From the Editor:

Will Tax Fairness Issues Sink Romney?

By Jeremy Scott — jscott@tax.org

The stage is now set for 2012's showdown between President Obama and likely Republican nominee Mitt Romney. The withdrawal of his main challenger means that Romney has all but sewn up the Republican nomination and can now turn his attention to the president. But as tax day approaches, it is Obama who has come out on the offensive, attacking Romney's failure to disclose tax information and the GOP's resistance to higher taxes on the wealthy. While it is unlikely that Obama will make higher taxes on anyone the centerpiece of his reelection campaign, he does seem to think that Romney's wealth can be used to make voters uncomfortable with the Republican candidate.

Romney is opposed to raising taxes on the wealthy. Like most Republicans, he favors lowering rates for everyone, going beyond simply calling for a permanent extension of the Bush tax cuts. Conservatives argue that taxing the wealthy kills jobs and hinders capital creation. Martin Sullivan agrees — in part. While there are good economic reasons for the government to keep its hands out of the pockets of the rich, issues of tax fairness should be allowed to trump economic efficiency in some cases, Sullivan writes. He exposes several myths about the taxation of the wealthy, including the belief that the United States has the world's most progressive tax system and that there are limits to how much revenue can be raised by implementing something like the Buffett rule. (For Sullivan's analysis, see p. 251.)

Romney's resistance to taxing the rich doesn't enjoy the support of most voters. Recent poll data indicate that there is strong support for raising taxes on high-income individuals, according to Bruce Bartlett (p. 361). A December Pew poll found that 57 percent of Americans believe that the rich don't pay their fair share, up from 51 percent in 2003. Bartlett believes that this will pose trouble for the GOP in the fall and in the future. If Romney loses to Obama, it could change the political dynamics in Congress pretty quickly, he writes. Obama might be strengthened enough to resist an extension of the Bush tax cuts.

Republicans have always shrugged off poll data showing that Americans favor higher taxes on the rich. The reason is that voters typically punish politicians who are in favor of *any* tax increase much more than they reward lawmakers for pushing popular tax hikes. In other words, it is much more dangerous for Democrats to emphasize their support for higher taxes on the wealthy because Republicans can always simplify the question to whether their opponents support tax increases or tax reduction. And for the last 30 years, the party in favor of tax cuts has owned the high ground on taxes with the American electorate.

Tax Season

The 2012 tax season for individuals will conclude on April 17. Because April 15 fell on a weekend, taxpayers received two more days to complete their tax returns. Originally, taxpayers did not have quite so much time, Joseph Thorndike writes. Thorndike looks at how April 15 came to be a national anti-holiday, and he recaps the factors that led Congress to give taxpayers (and the IRS) an extra month to prepare their returns. The history of April 15 is an example of a rare coincidence of interest between taxpayers and the tax administrator. (For Thorndike's article, see p. 247.)

The 2012 tax season was plagued by problems with the IRS's attempts to roll out new technology, but on the whole it went smoothly, William Hoffman writes. The modernized e-filing system and new requirements helped boost the e-filing rate. The IRS was also spared from having to implement last-minute changes to the tax law, as Congress refrained from making significant changes at the end of 2011. With the Bush tax cuts expiring at the end of 2012, it is likely that the 2013 season will be extremely challenging for the agency, and possibly for taxpayers as well. (For full coverage of tax season, see p. 248.)

1986 Revisited

Our 40th anniversary retrospective has reached 1986, one of the momentous years for tax policy. Tax reform, which is just a myth today, was then a reality, as a divided Congress and Republican president were able to agree on sweeping changes to the tax code. One of the most significant changes in the 1986 act was the end of the *General Utilities* doctrine.

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The doctrine allowed corporations to avoid recognizing gain or loss on the liquidating distribution of property to its shareholders. Fearing that Congress might miss the opportunity to end the doctrine, George Yin wrote a piece listing all of the arguments in favor of preserving *General Utilities* and found fault with each (p. 301). He wrote that Congress should not pass repeal by and that ending the doctrine would promote equity and simplicity. In a rebuttal to Yin's article, James Gould, an aide to Lloyd Bentsen, argued that Congress should pass up the opportunity to repeal the doctrine (p. 312). He believed that repeal would drastically increase the tax rate on sales and distributions during corporate liquidations, which would be inconsistent with tax reform. Gould wrote that repeal would provide a disincentive to incorporation. In the end, Congress did repeal *General Utilities*, but Gould was proven right: The corporate form of business is rapidly being replaced by passthroughs.

The implications of the 1986 act were far reaching, and shortly after its passage, Bernard Wolfman summarized the effects of reform on subchapter C (p. 316). In addition to discussing the ramifications of the act, Wolfman lists several recommendations to Congress, including narrowing the distinction between dividend and non-dividend distributions.

In an article adapted from remarks made during the November 2011 meeting of the National Tax Association, Charles McLure argues that renewed interest in the 1986 act by prospective reformers today needs to be tempered by knowledge of how the impossible became inevitable (p. 345). He concludes that the polarization present today, which was absent in 1986, will make a repeat of the 1986 reform effort difficult.

Commentary

The low market interest rates that have been a constant feature during the recession and its aftermath require special debt instruments. Since 2008 issuers have devised several new principal-protected structured notes to accommodate investors' needs. According to Omri Marian and Andrew Moin, challenging tax questions have been raised by the new types of notes, particularly those that involve fixed-to-floating rates, range accrual debt, and callable step-ups (p. 323). There are several ambiguities in the regulations dealing with variable-rate and contingent payment instruments that need clarification, particularly in this market, the authors write. The counterintuitive results from the regulations are probably explained by the fact that the guidance was drafted for a much different market, they conclude.

Starting this spring, brokers have begun to report stock basis to the IRS. Technology has made that possible, but the government's increased focus on information disclosure (shown also by FATCA and UTP reporting) explains why Congress sought to require this new reporting. Steven Rosenthal discusses the new reporting and highlights how the information reports were created and the issues being raised by stock basis disclosure (p. 353). Congress required brokers to report basis to help taxpayers calculate their gains and losses and to help the IRS verify those calculations, according to Rosenthal. The reporting requirement was based on the assumption that brokers could send those reports efficiently, something that hasn't necessarily happened, he concludes.

Distrust of the financial sector in the wake of the 2008 meltdown has led many tax administrators and policymakers to criticize some financial instruments as being unsafe or instruments of tax avoidance. Prepaid forward contracts are among the most heavily attacked, primarily because many have been used in shady tax-motivated transactions. But not all prepaid forward contracts are bad, Robert Wood writes (p. 365). Although they may seem like smoke and mirrors, many prepaid forward contracts are entitled to favorable treatment, he writes. He analyzes the government's recent victory in *Anschutz* and concludes that there will probably be a great deal of uncertainty in the wake of that Tenth Circuit decision.

In a practice article on p. 337, Sean Mullaney discusses Notice 2012-15, the government's latest guidance on cross-border section 304 transfers. He finds problems with the potential overlap between sections 304 and 367 and notes that the three regulation packages from the government have done little to clarify those concerns. When regulations are issued under Notice 2012-15, the government hopefully will provide examples illustrating this complex area of the tax law, he says. ■

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