunt for revenue. In the first part of his ''Where the Money Is'' series, Johnston wrote that billions of dollars could be raised by converting corporate taxes on utilities into a direct use tax that appears on customers' electric bills. This week Johnston turns to the unlimited deferral of compensation that highly paid executives receive (p. 935). Johnston shows that many executives have been able to defer millions (and even billions) of dollars in compensation, something that an average wage earner cannot do (for most people, the limit on tax-deferred savings is $16,500 for those under 50 years old, and $22,000 for those between 50 and 70 years old). Ending the ability of highly compensated taxpayers to defer wages would raise revenue and restore a sense of fairness to the tax code, according to Johnston. He concludes by challenging readers to defend unlimited deferral so that a robust debate over tax policy might result.

The American Recovery and Reinvestment Act of 2009 contained myriad tax provisions that were designed to help stimulate the economy. The success of ARRA in helping end the recession is debatable (and will certainly be debated during election season in 2010), but there is no doubt that many targeted taxpayers have benefited, and can benefit, from the law's provisions. But time is running out for businesses to take advantage of two provisions regarding investment in eligible machinery and equipment, write Cherie Hennig, John Everett, and William Raabe (p. 889). The provisions allow bonus depreciation for qualifying property placed in service in 2009 and an enhanced section 179 deduction for equipment. The authors point out that to use those tax incentives, businesses must take action to place the equipment and machinery in service by December 31, 2009. The authors believe that both profitable corporations and those with losses can take advantage of these incentives (especially the ability to get a refund for unused AMT and research credits), but they say that it takes careful planning to maximize the tax benefit.

Recent court decisions and changes in accounting and audit documentation standards have created new issues for taxpayers, their advisers, auditors, and examiners. In a special report, Prof. Thomas Monks tries to help those caught at this intersection of tax, accounting, and discovery rules and laws. Monks focuses on how taxpayers should decide whether to comply with discovery requests and discusses the limits on the IRS's discovery power. The report primarily deals with tax accrual workpapers, the focus of the recent *Textron* decision, and presents a series of questions and answers designed to help practitioners and taxpayers determine the status of the law and their obligations under the various regimes that govern taxpayer conduct in this area. For the special report, see p. 901.

Collection due process hearings were created by Congress in 1998 to allow taxpayers to object to the IRS filing of a lien or to the first notice of an intent to levy. Profs. Carlton Smith and Keith Fogg believe that Congress intended the hearings to be expedited based on the fact that taxpayers have only 30 days to request a hearing with Appeals (p. 919). But the professors write that CDP hearings are anything but expedited affairs. Smith and Fogg have found that the IRS's ability to delay the issuance of a notice of determination puts pressure on taxpayers to drop the appeal. Interest can continue to accrue on the delinquent account in some cases. The authors want Congress to impose time frames for the administrative process, coupled with consequences when the deadlines are not met. Specifically, Smith and Fogg want an end to unlimited tolling of the statute of limitations on collection. Their proposal would cap the tolling at six months.

In the first Views on VAT, the column discussed why the value added tax was an emerging issue for the United States. The second installment, by Leah Durner, Bobby Bui, and Jon Sedon, looks at the general factors that lead countries to adopt a VAT and evaluates those factors as they apply to three countries with a federal structure similar to that of the United States (p. 929). The authors point to three major factors that drive the adoption of a VAT: the need for a more stable revenue system, the simplification of tax administration, and external influences such as European Union requirements and IMF lending restrictions. They use the struggles of India, Canada, and Australia as examples of how a reform process in the United States might take shape. Canada is still attempting to harmonize its VAT with provincial governments' while Australia imposed a fully harmonized national tax whose revenues are shared with its states. For its part, India is in the beginning stages of revisiting its indirect tax structure. Views on VAT concludes that the experiences of these three countries can provide valuable lessons for the United States should it choose to adopt a VAT soon. ■