(C) Tax Analysts 2013. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Shutdown Ends; Tough Issues Remain

By Fred Stokeld — fstokeld@tax.org

The lights are on again at the IRS and other federal agencies.

After nearly three weeks of a government shutdown triggered by the showdown between Republicans and Democrats over the funding of the Affordable Care Act, an eleventh-hour agreement was reached that allows the federal government to resume operations. Although the ACA was at the center of the dispute, the agreement leaves the healthcare law almost untouched, aside from tweaking a provision on premium tax credits under section 36B. It leaves the ACA's medical device excise tax unchanged.

While there is general relief that the stalemate is over, there is also uncertainty about the future of tax reform and how long it will take the IRS to get up to speed again. The centerpiece of the agreement is the formation of a budget conference committee that will explore spending reforms. House Budget Committee Chair Paul Ryan said he didn't know whether the budget conference would address tax reform, and several Republicans on the Ways and Means Committee were doubtful that it would. Ways and Means Committee Chair Dave Camp said his committee will proceed with tax reform regardless of what the budget conference does but said the budget conference presents an opportunity to facilitate tax reform. Senate Finance Committee Chair Max Baucus said it was too early to tell if his committee would mark up a tax reform bill this year.

Meanwhile, the doors at the IRS are open again and the agency's 85,000 furloughed employees have returned to work. But it may be awhile before operations are running smoothly. IRS employees undoubtedly will face backlogs of unfinished work and could be slammed with phone calls from taxpayers needing assistance who haven't been able to reach the agency for 16 days. Practitioners who call the IRS's practitioner hotline may have trouble getting through if there's a huge volume of calls.

An aggravating factor is that the shutdown occurred during the October 15 filing deadline for most taxpayers who asked for an extension. During the shutdown, the IRS said the deadline still applied.

Tax Reform at Home

Martin Sullivan explores another frustrating aspect of tax reform. In his analysis, he urges divorcing individual tax reform from business tax reform but acknowledges the challenges that will come from passthrough entities (p. 259.)

European Taxes and Reporting

While the U.S. tax system has seen more efficient days, Europe is making progress on its realizable taxes. Lee Sheppard discusses new European laws that are getting at previously nontaxable income of companies. The potential for income arises when companies buy questionable loans and participate in the ensuing workouts. At the same time, the companies purchase profitable targets. The companies push their leverage down to the targets and take interest deductions, thus eliminating any income tax that would be generated by the target. Sheppard examines the different methods European countries are adopting to end those interest deductions (p. 251). Marie Sapirie takes a look at the ways the OECD is addressing the more general problem of base erosion and profit shifting (p. 263). In another article, Sheppard looks at the U.S. accounting rules that deal with taxing companies' repatriated earnings (p. 255.)

Commentary

Former IRS Commissioner Lawrence B. Gibbs questions the recent decision in *Loving v. IRS* (p. 331). In that case, the district court held that Treasury lacks the authority to issue regulations that would enable the IRS to regulate unregulated, commercial tax return preparers. Gibbs argues that Treasury does have that authority and that the district court decision should be reversed.

Cloud computing, in which the taxpayer shares a pool of configurable computing resources provided by a cloud service provider, is expected to grow and increasingly be relied on for record-keeping and other purposes. But how can a taxpayer be sure a cloud service provider's systems will meet IRS record-keeping requirements? That's the question posed by H. Karl Zeswitz Jr. and Mary Monahan (p. 307). They write that IRS guidance on electronic record-keeping systems applies more to systems operated by the taxpayer rather than cloud computing systems and that taxpayers using cloud computing could face compliance risks unless they ensure the integrity of the cloud services.

Can contingent fee lawyers deduct litigation costs immediately? Or must they capitalize them

instead? The IRS says the costs must be capitalized, according to an article by Gregg Polsky and R. Kader Crawford (p. 295). The authors contend that the *INDOPCO* regulations that came out in 2004 now determine whether litigation costs have to be capitalized. They conclude that although costs generated under gross fee contracts are deductible immediately under current doctrine, Treasury and the IRS should require them to be capitalized prospectively and that legislation to allow immediate deductions for litigation costs should be rejected.

It is not unusual for courts to preclude discovery of the IRS, including depositions of IRS agents. But according to Robert Wood and Dashiell Shapiro, when formal discovery is not available, informal discovery can be used (p. 325). The Tax Court has formal procedures for informal discovery, they write, adding that informal discovery can include informal requests for documents and information from third parties, informal interviews of potential witnesses, and requests for government records.

On the international front, Brett Weaver, Sean Foley, and Andrew Hickman discuss the growing concern about profits of multinational enterprises whose profits go untaxed because they do not have a significant tax relationship with any nation (p. 318). The authors discuss the OECD's efforts to address its member state concerns about BEPS, in particular the OECD's July 19 release of an action plan on BEPS. The authors explain the topics outlined in the action plan — the digital economy, anti-base-erosion provisions, transparency and dispute resolution, among others — and offer their thoughts on each.

A Government Accountability Office report released in May on corporate effective tax rates led to media reports that federal tax payments of profitable corporations equaled only 12.6 percent of their financial statement income in 2010. But according to Andrew Lyon, that conclusion does not tell the whole story (p. 313). After examining the GAO's findings and using the same IRS data used by the GAO, he concluded the GAO understated the worldwide effective tax rates of U.S. corporations by, among other things, focusing on 2010, when rates were distorted for various reasons. He says that when the GAO analysis is extended to 2004-2010, the tax rate for all U.S. corporations was more than 35 percent.

Jasper Cummings, Jr., discusses the challenge of trying to deduct the payment of an obligation assumed in a purchase of property (p. 281). Although there are several grounds for deductions, the authorities are confused, he writes, adding that the IRS's facts and circumstances approach adds to the confusion. Cummings tries to organize the capitalization rule and its exceptions into a checklist for determining if an assumed liability can be deducted when paid. ■

(C) Tax Analysts 2013. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

© Tax Analysts 2013. 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.