Book Reviews

In each issue, JATA publishes reviews of textbooks and other books of interest to tax scholars. All book reviews are solicited by the Associate Editor. However, if you know of a book that you would like reviewed, or if you are interested in reviewing a book, then please contact the Associate Editor.

The Associate Editor is:

Carol M. Fischer
Department of Accounting
St. Bonaventure University
St. Bonaventure, NY 14778
Phone: (716) 375-2092
Fax: (716) 375-2191
Email: cfischer@sbu.edu


Taxation of International Transactions is an issue of the American Casebook Series. It comes with an accompanying Teacher’s Manual. This text has a rich ancestry. It started out as Taxation of Transnational Transactions decades ago, which was published by CCH, Inc. The first edition of this text was published in 1997, followed by the second in 2001. The newly updated third edition reflects developments through October 1, 2005. Richard Crawford Pugh has been part of the text all along. He was a Rhodes Scholar, a professor of law at Columbia University, a deputy assistant attorney general of the United States (Tax Division) and a senior partner in New York City with the international law firm of Cleary, Gottlieb, Steen & Hamilton before he joined the faculty of the University of San Diego. The text reflects each of the aspects in his professional career spanning about half a century—topics addressed from an academic, government, and private practice perspective. Charles Gustafson and Robert Peroni, distinguished scholars of international taxation in their own rights, contributed their insights.

The basic structure of the book has been the same since its first edition. The textual discussion, cases, rulings, and other materials are accompanied by problems designed to demonstrate the operation of the applicable provisions in both tax compliance and planning settings. The Teachers’ Manual contains sample solutions to each problem and frequently provides variations on a problem scenario for class discussion.

Chapter 1 provides an introduction and overview. It starts with background information including current statistics presenting the magnitude of international transactions that establishes the increasing importance of international commerce and investments and the resulting tax aspects. A discussion of the basic questions in designing a system for taxing
international transactions follows. This short but powerful section gives the student a big-picture view of designing a tax system and a frame of reference to return to. They discover the sources of complexities when international transactions meet tax rules that vary by jurisdiction due to different policies, or as Tip O’Neill used to say, “All politics are local.” The first chapter also addresses the role of income tax treaties, which rank equally with the Internal Revenue Code as primary sources of tax law.

Chapter 2 introduces the reader to the relevance of the source rules for income and deductions as well as different contexts of their application. What follows is a detailed analysis of the rules for income and deductions: interest, dividends, rentals and royalties, compensation for personal services, sale of real and personal property, special statutory and non-statutory solutions including electronic commerce, general rules for deductions, interest expenses, and research and experimentation expenses. It ends with reflections on source rules.

The following two chapters deal with “inbound taxation.” Chapter 3 teaches the reader when a foreign person or entity is engaged in a U.S. trade or business, or, differently put, required to file a tax return in the U.S., frequently the first question of a potential U.S. taxpayer. The chapter continues with determination of the amount to be taxed, the effect of treaty provisions, how the branch profits tax is applied and exceptions based upon foreign policy considerations. Chapter 4 covers the taxation of non-business U.S.-source income of foreign persons, the limited flat tax system in the current U.S. income tax law, and the tax withholding mechanism. It also addresses the decision of debt versus equity in financing a U.S. enterprise.

The next three chapters deal with “outbound taxation.” Chapter 5 provides an introduction to the intricacies of the complex foreign tax credit system, the tax exemption for certain U.S. taxpayers living and working abroad, and the role of tax treaties in mitigating the double taxation of U.S. persons and entities. In general, the taxation of the income of foreign subsidiaries is deferred until dividends are distributed to the U.S. parent company. Furthermore, foreign tax credits are limited in amount in order to prevent an erosion of the U.S. tax base. Chapter 6 guides the reader through the Controlled Foreign Corporation provisions and other anti-deferral regimes, which have been legislated in order to curtail abuse of the deferral principle. Chapter 7 leads the student through the rules determining foreign tax credit limitations: separate baskets, losses, and look-through rules.

The following three chapters apply to both “inbound” and “outbound” transactions. Chapter 8 is devoted to transfer pricing, the single most important international tax issue. It states the problem and the statutory response, followed by the most common approaches to arm’s length pricing for different types of transactions, concluding with the administration of transfer pricing issues. Chapter 9 illustrates the separate transactions method and the profit and loss method for foreign currency conversion. Chapter 10 lays out the rules dealing with international tax-free exchanges.

