From the Editor:

Republicans Push Ahead With Healthcare Repeal Efforts

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Chief Justice John Roberts's surprise support for the individual mandate in the healthcare reform law has continued to reverberate through the political world. In the wake of the divisive healthcare decision, pundits have struggled to figure out whether President Obama or Mitt Romney benefitted more from the healthcare law being upheld. On the one hand, Obama's signature achievement was preserved. But the law's unpopularity means that Roberts's decision has kept a major issue alive for the president's Republican opponent, allowing the GOP to dream of a repeat of 2010, when healthcare reform contributed to a large enthusiasm gap between conservative and liberal voters.

Congressional Republicans have wasted no time going on the attack, reminding voters of the unpopular provisions in the upheld law. House Speaker John Boehner plans to hold a vote July 11 to repeal the law. While repeal will pass the House easily, it is unlikely that it will even be taken up by the Senate. Senate Minority Leader Mitch McConnell pointed out last week that because the Court found that the mandate was a tax, it could be repealed through reconciliation. That means that Republicans would need only 51 senators (or 50, if they defeat Obama) to undo the tax portions of Obama's healthcare law. Democrats criticized McConnell's interpretation, which was odd considering they were forced to use reconciliation to pass portions of the law in the first place. (For coverage, see p. 144.)

The unpopularity of healthcare reform is likely to play a much larger role in congressional campaigns than in the contest between Obama and Romney. Romney's support of a mandate during his time as governor of Massachusetts limits his ability to make his challenge to Obama centered on the president's position on healthcare. But that won't spare Democratic representatives and senators in swing districts and states from being attacked for their support for the law. Healthcare reform played a major role in Republicans retaking the House in 2010, and it is likely that it will again hamper Democratic efforts to hold the Senate and preserve competitive House seats. Until public opinion on the law changes or the furor over the mandate cools, Democratic candidates will continue to wear Obamacare like a hair shirt.

Foreign Tax Creditability

The United Kingdom has a windfall profit tax on privatized utility companies. The tax has recently caused controversy at the IRS and in several circuit courts. The question is whether the windfall tax should be creditable under section 901. The Fifth and Third circuits disagreed. In her analysis of the decisions, Marie Sapirie points out that the Third Circuit used a mechanical framework, while the Fifth Circuit decided to consider the purpose of the tax. The opinions heavily rely on different interpretations of the predominant character standard, according to Sapirie. She notes that if the textual approach to the predominant character standard is correct, the decisions raise fundamental questions about the creditability of foreign taxes. (For her analysis, see p. 139.)

Commentary

There is a lot of focus in Washington on corporate tax reform. House Republicans and Obama have plans that would lower the corporate rate, while broadening the base to ensure revenue neutrality. Business lobbying groups have been pushing for a territorial system without stringent antiabuse provisions. There is a strong sense that votes might occur on corporate tax reform in 2013. While most would-be reformers are calling for broad-based corporate tax cuts, Michaele Morrow, Robert Ricketts, and Larry Tunnell suggest that a targeted reduction of the U.S. corporate tax through an increase in the domestic production activities deduction might reduce prospective revenue losses and allow more effective reform (p. 181). They write that it is even possible that an increased deduction would result in higher individual income and FICA taxes, giving their proposed reform a positive revenue result. An increased domestic production activities deduction would also encourage companies to focus investment in the United States, helping the economy to recover from the job losses of the last few years, they conclude.

The IRS has touted the success of its offshore voluntary disclosure initiatives. The agency claims that it has brought thousands of taxpayers back into compliance with the tax code and has helped curb offshore tax evasion. But the one-size-fits-all approach of the initiative's penalty structure makes it a poor choice for many Americans living overseas, according to Steven Mopsick (p. 189). Mopsick argues that it is bizarre that the United States is still tied to a citizenship-based taxation model. If the IRS enforces the 27.5 percent penalty in the programs, then taxpayers could make a successful Eighth Amendment challenge. The rules make no sense, he writes. Mopsick concludes that the IRS is driving more people underground with its enforcement of FATCA and FBAR penalties.

In *Dunlap*, the Tax Court found insufficient evidence of value for the taxpayers' charitable contribution of a facade easement. Wendy Gerzog analyzes the decision in Estate and Gift Rap and writes that expert testimony is the key to establishing valuation in those types of cases and that the testimony in *Dunlap* was insufficient (p. 199). The taxpayers' experts did not use comparable sales figures when computing the value of the easements and did not explain the nature of the restrictions, according to Gerzog. She argues that an expert must use an acceptable valuation method as defined in regulations and then provide data that reasonably explains the diminution in value caused by the granting of the easement.

It is rare for the IRS to argue that equity is actually indebtedness. The argument is usually rejected by courts. However, *Hewlett-Packard* was an exception to that trend, with the government successfully recasting preferred stock as debt instruments. Robert Willens points out that enterprising taxpayers are likely to use the decision against the IRS in the future (p. 209). The government could have achieved the same objectives by contending that Hewlett-Packard did not hold the instrument long enough to earn foreign tax credits, Willens writes. The court would have been receptive to an argument that HP had both an option and an obligation to sell, he concludes.

The compensation paid to shareholders in S corporations raises serious tax questions. The distinction between dividends and salary can be very significant given the preferential tax rates currently in place for dividends. A recent decision by Judge Posner in *Mulcahy* sheds new light on both sides of the compensation issue, according to Robert Wood (p. 205). S corporations seek to characterize compensation as dividends, while C corporations prefer to have deductible salary, which avoids double taxation, Wood writes. While Posner's opinion is very fact-specific and doesn't radically change the corporate tax landscape, S corporations might still find some support in it for paying small salaries, Wood writes. Taxpayers should continue to adequately document their compensation agreements, while paying close attention to reasonableness, he concludes.

The IRS's successful war on tax shelters has changed the tax practice landscape over the last 15 years. Through the use of expanded penalty provisions and aggressive litigation strategies, the government has been successful in sharply curtailing many abusive transactions. In 1999 David Hariton wrote an article arguing that not all transactions with favorable tax outcomes are tax shelters (p. 169). His special report detailed the daunting task facing Congress as it attempted to define tax-motivated transactions and suggested statutory language that would not be overbroad.

Kenneth Orbach responds to an article by Tom Daley on the Tax Court's decision in *Bailey* on p. 196. Orbach analyzes how the court interpreted the passive income limitations in section 469 and finds the opinion in *Bailey* unpersuasive. (For Daley's take on the case, see *Tax Notes*, Apr. 30, 2012, p. 655.) ■