From the Editor:

Financial Transactions Taxes In the United States

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Europe's march toward a financial transactions tax (FTT) has not been constant or without controversy. While the European Commission has recommended that all EU members adopt an FTT, the United Kingdom has argued that the burden of the tax will fall almost exclusively on London and will affect ordinary taxpayers. U.K. resistance hasn't stopped France and other members from going forward with FTTs or financial activities taxes, but it has lessened the prospects for universal adoption. In the United States, two Democratic lawmakers see an FTT as an excellent revenue raiser, but they have ignored its potential to help curb the financial sector.

An FTT can accomplish much more than just raising revenue, although revenue estimates for the tax are impressive, according to Lee Sheppard. In an adaptation of her remarks to the Urban-Brookings Tax Policy Center, Sheppard writes that an FTT should raise revenue, seek recompense from the financial sector, discourage risk taking, and reduce wasteful speculation. She argues that trading has become too cheap and that increasing the transaction costs will drive high-frequency traders from the market, which will substantially reduce market volatility. Sheppard analyzes the proposal of Sen. Tom Harkin and Rep. Peter DeFazio and finds that it doesn't do enough to eliminate risky financial products. Harkin and DeFazio's primary goal is to raise revenue without interfering with existing activities, but an FTT should be viewed more as a Pigouvian tax, Sheppard concludes. She would like an FTT to reach more derivatives and repos. (For her analysis, see p. 1087. For coverage of FTTs, see p. 1102.)

The Harkin-DeFazio bill, introduced in the Senate as S. 1787, would raise $350 billion over 10 years, according to Harkin. The tax rate would be 3 cents per $100, which is much lower than the EU proposal. That such a low rate would raise significant amounts of revenue supports Sheppard's view that there might be too much speculation occurring in the markets. But an FTT is a lot like a sin tax. If the purpose is to discourage the activity being taxed, then the revenue-raising effect will drop over time. That explains Harkin's desire for a low rate that will only tax, not curb, financial activities. However, Sheppard points out that high-frequency trading, which is responsible for 50 percent of the volume on U.S. exchanges, would essentially end under any FTT because of the small margins on each trade, meaning the Harkin bill might not be the deficit-reducing home run that he is hoping for.

Commentary

The taxation of carried interest caused a stir during the first years of the Obama administration. With large majorities in both chambers of Congress, Democrats pushed to tax carried interest at ordinary income rates. Unfortunately, their drive collapsed as internal divisions within their own caucus and staunch Republican opposition derailed several legislative proposals. The IRS, however, took note and began preparing guidance in case the characterization of carried interest changed. (For coverage, see p. 1100.) Opponents of a change in the treatment of carried interest argue that it is investment income and therefore should receive preferential capital gains rates. Samuel Brunson disagrees, writing that the justifications for preferential rates do not apply to carried interest (p. 1137). In his special report, he proposes that carried interest be taxed using a modified mark-to-market approach. He uses the compensation of Republican candidate Mitt Romney as an example of how carried interest compensation is undertaxed.

The Supreme Court's *Home Concrete* decision has generated discussion among the tax community about the future of inflated basis claims and how IRS guidance will be treated by future courts, especially when guidance implicates Court precedent. Robert Wood writes that the debate over *Home Concrete* has overlooked the issues that many clients will find most important (p. 1167). All taxpayers care about the statute of limitations, he writes. The decision might encourage more taxpayers to contest the IRS, even if it involves challenging a regulation, he concludes. While the case might not lay out an exact framework for how regulatory contests will be judged, practitioners and clients should not look a gift horse in the mouth, Wood says.

Michael Graetz is a well-known champion of consumption taxation. His most famous proposal would eliminate the vast majority of tax returns processed by the IRS. In a 1992 article in *Tax Notes*, Graetz wrote that there is a near-consensus among economists that the economy would benefit from a shift to consumption taxation (p. 1129). In the article, he does not call for a broad consumption tax, instead arguing for a tax on energy. *100 Million Unnecessary Returns* was still 16 years away, and Graetz's initial proposal for targeted consumption taxes is an interesting look back at the evolution of his work.

The first installment of estimated taxes was due April 17 for calendar-year corporations. Many corporations will find their estimated tax burdens a little lower this year because of 100 percent bonus depreciation deductions. David Culp and Carol Conjura summarize some estimated tax and depreciation rules and explain how the interaction of those rules can provide taxpayers with important benefits (p. 1145).

Recent formula gift cases indicated that taxpayers can give away a particular dollar amount of closely held assets to family members without risking increased gift tax if the IRS reevaluates the assets. However, it was unclear whether a formula gift could be made without involving a charity. Jeremy Ware writes that *Wandry* provided a method to completely limit gift tax exposure, even when gifting assets with uncertain valuation (p. 1148). That method is important because many taxpayers are trying to use the expanded exemption amount in case it expires at the end of 2012, Ware says. He concludes that the future looks bright for formula gifts, as long as donors respect the formalities of the transaction and the requirements of the documents.

Wendy Gerzog provides a different view of *Wandry* in Estate and Gift Rap (p. 1171). She contends that the Tax Court read the *Procter* decision too narrowly and ignored the fundamental rationale of *Robinette*. She argues that it is not the IRS's responsibility to recalculate a taxpayer's gifts when the taxpayer has created the valuation complexity in order to avoid accurate and easy valuation.

Last week Martin Sullivan asked whether policymakers and taxpayers were ready to deal with "Taxmageddon." Sullivan was referring to the wide range of tax provisions that will expire at the end of the year and the new taxes that will begin in 2013. He referred to that as a massive "negative stimulus" package. Diana Furchtgott-Roth responds that few are truly ready for Taxmageddon because the OMB and CBO have had difficulties in reaching budget projections (p. 1155). She argues that the conflict over whether President Obama's 2013 budget will increase or reduce the budget deficit is an example of competing budget estimates. OMB claims that the budget will reduce the deficit by $4 trillion, but the CBO estimates that the same budget will increase it by $3.5 trillion. She points out that under both estimates, absolute spending will increase sharply.

Many progressive policymakers and commentators would like to attack the budget deficit by raising taxes on the rich, particularly the so-called 1 percent. But Kip Dellinger argues that those proposals are unrealistic because of the often-ignored combined federal and state tax burden (p. 1159). He does not believe that soak-the-rich taxes will yield nearly as much revenue as some forecast and points to California's phantom Facebook dividend as an example. There is far more elasticity in response to marginal rate increases on the 1 percent than is suggested in some recent studies, Dellinger concludes.

Constructive ownership of stock rules are complicated, and there are many different provisions in the code dealing with stock attribution. Stewart Karlinsky attempts to simplify the variety of rules by examining different relationships and discussing four major sets of statutory rules that further complicate an already complex portion of the tax law (p. 1163). Concluding his examination, Karlinsky writes that Congress should focus the constructive ownership of stock rules on preventing perceived abuses and not worry as much about relaxing the rules to include a larger group under the provisions.