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From the Editor:

Are Some Taxpayers Stuck Between a Rock and a Hard Place?

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The severe economic downturn of the past two years has created many difficulties and challenges to a large portion of the U.S. population, as well as for businesses. On top of the financial strain borne by many in the form of unemployment, faltering mortgages, and credit workouts that force individuals into a vicious cycle of debt, some taxpayers who owe the IRS appear to have learned the hard way that Uncle Sam can be a hard-line debt collector. The national taxpayer advocate's annual report to Congress emphasizes the harshness of IRS lien practices regarding delinquent taxpayers and argues that the lien process lacks specificity and fails to provide good results. (For coverage of the annual report, see p. 143.)

The Taxpayer Advocate Service found that in the past 10 years, the IRS increased its lien filings by almost 475 percent while revenue collected during the same period declined by 7.4 percent, in inflation-adjusted dollars. In some cases, lien filings did not attach to any specific property or assets of taxpayers and were executed in a rushed manner by IRS employees, the taxpayer advocate's report states. A lawmaker expressed disappointment that Treasury and the IRS seem to give more time, consideration, and discernment to the financial distress of banks that are ''too big to fail,'' than to the little guys — individual taxpayers and small businesses. The taxpayer advocate's report recommends requiring managerial approval for the imposition of liens against taxpayers with no assets and that automatic, computer-generated lien filings be eliminated for some ''currently not collectible'' hardship accounts. These automatic liens remain on taxpayers' credit reports for many years (and in some cases, permanently), putting the taxpayer at a severe disadvantage in the pursuit of a job, financing, housing, or insurance and furthering a downward spiral with no substantial likelihood of payment of the tax owed.

In fairness, the IRS faces every creditor's predicament: whether to file a lien and ensure priority in case a taxpayer eventually acquires assets or an income stream, or not to file so as not to cause credit harm, thereby increasing the chance that a taxpayer will obtain gainful employment and voluntarily pay the tax owed. Perhaps to increase compliance and the chance of ultimate payment, the IRS can adopt certain aspects of the sometimes more holistic approach of other countries' tax administrations, which consider a taxpayer's overall debt picture and collect tax debts in unison with other creditors and in proportion to other outstanding debt.

This week Martin Sullivan discusses the rationale behind tax extenders and the budgetary effects of a perpetual extension of expiring tax cuts that for all substantive purposes are permanent, and argues that all tax provisions should be treated as permanently extended. He also proposes two approaches to limit the repeated extension of expiring provisions. For Sullivan's analysis, see p. 139.

Lee Sheppard provides an in-depth analysis of the latest district court decision in *Castle Harbour* (see p. 131). The author examines the ambits of section 704(e) and challenges the proposition advanced by the district court that it supplants *Culbertson*. She posits that if the district court is correct, Congress ought to act to limit 704(e)'s reach. Otherwise, the section would be invoked to condone tax shelters involving partnerships.

Commentary

The IRS has surprised many in the business community with its recent interest in how corporate governance practices influence tax compliance. Commissioner Douglas Shulman's goal seems to be to encourage corporate boards to take a more active role in managing taxes and disclosure. Shulman's recent speech to the National Association of Corporate Directors initiated a conversation with corporate boards in an effort to promote broader transparency and influence the management of tax risks, according to John Klotsche, Neil Traubenberg, and Tracy Hollingsworth. In their special report on p. 191, the authors analyze the data from a survey they designed for the Manufacturers Alliance/MAPI. The survey targeted the tax executive membership of the group and revealed several interesting facts about how the membership viewed the IRS's role in corporate governance and tax risk management in general. Although an overwhelming majority of the tax executives surveyed thought it was inappropriate for the IRS to become involved

in companies' tax risk management or governance, the authors conclude that this can be a win-win process for both parties.

The possibility of a U.S. VAT has increased over the last few years. The likelihood of the federal government turning to some form of consumption tax to ease deficit and debt-to-GDP concerns is now so high that the national taxpayer advocate addressed the administrative issues raised by a VAT in her annual report to Congress. Any attempt by Congress to impose a VAT, however, is likely to cause a political firestorm and ignite furious opposition. Count Amity Shlaes among the opponents of a European-style VAT. Shlaes is convinced that VATs only serve to promote the rise of black market economies and decrease productivity (p. 251). She writes that in the 1970s, Europeans worked more hours than Americans, but by the 1990s Americans' work hours exceeded Europeans' by more than 50 percent. Shlaes concludes that the United States can do without the negative effects of a VAT and warns that such a tax will only increase cynicism among taxpayers and slow down economic growth as more energy is diverted into off-the-books activity.

Section 956 is a sweeping provision in the code that defines when the assets of a controlled foreign corporation used as security for a related U.S. person's debt cause income inclusion for U.S. shareholders of the CFC. Kimberly Blanchard writes that beyond the basic rule, section 956 is often unclear and entangles transactions that do not implicate the policy concerns addressed by the section (p. 201). Even though the IRS is aware of these problems with section 956, guidance is not forthcoming because the Service believes only Congress can fix it. Blanchard disagrees, finding that the statute gives the IRS very broad regulatory authority. She believes that the Service can issue guidance to address most of the problematic fact patterns. Her special report uses several sets of examples to describe issues that arise under section 956 and suggests several alternative items of guidance that could reduce uncertainty. Blanchard concludes this guidance is necessary because the collapse of the credit market has made lenders insist on increased security from borrowers.

The estate tax is likely to be the next major tax issue tackled by Congress once healthcare reform is complete. Democrats have signaled that they intend to pass an estate tax bill that will be retroactive, wiping out the lapse of the tax that took effect at the start of 2010. The prospects of such a law have already caused some debate over its constitutionality. Mitchell Gans writes that a retroactive estate tax fix will probably be constitutional based on the Supreme Court's decision in *Carlton*. However, this result is far from certain because the *Carlton* opinion considers the retroactivity of a bill involving an old tax versus a new tax. If the Court considers the estate tax a new tax because of its 2010 lapse, a retroactive fix may not be constitutional, according to Gans. He believes there is a simple solution to this issue and recommends that Congress use a severability provision. In a separate article, Naomi Goldberg and Michael Steinberger write that the House-passed estate tax bill will not provide relief to same-sex couples. The authors address several proposals in Congress that would change the definition of a couple in estate tax law. (For Gans's analysis, see p. 222. For Goldberg and Steinberger's article, see p. 221.)

A key provision in both the Senate and House healthcare reform bills concerns the penalty applied to individuals who fail to purchase health insurance. The Senate bill was subjected to a point of order by Republicans who questioned the penalty's constitutionality. Rodney Mock and Jeffrey Tolin address whether the penalty constitutes a tax and, if it does, whether it is an unconstitutional regulatory tax (p. 224). This week's Shelf Project by Calvin Johnson proposes eliminating capital gains treatment for the sale of an asset by that asset's creator. In Johnson's view, such a sale is more properly characterized as compensation for services (p. 233). Robert Wood analyzes California's tax system and lists 10 things that all practitioners should know about the Golden State's labyrinthine code (p. 247). Robert Willens looks at "cash-rich" split-offs in Of Corporate Interest on p. 243. ■

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