From the Editor:

The 15-Year Anniversary Of IRS Restructuring

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Fifteen years ago, Congress passed the Internal Revenue Service Restructuring and Reform Act (RRA). The RRA dramatically overhauled the IRS, ending its focus on geographical areas and limiting its enforcement powers. The act was hailed by its proponents as a means of reining in an agency that was out of control, and also forcing the Service to modernize its services and technology. But critics pointed out that the RRA hurt compliance, left IRS employees demoralized, and was based on uncorroborated testimony and anecdotes.

The RRA's successes and failures are being put in sharp focus by the exempt organization scandal at the IRS. Republicans have been hinting that another restructuring act might be needed to address the agency's failing customer service and lax (or worse) leadership. William Hoffman writes that many of those involved in the RRA consider the act a mixed blessing, and others point to declining employment and serious resource cuts as being behind many of the Service's problems today (p. 647). Many participants in the drafting and implementation of the RRA are critical of the IRS Oversight Board, which has not developed as Congress intended. Hoffman writes that the board was supposed to function like a corporate governance board, but instead participants feel that the board is simply a tool for the IRS to push for more funding. Some interviewed by Hoffman thought that the Service should return to its old geographic organization, which helped employees feel more accountable. Most participants thought that the IRS has dramatically improved its use of technology in the wake of RRA, but that the act did little to improve customer service, according to Hoffman.

The IRS is certainly in crisis, but it doesn't feel quite like the mid-1990s all over again. The 1998 act was the product of a bipartisan effort — it was passed by a Republican Congress and signed by a Democratic president. There is no such bipartisan consensus today. Democrats in Congress have become disenchanted with GOP-led investigations into the EO scandal, and the working relationship between Reps. Darrell Issa and Elijah Cummings, in particular, seems to have completely broken down (p. 662). The political atmosphere is unlikely to produce any kind of IRS restructuring, although many are holding out hope that President Obama's pick of John Koskinen for commissioner might lead to the agency reforming itself without ''help'' from Congress.

Hedge Funds

The IRS is not doing a very good job auditing hedge funds. In two articles, Lee Sheppard analyzes what the IRS is auditing (p. 635) and what it is not (p. 639). TEFRA and the difficulty in tracking straddles constrain the IRS's ability to adequately monitor large funds, she writes. She looks at the case of SAC Capital Advisors, which is now under investigation by the government. She also questions whether stuffing allocations, which are used by virtually every hedge fund, should be permitted at all.

Pharmaceutical Mergers

Mergers and acquisitions are nothing new in the pharmaceutical industry. The trend has been for drugmakers and developers to buy up smaller competitors for years. But Martin Sullivan looks at how inversions are becoming a much more important part of pharmaceutical M&A activity (p. 644). Perrigo Co., a Michigan-based healthcare provider, is merging with Elan, a Dublin-based biotechnology company. The resulting company will be an Irish firm with the name Perrigo. These types of inversions are becoming increasingly common and are undoubtedly tax motivated, Sullivan writes. He points out that drug companies can lower their effective tax rates dramatically by being based in Ireland or other low-tax jurisdictions. Pharmaceutical companies are now using these kinds of tax strategies as the basis for acquisitions, he says.

Commentary

The net investment income tax is a 3.8 percent tax imposed on the investment income of high-income taxpayers. The tax was a pay-for included in health-care reform and has been the subject of intense practitioner discussion. Richard Dees explores how the 3.8 percent tax will affect trusts and family businesses (p. 683). Dees presents 20 questions and answers on the new tax, 11 of which are in the first part of his special report. The first question and answer makes it clear that a trust can probably avoid the net investment income tax, as Dees clarifies over the course of the rest of the Q&A.

As tax equity financing for renewable energy projects has dried up, the green energy sector has looked to other sources of finance. Laura Hegedus explains that uncertainty exists about whether solar energy companies can use asset-backed securities (p. 701). She writes that demand for solar energy financing continues to exceed supply, but companies should be careful before bringing asset-backed securities to the market. Although there are still questions about whether solar-asset-backed securities can work, Hegedus predicts that the growing demand for financing will lead to the securities being introduced to the market.

City of Arlington was not a tax case, but it does contain an important clarification of the *Chevron* doctrine. In the case, the Supreme Court addressed whether the *Chevron* test applies to issues of statutory interpretation of the scope of an agency's authority to act. The Court held emphatically that it does. Patrick Smith writes that tax litigation will be affected by the Court's clarification of step zero, which is essentially an inquiry into whether the two-part test applies (p. 713). Smith discusses how *City of Arlington* might have changed some aspects of the *Mead* test. He argues that the multifactor analysis approach of the *Mead* test, which was unpredictable, has been eliminated by the Court.

Sun Capital has drastically altered the trade or business landscape for private equity funds, according to Lori McMillan (p. 721). She writes that the First Circuit holding means that funds can no longer be certain that they are not in a trade or business just because their income is passive. The holding will have a significant effect on treaties, she says. Substance will now trump form, and foreign funds will no longer be able to rely on a strategy of outsourcing the ''real work,'' she concludes. The hedge funds involved in the Sun Capital case have requested an *en banc* rehearing (p. 657).

In 1986 Congress fundamentally reformed the corporate income tax. The 1986 act was a landmark for tax reform and is the standard by which other reform efforts are measured. But Clint Stretch argues that another fundamental tax reform has taken place since 1986 — in the form of the cumulative changes made to the code during the 1990s and 2000s (p. 723). He traces the history of this second reform effort through the deficit reduction legislation of the 1990s and the tax cuts of the 2000s. He says that corporations should be concerned about what these changes mean for tax reform today. Corporate tax reform has seldom been unequivocally pro-business, he writes. Permanent changes that result in tax increases have been made, but the taxpayer-favorable elements have usually been temporary, he adds, concluding that businesses should not be so sure that today's corporate reform effort will lead to lower effective rates and a more business-friendly tax code.

Tax deductions taken by wrongdoers frequently are attacked by the media, even if they are permitted by the code. The SEC has come under fire for its long-standing practice of settling civil litigation without requiring defendants to admit guilt, which allows the defendant to take a deduction for whatever fines are paid. In response, the SEC chair has announced she will require guilt admissions in some cases. Robert Wood calls this a watershed development, questions the implications of this new practice, and breaks down *Fresenius*, a case in which the IRS challenged a medical device company's deduction for fines related to criminal and civil healthcare fraud (p. 733). Section 162(f) prohibits the deduction of some fines and penalties, but its scope has long been unclear. Wood advises practitioners and taxpayers to be careful about drafting their settlement agreements with the government.

In Of Corporate Interest, Robert Willens discusses the bad debt deduction and purchase money notes (p. 739). He analyzes a recent ILM in which the IRS permitted a bad debt deduction for a purchase money note that became worthless in the hands of the partners. He points out all of the net operating loss implications of the ruling and how taxpayers can benefit from a deduction if the note is created in the course of the normal active trade or business. ■