From the Editor:

Reconciling Corporate Tax Reform With Deficit Reduction

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Revenue-neutral corporate tax reform is the latest tax issue to draw the ephemeral attention of the Obama administration. The president pushed for it in his State of the Union address, and the Treasury secretary has been holding meetings with various groups to solicit their ideas for how to make the U.S. corporate tax system promote competitiveness. Although nothing specific has come from President Obama yet, it is likely that the administration wants to push for a U.S. corporate rate in the 25 to 30 percent range and to pay for that decrease by repealing many, if not most, corporate tax expenditures.

Deficit reduction is also a major topic of discussion in Washington, although many are beginning to note that most of the effort on broader tax reform aimed at solving the government's fiscal crisis is coming from Capitol Hill, not the White House. Senate Budget Committee Chair Kent Conrad has continued to insist that a major deficit reduction package can only be successful if Obama provides leadership and pushes for it. However, Conrad maintains that his committee will do what it can regardless of Obama's involvement. A large bipartisan group of senators, led by Mark Warner of Virginia and Saxby Chambliss of Georgia, are trying to put together a major bill that encompasses the recommendations of Obama's deficit reduction commission. This legislation would presumably involve major spending cuts and tax reform designed to reduce the deficit by $4 trillion over the next 10 years. This effort is noble, but probably doomed to fail given statements by Majority Leader Harry Reid. (For coverage, see p. 635. For coverage of corporate tax reform, see p. 632.)

There are many reasons why the White House might not want to put much political capital in deficit reduction while also pushing for corporate tax reform. Perhaps the easiest to understand is that the two goals conflict. Corporate tax reform is usually just a euphemism for lower corporate tax rates, and it is almost impossible to imagine a lower U.S. corporate rate helping close the federal deficit. Business leaders continue to insist that a rate cut not be offset by the repeal of deductions, and it is likely that Republicans agree (despite one GOP senator declaring his openness to paying for a corporate rate reduction). Will Obama and Democrats insist on a revenue-neutral package? Perhaps. Or maybe the president's new use of the word "competitiveness" will trump his commitment to controlling the federal deficit. After all, wouldn't many multinationals argue that they would be a lot more "competitive" if they paid a great deal less in taxes?

REMICs

The collapse of the housing market rippled throughout the economy and the tax code, affecting investors, transactions, and programs. REMICs are one victim of the bubble bursting. Lee Sheppard writes that the REMIC rules never envisioned a scenario in which so many mortgages held in REMIC pools would be bad and practitioners are now struggling with bad debt deductions and OID issues. Her article examines remarks made by the IRS at the recent ABA Section of Taxation meeting in Florida and looks at how several court decisions might affect REMIC deductions. (For her analysis, see p. 608.)

Commentary

The advance pricing agreement program is a controversial aspect of U.S. transfer pricing rules. The program is designed to simplify transfer pricing disputes between the government and multinationals, but it is often criticized for being secretive. Many suspect that the deals received by taxpayers in the program are far too favorable. The APA program is the sole instance in which the IRS applies transfer pricing principles to complex real-world fact patterns, according to Richard Stark, Hartman Blanchard Jr., and Saul Mezei (p. 655). However, the program needs to be subject to more disclosure, they write. In their special report, the authors examine the unique status of APAs under FOIA law. They argue that APAs can represent IRS legal thinking on transfer pricing issues and can produce guidance equal to technical advice memorandums, which are disclosed. Disclosing APAs would help taxpayers comply with transfer pricing rules and, importantly, would ensure that similarly situated taxpayers receive similar treatment, according to Stark, Blanchard, and Mezei. They conclude that Congress and the IRS should reconsider the secrecy of APAs in order to improve the administration of transfer pricing and reduce the costs of compliance and enforcement.

The codified economic substance doctrine is likely to remain a major practitioner concern in the near future. Besides the uncertainty over how codification will affect litigation, many are worried that IRS agents will seek to broadly apply the doctrine during audits. The strict liability penalty only exacerbates these concerns and raises the stakes for taxpayers and planners. This level of uncertainty is bad tax policy and could render the new doctrine vulnerable to a constitutional challenge, write Thomas Cullinan and Shane Lord (p. 700). They argue that the IRS and Treasury have a vested interest in releasing guidance that will eliminate the possibility that the codified doctrine will be found unconstitutionally vague. The IRS might want to maintain flexibility in how it uses the new doctrine, but that flexibility creates an unacceptable level of uncertainty, the authors conclude.

Valuation is a contentious part of business acquisitions. Sellers want to value items at the highest level possible, of course, while buyers might be concerned that an overvalued business will not perform at expected levels. A possible solution to the valuation dilemma is the use of earn-outs, which usually function like contingent sales proceeds. Earn-outs are one mechanism that can be used to bridge the gap between buyers and sellers, according to Peter Martin and William Weatherford (p. 685). They write that earn-outs can be win-win, shielding buyers from overpaying for a business and allowing sellers to reap benefits if certain milestones are met. They analyze the tax treatment of earn-outs and several important judicial decisions and doctrines.

Foreign currency is one of the few areas of tax law in which macroeconomic trends directly influence results. Dollar exchange rates can have important tax consequences on certain types of transactions. John Bates highlights the important tax issues facing U.S. multinationals and how volatile currency exchange rates have affected tax law on p. 689. Bates argues that policymakers and Treasury could mitigate uncertainty in this area with proper guidance and by plugging holes in the law. The wild fluctuations in the value of the dollar make this issue more pressing, he writes. He concludes that currency tax consequences can creep into all manner of cross-border activities and that practitioners should be wary of how global economic trends might affect transaction planning.

Paying for the federal highway system has become difficult over the last few years. The Highway Trust Fund is depleted, and the federal gas tax is no longer adequate to cover transportation spending. Attempts to increase the tax or revamp the funding mechanism for the trust fund have met strong conservative opposition in Congress. Recent projections from the CBO that put the fund in the red by 2013 suggest that the time has come for Congress to let the Highway Trust Fund expire, writes Diana Furchtgott-Roth (p. 711). If the fund is allowed to expire, then highway spending and fuel taxes could be administered by the states, she argues. The purpose of the fund was to establish an interstate highway system, and such a system now exists, Furchtgott-Roth says. She concludes that devolving the trust fund would reduce federal spending and help eliminate the type of earmarks that many in Congress claim to want to end.

Attorney fee deductions are once again the target of Robert Wood (p. 707). In his article this week, Wood writes that a 2005 Supreme Court decision left many taxpayers scrambling to figure out ways to deduct the fees paid to their attorneys, with imperfect results. Most taxpayers must claim attorney fees as miscellanous, itemized deductions, Wood writes. The only exceptions involve personal injury, employment, and discrimination cases. He argues that many practitioners fail to advise their clients how to allocate fees even in those cases, jeopardizing a taxpayer's deductions. ■