Chapters 11 through 13 deal with different types of “outbound” transactions with a focus on tax planning. These are the international sale of goods, exploitation of intangible property rights abroad, and direct investment abroad. The core of Chapter 11 deals with alternative arrangements for handling export sales into a particular foreign country including financing aspects. Chapter 12 presents the tax consequences for both licensing and the transfer of intangible property. It pays special attention to the tax aspects of transactions with related persons. Chapter 13 focuses on the comparison of direct investment abroad through a foreign branch versus subsidiary and discusses some aspects of international joint ventures.
Chapter 14 demonstrates the use of tax law to advance foreign policy objectives, such as international boycott and foreign bribery. Appendices A and B contain the 1996 U.S. Model Income Tax Convention and the accompanying U.S. Treasury Department’s technical explanation. The book also contains a detailed alphabetical index as well as tables of Internal Revenue Code sections, IRS Notices, Revenue Procedures and Revenue Rulings as well as the cases discussed in the text.

The text reflects the deep insights of the authors, combined with their special ability to communicate the complex area of the taxation of international transactions in a way that draws in the reader. I adopted the text for my graduate course Multi-Jurisdictional Taxation at Bentley College when the second edition was published in 2001. The course typically draws students from the graduate programs in taxation, financial planning, finance, accountancy, and business administration. While I do not assign all 1,000+ pages as course readings, I cover a significant portion of the book. Students’ feedback on this text has been positive all along.

This text is also a terrific resource for instructors of any courses in income taxation. The marketplace is increasingly global. An increasing number of business planning decisions require analysis of many international factors including taxation. Most textbooks for undergraduate and graduate tax courses include materials for course segments dealing with international taxation. As instructors adopt such course segments for the first time or update existing ones and prepare for teaching them, they will find this text immensely useful.

BRIGHTITE W. MUEHLMANN
Associate Professor
Bentley College


This is the second book in a series. The first book, Restoring Fiscal Sanity: How to Balance the Budget, was a moderately accessible discussion of three different models that would balance the federal budget by 2014. The authors themselves didn’t agree with all aspects of any of the models, but it gave a thoughtful look at three ways to balance the budget comparing a larger government that relies predominately on tax increases, a smaller government that relies on mainly spending decreases, and a more efficient government that keeps the budget about the same but changes the mix. The six chapters covered why deficits matter, the three alternative plans, national security, domestic spending, the aging population, and meeting the revenue challenge. The contributors were Henry J. Aaron, Lael Brainard, William G. Gale, Ron Haskins, Michael O’Hanlon, Peter R. Orszag, Alice M. Rivlin, Isabel Sawhill, and Charles Schultze. It was a thought-provoking look at possible trade-offs and necessary sacrifices that would need to be made in order to balance the budget.

The second book expands on the first one. In addition to the editors, Henry J. Aaron, William G. Gale, Ron Haskins, and Peter Orszag return and are joined by Jack Meyer, Rudolph Penner, John Shoven, and C. Eugene Steuerle. The premise of this book is that because people are living longer and medical care has become dramatically more expensive, and because the boomers are retiring, we have an impending budget disaster looming. It also points out that despite the focus on Social Security, its problems will be dwarfed by
those of Medicare in the next couple of decades. The authors firmly advocate increasing national savings as a way to finance future consumption. The broad-brush outline of the problem is addressed in Chapter One. The contributors start with the Congressional Budget Office (CBO) baseline projection, but adjust that to eliminate some of the unrealistic restrictions place on the CBO. The conclusion in first chapter is that we are faced with four choices: raise taxes to unprecedented levels, slash programs for the elderly and other health-care programs, virtually eliminate all spending other than on the elderly and healthcare, or allow deficits to increase out of control with national debt reaching 100 percent of GDP before the middle of the century.

Continuing with the smaller, larger, and better government scenarios from the previous book, this one has four prototype governments in which the budget has been projected to 2030. In the first, the smaller government, they cut back on entitlement programs, leaving the elderly to finance much of their retirements themselves, and they move primary responsibility for education, housing, law enforcement, and the environment to the states. In the larger government scenario increased taxes provide the means to fulfill promises to the elderly, increase defense and national security spending, and continue and/or increase current spending programs especially in health and child development. In the two better government scenarios, there is a mix of spending adjustments. One restricts spending on the elderly in favor of other programs and the second does the opposite. Both maintain a moderate tax burden. These are described in detail in Chapter Two.

Chapter Three discusses the Social Security problem in-depth. The bottom line is fairly self-evident: spending must decrease or contributions must increase. They offer several elements that can be mixed and matched: increase the benefit age, revamp the benefit calculation, index benefits to prices instead of wages, or increase the payroll tax rate or cap. A side benefit of some of the suggestions is that they strive to increase the progressivity of the system while reducing the long-term deficit.

