From the Editor:

Talking Tax Reform — And Stimulus, Too

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We know there are pressing problems — like a recession to ward off — but allow us a minute to talk about tax reform.

We expect next year will be a big year for tax policy. A new president and a new Congress will face many tough choices about taxes. Should the Bush tax cuts be extended, allowed to expire on schedule, or killed outright? What should be done about the estate tax? Should the corporate rate be cut? Should the United States adopt a national consumption tax?

Those are big questions, and most of this year, policywise, will be devoted to analyzing those questions, so the answers in 2009 will be arrived at more easily. For example, House Ways and Means Chair Charles Rangel's tax reform bill, proposed last fall, will probably go nowhere this year. But there will be lots of hearings on it, and those hearings could clear the path for the bill in the next session.

Others are laying the groundwork for reform as well. Treasury recently released a report on global competitiveness that raises three possible alternatives to reform the corporate income tax. One of the options is to adopt a territorial system, and another is to adopt a business activities tax — a subtraction-method VAT — that Treasury dismisses as too disruptive to the economy.

But Michael Graetz, a law professor at Yale, doesn't think a VAT would be too disruptive. ''It's not a crazy system if you look around the world,'' he told students at Columbia last month. What he thinks is crazy is that the United States doesn't have a ''business-to-business consumption tax at the national level as a matter of policy.'' As he lays out in his new book, *100 Million Unnecessary Returns*, a VAT could lower the corporate tax rate and allow the United States to exempt millions of individual taxpayers from the income tax.

But is the United States ready to adopt a national consumption tax? Proponents of the FairTax think it is, so why not a hybrid VAT/income tax system? It's a great question, but maybe the country and its policymakers aren't ready for the answer. Maybe next year.

Lee Sheppard isn't afraid to raise tough questions, and she delves into Graetz's book along with the Treasury report and another new book, *Free Lunch*, from *New York Times* reporter David Cay Johnston. See p. 359 for her analysis of all three.

Stimulus

Back to the present, where things aren't looking so hot for the U.S. economy. Rumblings about some sort of stimulus package began late last year as the mortgage crisis deepened, but worrisome economic indicators this month have grabbed Washington's attention. And everyone — from Congress to President Bush to presidential candidates — has turned their attention to pushing a stimulus package. Last week Bush outlined what he says a stimulus package has to have to meet his approval. He wants a package of around $140 billion, or 1 percent of GDP, and wants it to consist of tax relief. Democrats want a mix of tax breaks and spending and indicated they are willing to suspend pay-as-you-go rules for a stimulus package (p. 355).

One thing that probably won't stimulate the economy is an increase in the federal gas tax, especially while prices at the pump are still high. However, the National Surface Transportation Policy and Revenue Commission recommended increasing the tax by 25 to 40 cents a gallon to pay for a massive reinvestment in transportation infrastructure. The proposal is probably dead on arrival; Finance Committee Chair Max Baucus and ranking minority member Chuck Grassley are both against it. Grassley predicted most members of Congress would ''toss that recommendation right in the trash'' (p. 357).

APA Report Mystery

Back in 2003, the Finance Committee started an investigation into the IRS advance pricing agreement program. The details of the investigation were never that clear, but a draft report was supposed to be completed in June 2005. Now that the calendar says 2008, Lisa Nadal wondered what happened to the report. She's still wondering. Baucus and Finance wouldn't respond when asked, so we can only surmise that the report has died. But did it die of neglect or was it killed (p. 366).

Conversation

Robert Carroll, the former deputy assistant secretary for tax analysis, recently left Treasury for the Tax Foundation. In an exclusive interview, Carroll sat down with Joann Weiner to discuss his experiences at Treasury and his views on tax reform, including current proposals and a VAT (p. 379).

Other News

The IRS last week released statistics that its stepped-up enforcement efforts in fiscal 2007 netted $10 billion more revenue than in the previous year. The gain was attributed to increased audits of individuals, partnerships, and S corporations (p. 372).

Remember the IRS investigation of All Saints, a California church, and a sermon preached there right before the 2004 election? The IRS closed the investigation without revoking the church's tax-exempt status, and that result has led a Wisconsin minister to challenge the IRS's interpretation of the part of section 501(c)(3) dealing with prohibited political campaign intervention. The minister took out an ad in *The Wall Street Journal* and posted a video of a sermon he gave on the eve of the 2006 election. ''All Saints was brave enough to call your bluff, and now we will too,'' he wrote in the ad. Stay tuned (p. 378).

Commentary

In a practice article, Robert Wood discusses structured attorney fees. While the 1994 *Childs* case settled many of the questions about the tax treatment of those fees, Wood looks at some developments from the last few years that should be considered when dealing with a structured attorney fee arrangement (p. 401).

Prof. Karen Burke analyzes the Sixth Circuit's decision in *Hubert*. The case deals with whether limited liability company members are at risk for the LLC's state-law recourse obligations. The Tax Court had determined that the LLC members' deficit restoration obligations didn't give rise to amounts at risk under section 465. The Sixth Circuit vacated the Tax Court opinion, concluding the Tax Court hadn't considered whether the LLC members would be on the hook for the obligations in the worst-case scenario. See p. 405 for Burke's special report.

In our first viewpoint this week, David Brunori notes that few government reports are read very closely by members of Congress or their staffs. National Taxpayer Advocate Nina Olson's annual report, the release of which headlined our coverage in the last issue, deserves to be read and, in some cases, applied, according to Brunori (p. 421). We agree wholeheartedly.

The second viewpoint, from Thomas Cullinan and Julie Bowling, critiques the opinion from the Court of Federal Claims in *Jade Trading*. The decision doesn't sit well with Cullinan and Bowling because, they say, it applies penalties against the partnership based on positions taken by the partners on their individual returns yet doesn't allow the partners to present defenses to the penalties (p. 422).

In Of Corporate Interest, Robert Willens analyzes Temple-Inland's planned restructuring to break off its banking and real estate operations from its manufacturing company (p. 429).

In letters, Michael Murphy writes that the IRS got it right when it canceled a previous chief counsel notice that had concluded that tax reconciliation workpapers were not tax accrual workpapers or audit workpapers (p. 433). In another letter, Christopher Hesse writes in response to a statement Prof. Calvin Johnson made in a Shelf Project proposal (*Tax Notes*, Jan. 14, 2008, p. 321) about Congress acting rationally to subsidize transactions through the federal budget. Hesse disagrees, saying that the tax code should be reserved for raising revenue and social programs should be put in appropriations (p. 433).

Sad News

We learned last week that Michael Saltzman, a partner at White & Case, New York, died on January 5. A successful litigator, Saltzman's biggest contribution to the tax world was *IRS Practice and Procedure*, which is *the* book on practice before the Service (p. 380). Our condolences go out to his family and colleagues. ■

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