From the Editor:

Healthcare, Massachusetts, Mandates, and the IRS

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The Pennsylvania primary is about a month away, and it may (or may not) put us closer to knowing whether Hillary Clinton or Barack Obama will be the standard-bearer for the Democrats in this fall's presidential election.

But whatever the outcome in the Keystone State (and Indiana and North Carolina, which follow a few weeks later), we know that the eventual Democratic nominee will run on a platform that includes reforming the U.S. healthcare system to reduce the number of Americans without health insurance.

The details vary, but both candidates have proposed reforms that look a lot like the system that Massachusetts adopted two years ago. Our cover shows then-Gov. Mitt Romney signing into law a sweeping reform bill that requires everyone in the state to have health insurance.

To get a head start on the coming policy debate about healthcare reform, Marty Sullivan examines the Massachusetts system, particularly its use of mandates to require individuals to purchase health insurance and employers to offer and help pay for employees' health insurance.

Proponents of the Massachusetts system as well as of the candidates' plans don't like to talk about mandates, because of the discussion of what "stick" will be used to enforce them. The stick may be called a penalty, or a surcharge, or a contribution, but its compulsory nature makes it sound like a tax. Not surprisingly, the candidates' plans are vague about mandates, but in Massachusetts, they are backed by tax penalties and enforced by two state agencies that collect taxes.

Sullivan says that mandates mean taxes and will add a compliance burden for individuals and employers. So if they're taxes, that means the tax collector must be involved. Sullivan says that if the Clinton or Obama proposals "do not use the IRS to enforce their mandates, they will have to construct an agency that performs similar functions and exercises similar powers" (p. 1271).

Tax Reform

At an American Enterprise Institute forum last week, Douglas Holtz-Eakin, former Congressional Budget Office director and now a campaign adviser to John McCain, said that healthcare reform and other issues, like energy and the alternative minimum tax, will push legislators to reform the tax code. However, Jonathan Talisman, former Treasury assistant secretary for tax policy, said that reform efforts may be difficult because of budget deficits, entitlements, and economic uncertainty (p. 1276).

Reform also came up at an Urban Institute conference on the earned income tax credit. The moderator noted that whether a Republican or a Democrat wins the presidency, "we are approaching a 'cracking point' in tax policy, and we will need to look across the board for solutions." Whether Congress decides to look at the EITC as part of reform efforts is anyone's guess, but participants in the conference argued that the EITC is a cost-effective means of providing assistance to low-income taxpayers (p. 1274).

Congress is in recess right now, but negotiations continue over the farm bill's spending framework and tax provisions. The House and Senate agriculture committees developed the $10 billion spending framework, but Republicans on the Senate Finance Committee said the framework had pulled back several agriculture and energy tax incentives. Finance Chair Max Baucus has said the proposal is "dead on arrival" because it doesn't spend enough on a disaster relief fund (p. 1277).

In other congressional news, GOP House taxwriter Thomas Reynolds announced last week that he will retire at the end of this session. Reynolds is the sixth GOP member of the Ways and Means Committee to announce his departure (p. 1277).

IRS Security

The Treasury Inspector General for Tax Administration released a report last week on IRS database security, and the news wasn't good. The report says that even though the IRS has security measures in place, it isn't vigilant in monitoring and enforcing security throughout the agency. The report concludes that until improvements are made, sensitive taxpayer data will not be "adequately protected from security breaches" (p. 1278).

More on 'Its'

The recent proposed regs on foreign base company sales income have generated a lot of discussion about the definition of "its" as used in section 954(d)(1). (See, e.g., *Tax Notes*, Mar. 17, 2008, p. 1249, for two letters on the subject.) In news analysis this week, Lisa Nadal traces the use of "its" to get some contract manufacturing arrangements out of subpart F. Now that the IRS says that the "its" defense is not and never was a correct reading of the statute, Nadal also looks at what that will mean for taxpayers who relied on the defense in structuring contract manufacturing arrangements long before the proposed regs were issued (p. 1280).

In other news analysis, Kristen Parillo revisits *Cudd Pressure Control Inc. v. The Queen*, a 1998 Canadian case that said a U.S. company could not deduct notional rent in computing net profits attributable to the company's permanent establishment in Canada. Tax officials from the United States and Canada are now discussing whether *Cudd* will remain good law once the fifth protocol to the Canada-U.S. treaty is ratified and takes effect (p. 1287).

The IRS Large and Midsize Business Division last week released a coordinated issue paper that says stock-based compensation is an intangible development cost to be included in the pool of costs to be shared in a qualified cost-sharing arrangement. The paper also repeats the IRS's position in *Xilinx*, which is currently on appeal in the Ninth Circuit. That case, however, predates the current regulations, and one practitioner said he was surprised the IRS would reiterate its position (p. 1283).

Do-Over for Deferred Comp?

In our first special report this week, Prof. Michael Doran says final regs under section 409A are "irreparably and inexcusably flawed." Even the statute itself is unsound, he says, and the outlook for legislative correction isn't promising. Accordingly, Doran says the better approach is to withdraw the regs and start over (p. 1311).

Stimulus

President Bush signed the stimulus bill in February, and that legislation is the subject of two articles this week. In a special report, Prof. Michael Watts discusses the stimulus bill's bonus depreciation provisions. He also provides revised modified accelerated cost recovery system tables that reflect the 50 percent bonus depreciation (p. 1317).

The stimulus package also authorizes tax rebates to individual taxpayers, and the IRS recently announced that direct deposits of the rebates will begin in early May and paper checks will follow soon after. Prof. Stanley Veliotis says that's inefficient and that there's a better way to pay those rebates. He suggests integrating the rebate with the Form 1040. See p. 1325 for his proposal.

More Commentary

Charles Kingson recommends changes to the earnings stripping rules in the latest installment of his series of Shelf Project proposals on the U.S. international tax rules. He says the rules that limit the deduction for interest paid by domestic corporations to foreign owners to the extent the owners are exempt from U.S. tax should be extended to U.S. owners (p. 1329).

United Airlines recently announced a special distribution but told its shareholders it doesn't yet know if it will have sufficient earnings and profits for the distribution to be a dividend. Robert Willens looks at the issue and the tax consequences in Of Corporate Interest (p. 1331).

In a practice article, Robert Wood discusses constructive receipt of income and ways to avoid it when executing settlement agreements (p. 1307). And finally, attorneys for Countryside Limited Partnership, in a letter to the editor, respond to an article by Lee Sheppard and clarify the status of their client's litigation with the IRS (p. 1333). ■

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