Rangel's Fall Complicates Tax Reform Picture

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Although it was widely expected for some time, Charles Rangel's stepping aside as House Ways and Means Committee chair is a serious blow for tax reform. His replacement, Rep. Sander Levin, D-Mich., is not as committed to fundamental reform. In fact, Levin's primary focus seems to be on labor issues and the treatment of carried interests. Those aren't exactly groundbreaking tax agenda items.

Republicans have been calling for Rangel's removal for months. Their latest attempt for a vote might have hastened the chairman's decision. Now Republicans have their wish, but are they better off? Rangel was the most powerful Democrat to endorse a corporate rate cut. He was also a consistent opponent of enacting international tax reform piecemeal, preferring to consider President Obama's proposals only as part of broader tax legislation. It is impossible to know what kind of effect Levin will have on tax policy, but it seems reasonable to conclude that he might be more willing to use international tax reform measures as pay-fors for various other spending bills. If so, it is hard to see how that helps the GOP. Rangel once called on business to get behind his "mother of all tax reforms" bill or risk seeing the base-broadening measures enacted without the rate cut. Maybe Republicans should have taken that advice.

Rangel's replacement is unlikely to have an immediate impact on healthcare reform legislation or the Democrats' chances of rounding up the votes necessary to pass the Senate version. However, Levin might be able to play a more active role than his embattled predecessor if the House moves to pass tweaks to the Senate bill for the upper chamber to consider under the controversial reconciliation process. Because only revenue-related measures can be considered under reconciliation, the Ways and Means Committee presumably will be at the forefront of shaping this second round of healthcare reform. Of course, all this assumes that the House passes a bill at all, something that at press time was uncertain. (For coverage of Rangel, see p. 1178. For healthcare reform coverage, see p. 1198.)

News Analysis

The Kanter/Lisle/Ballard saga has dogged the Tax Court for decades. The case, originally heard by a special trial judge, involved a kickback scheme devised by two insiders and an attorney, Burton Kanter. Although the special trial judge found no evidence of fraud, Tax Court Senior Judge Howard Dawson disagreed. Unfortunately, things did not develop quite that simply, and over a myriad of cases, Kanter's attorneys won a Supreme Court case that allowed them access to the special trial judge's opinion and several appellate-level reversals of Tax Court decisions that tried to maintain Judge Dawson's findings of fraud. Kanter's camp is now calling for an investigation of Judge Dawson and the Tax Court's conduct by Congress and the administration. On p. 1181, Sam Young presents an analysis of Kanter's claims, the history of Judge Dawson's involvement in the case, and the outlook for the future.

After briefly reviewing the movie *Crazy Heart*, Lee Sheppard continues her exploration of the impact of the *Container* decision on guarantees. This week Sheppard writes about the remarks of Michael DiFronzo, IRS deputy associate chief counsel (international/technical), at a recent meeting of the International Fiscal Association. Sheppard believes that practitioners should be prepared for the Service to invoke section 956 more often in the future to force some items to be included in income. (For the article, see p. 1172.)

The idea that transfer pricing abuses (or lax enforcement or poor rules) have allowed U.S. multinationals to shift profits offshore is not new, but Martin Sullivan writes that the extent of the problem is not widely appreciated. Using data from nine pharmaceutical companies, Sullivan paints a dramatic picture showing how drug companies have reported increased profits abroad, while domestic profits have remained stagnant or declined. This increase in foreign profits is not explained by greater sales abroad, according to Sullivan. He concludes that the only possible explanation is a failure of the arm's-length method to protect the domestic tax base. Sullivan's analysis and supporting data start on p. 1163.

Commentary

In the return of Camp's Compendium, Bryan Camp explores the role of the national taxpayer advocate (p. 1243). Camp argues that changes to the tax code since World War II have created the need for an organization like the Taxpayer Advocate

Service and that Nina Olson has fulfilled her responsibilities very well during her tenure. However, Camp believes that the TAS has too much separation from the IRS and that some taxpayers view it almost as a shadow organization. He concludes that the real solution to the problems confronting the TAS is for Congress to reduce the complexity of the tax code. In her response to Camp's article on p. 1257, Olson writes that Congress got the balance about right when it created the TAS. She believes that the tension between the IRS and the TAS can be a creative tension that works to the benefit of taxpayers and tax administrations alike. She does not believe that any reforms are needed to make the national taxpayer advocate more or less independent from the IRS. In fact, she argues that the high taxpayer satisfaction with the TAS shows that it is helping to rehabilitate the image of the IRS and the tax code.

In a new column for *Tax Notes*, Charles Rettig writes about the challenges confronting tax practitioners in an environment where tax administrators are concerned about the tax gap, enforcement, and compliance. Rettig believes that the IRS's efforts are highly dependent on a responsible tax return preparer community. He also explores the various penalties confronting tax practitioners, transfer pricing disputes, and the enforcement priorities of today's IRS. The Tax Controversy column is on p. 1263.

The battle over whether overstatements of basis constitute an omission from gross income is unlikely to be resolved soon. With the release of regulations that explicitly allow the IRS to use an extended statute of limitations for assessment in cases involving overstatement of basis, the government has signaled its intention to continue to pursue the matter. In a special report, Mark Allison argues that these regulations flout well-established case law, specifically the Supreme Court decision in *Colony* (p. 1227). He traces the history of the six-year statute of limitations provision through the 1954 and 1986 codes. While he finds that decisions at the district court level have been mixed, appellate circuits have dealt the government a series of significant defeats. Allison concludes that the government's attempt to create tax policy simply to assist its litigation position is an unwelcome development for tax practitioners and the tax code.

The taxation of carried interests is receiving a great deal of attention in Congress. The House used it as a pay-for in so-called extenders legislation, and many prominent House Democrats (including the new Ways and Means chair) want to see carried interest compensation taxed as ordinary income. Stephen Breitstone writes that carried interest reform would significantly affect real estate partnerships if enacted. He concludes that it would do far more than just deny capital gains rates to service providers; it would also change fundamental deal dynamics in real estate transactions. (For the article, see p. 1219.)

With the House passing a version of the Senate's jobs bill, Congress has tried to reduce unemployment. (For coverage, see p. 1180.) Amity Shlaes does not believe that simple hiring credits or other tweaks will go far enough (p. 1275). She writes that unemployment is also the product of the costs of labor and that these costs constitute a hidden tax on hiring. Shlaes would like to see policymakers confront issues like the wage requirements of the Davis-Bacon Act, the possible expiration of the Bush tax cuts, and Obama's pledge to raise wages of federal contractors. All of these affect companies' decisions on whether to hire or lay off employees, according to Shlaes.

House Majority Leader Steny Hoyer is not afraid to speak his mind, and last week he made it clear that any deficit reduction package will have to raise taxes on the middle class. (For coverage, see p. 1197.) Hoyer's fellow Democrats will probably distance themselves from his remarks, but in a viewpoint on p. 1261, Robert Michaelson echoes the call for tax increases. Michaelson also explores who should bear the burden of additional taxes. He concludes that economic data indicate that it doesn't matter who bears the burden of a tax increase and that equity concerns should cause the wealthy to bear these additional burdens.

Robert Wood addresses the general welfare exception to gross income in his column. Wood points out that it can apply beyond the context of government benefits. He writes that the doctrine is not codified and is instead ''fundamental stuff,'' as the IRS has long acknowledged. Woodcraft is on p. 1271. ■