Chapter Four covers Medicare with much the same ultimate message. Medical expenses are growing about 2.5 percent faster than GDP. Although mindlessly extrapolating that into the future is, as the authors noted, mindless, it does provide a launching point for the discussion of what needs to be done to curb that growth. The chapter also brings out the issues that changes in Medicare will trigger changes in Medicaid and Veteran’s Administration budgets. The conclusion is that some sort of health care rationing will need to be implemented—a distasteful conclusion at best, but perhaps unavoidable.

Chapter Five details the structure of the tax system and discusses revenue-enhancing alternatives such as a national sales tax. It also covers some of the inherent problem in some proposed solutions such as decreased progressivity or impractical tax rates. For example, they claim that 50 percent would be the required rate for a national retail sales tax (in addition to normal state and local sales taxes) that would be sufficient to completely replace our current system; however, at that rate the incentive for noncompliance greatly increases. Chapter Six addresses the political reality of fixing the problem and concludes that it will take presidential leadership, bipartisan cooperation, and an “external threat” to the economy to have a realistic chance of change for the better.

Overall, this book was very informative. The graphs and charts brought a lot of the concepts into clarity much more quickly than text alone could have. It is an accessible book as well. It could be supplemental reading in an advanced undergraduate or graduate level course on federal policy, tax accounting, or budgeting. It was well written and politically well balanced. Where the contributors did have strong opinions, they were not hidden, but rather labeled as such. Disagreements between contributors were brought forward as a
launching point for debate, something that would work well to stimulate classroom discussion.

TERESA STEPHENSON
Assistant Professor

University of Wyoming


*Bridging the Tax Gap: Addressing the Crisis in Federal Tax Administration* is very disheartening. Virtually every page details missed opportunities and political missteps regarding the continuing growth of the nation’s tax gap, i.e., the difference between what taxpayers actually pay compared to what they really owe. Since the inception of the income tax, the tax gap has been a festering wound, sapping the nation of its fiscal threat; now the wound threatens to metastasize and become even more pernicious in nature.

Reading this compendium of tax compliance experts, including two former IRS commissioners, reveals that there are some easy ways to help close the tax gap. First and foremost, Congress must increase the IRS’s funding. Congress has augmented the scope of the IRS’s responsibilities to include the implementation of various social programs (including the earned income credit) and, at the same time, drastically cut the agency’s funding. This one-two punch has rendered the IRS impotent insofar as its tax compliance responsibilities are concerned. Second, Congress should extend third-party information reporting—with its proven track record—to include payments to independent contractors and to track the tax basis taxpayers have in their investments. Finally, Congress should simplify the Code to help eliminate those instances in which taxpayers, due to their lack of comprehension, inadvertently underpay their taxes; simplification will also have the serendipitous effect of facilitating detection of noncompliant taxpayers.

Admittedly, closing the tax gap will not be easy. Few in Congress appear anxious to fund the IRS in the appropriate manner. To the contrary, many in Congress seem intent on using the size of the tax gap as a trump card to argue in favor of replacement of the income tax with a consumption tax. Globalization is another factor that apparently greatly contributes to the size of the growing tax gap. Catching tax cheats has never been easy; adding an international dimension whereby tax cheats can hide behind opaque international borders or secrecy laws further diminishes the chance of detection or the risk of being penalized. Consider, too, that taxpayers and their advisors have become more technologically and financially savvy; this has led to the emergence of various new tax shelters that are often within the literal framework of the law but have little economic purpose or substance.

What does *Bridging the Tax Gap* offer professors in the classroom? Let’s start by stating what it does not offer, namely, a stand-alone textbook in a tax policy course. Its style presupposes a fairly broad and commanding knowledge of the tax system, a knowledge that many students probably lack. Professors, however, may find this book useful to assign on a supplementary basis to those students taking a tax policy seminar who have expressed an interest in learning about the sources of the tax gap, its scope, and possible pragmatic solutions that are at hand.

The cover of the book has an interesting image of a taxpayer carting money over an imaginary Form 1040, which is depicted as a bridge away from a sign pointing to the IRS.
How Congress stops taxpayers from hustling tax dollars away is of paramount importance, particularly in the wake of hemorrhaging budget deficits. In sum, this book makes the compelling case that the nation is in the midst of a tax-collection crisis that threatens the solvency of the government and thus requires immediate attention.

JAY A. SOLED
Professor
Rutgers University