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From the Editor:

Romney Continues Fight Against Return Disclosure

By Jeremy Scott — jscott@tax.org

Despite mounting criticism from both Democrats and his Republican allies, Mitt Romney continued to resist releasing additional tax returns last week. Although Romney might ultimately decide to disclose more information about his financial position and his taxes, he remained defiant through press time. Despite his intransigence, it is hard to imagine that he would not ultimately release something — anything — to put the issue behind him.

So far the lack of financial transparency has not hurt the Romney campaign that much. President Obama and other groups have hammered the Republican candidate over his failure to release more tax returns and his ties to Bain Capital. Obama has attempted to paint Romney as a proponent of outsourcing, and in a speech in Ohio, he claimed that Romney supported a plan that would result in 800,000 jobs moving overseas. The attacks, however, have not sunk Romney's chances to unseat the president. In fact, polls showed the race remained tight, with a few even showing Romney in the lead nationally. The race also remained a tossup in key states such as Ohio, Michigan, and Florida, and Obama's lead in Virginia has largely evaporated. (For coverage of the Obama speech, see p. 367. For coverage of the Romney return issue, see p. 364 and p. 366.)

Many political pundits have been surprised that Obama has not been more successful at tying Romney to Bain Capital. The flurry of attack ads criticizing Romney as an outsourcer of jobs has not really improved the president's standing in the polls. Obama's assertion that Romney favors moving 800,000 jobs overseas might have fallen flat because of its disingenuous nature. The president's criticism was based on a report in *Tax Notes* by professor Kim Clausing that argued that a territorial system would result in U.S. job losses unless it contained stringent antiabuse provisions. Romney, like many on Capitol Hill in both parties, favors a move to a territorial system. But no one, not even House Ways and Means Chair Dave Camp, is arguing for a pure territorial system. Even Obama himself supports aspects of a territorial system, and until last Monday he hadn't exactly been a vocal critic of corporate reform proposals that move the United States in that direction. (For an analysis of Camp's plan by Martin Sullivan, see p. 359.)

Romney's failure to disclose additional tax information leaves him vulnerable to charges that he might be playing fast and loose with tax rules. Critics might also infer that the former governor is abusing tax havens or even hiding assets offshore. Neither is particularly likely, but until Romney agrees to release more tax returns, he will probably continue to endure attacks from the president. Of course, given how ineffective those attacks have been so far, perhaps Romney might choose to hold back information in hopes that Obama will continue to focus on a lackluster campaign strategy that has kept the race close during the months when incumbents generally enjoy a significant advantage.

Partnerships

It is no secret that more and more business entities are being formed as passthroughs. The traditional C corporation is in decline, with only large, public companies still locked into the corporate tax's double tax regime. But the IRS remains focused on the declining corporate population, which dominates the CIC's continuous audit program. In fact, there is evidence that the Service might not be auditing large partnerships much at all. As the result of her investigation, Amy Elliott concludes that large, multitiered partnership structures are being insufficiently audited by the IRS. There are a number of reasons for the lack of attention to partnership audits, according to Elliott's sources. They mostly relate to the complexities of the notices required by TEFRA, which can tax the IRS's computer and personnel resources. Elliott argues that the IRS should be auditing partnerships more because there are many possible abuses being perpetuated by publicly traded partnerships, hedge funds, and private equity funds. (For her article, see p. 351.)

Subchapter K is complex, and it was made even more so by TEFRA. The calculation of a partner's share of partnership liabilities can be both difficult and contentious. Kenneth Orbach, Edward Schnee, and W. Eugene Seago analyze how to allocate partnership debt when a partner's share of the earnings and profits is not equal to its share of capital (p. 415). Their special report focuses on situations when joint participants structure their agreements like partners, rather than mere co-owners. In those situations, it is rare for shares of

earnings and profits to be allocated strictly according to capital contributions. The authors advise caution in drafting such agreements and discuss how the code requires debt to be apportioned.

The taxation of partnerships is also the subject of this week's 40th anniversary retrospective article. In a special report first published in 2001, James Sowell, then an associate tax legislative counsel, discussed situations in which an employee of a partnership can still be treated as an employee after receiving an equity interest (p. 395). He concluded that the rules in this area were unclear, and offered a proposal to more clearly characterize partnership income.

The Taxing Power

The Supreme Court's decision to uphold the individual mandate as a valid exercise of Congress's taxing power has caused many to ponder whether all effective limits on the use of the power have been removed. The House Ways and Means Committee recently held a hearing debating the implications of the decision, with Republican members skeptical that the Court had placed adequate checks on what Congress can do with its power to tax. In her article this week, Marie Sapirie looks at the state of the taxing power in the wake of the holding in *NFIB v. Sebelius*. She argues that the opinion seems to write the direct tax requirement out of the Constitution. She also speculates about what limits still exist on the taxing power and how Congress might use its newfound authority. (For her analysis, see p. 356.)

The healthcare reform law and its proponents, including Obama, went to great lengths to define the payment required under the individual mandate as a penalty and not a tax. Chief Justice Roberts noted the law's use of the term ''penalty,'' but still found that the mandate was a tax. Kip Dellinger speculates that the chief justice could only have reached that conclusion if he was taking advice from the Mad Hatter, the March Hare, and Humpty Dumpty. Dellinger writes that the Supreme Court's interpretation that the mandate was a tax, but still not subject to the Anti-Injunction Act, was strained. (For his article, see p. 445.)

Commentary

Congress has long attempted to discourage or prevent corporate inversion transactions. Many policymakers are convinced that inversions allow U.S. companies to dodge U.S. taxes simply by changing the nominal location of their headquarters. Section 7874 was enacted to stop this perceived abuse. Despite the section's enactment, inversion transactions and their benefits are still available, according to Bret Wells (p. 429). Section 7874 only obscures the fundamental design flaws in the tax system that allow inversions to result in income shifting, Wells writes. Congress should fundamentally reform the international tax system and acknowledge that section 7874 has failed to stop inversions, he concludes.

Medicare reform is likely to reduce the earnings of physicians. If the nation cuts back on healthcare spending, doctors might suffer. But physicians are already being harmed by successful attempts by the government to cut back on their compensation deduction, according to John Cergnul (p. 440). He looks at a recent Eighth Circuit decision in *Wilson* that gave support to the Tax Court holding in *Pediatric Surgical Associates*.

Charitable contributions to fire departments can prove as controversial in practice as donations of conservation easements, writes Robert Wood (p. 449). A recent Tax Court case involved a couple who donated their house to the fire department for training purposes. Even though the fire department benefited from burning the house down for training purposes, the court denied the couple a charitable deduction. Because the case was decided by the entire Tax Court, it may be the most important decision in this area, Wood says. In many cases involving these types of donations, the court seems to look at whether you were motivated by true altruism or just a desire to get rid of an eyesore, he concludes.

In Of Corporate Interest, Robert Willens discusses a technique to achieve a tax-free merger between a corporation and a partnership (p. 453). The key to ensuring tax-free treatment for the partners on their exchange of partnership interests for corporate stock is maintaining the integrity of the corporate partner to the business combination, he writes. The tax-free result depends on the new corporation not being seen as a mere continuation of the old corporate partner, he concludes. ■

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