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Greek Crisis Threatens Euro, Shows Danger of Unchecked Deficits

By Jeremy Scott — jscott@tax.org

On the surface, Greece and the United States don't have a lot in common. Greece is a small, European country dependent on tourism and small businesses; it is also probably the poorest nation in the European Union. The United States, of course, is the world's richest country. But Greece and the United States do share one trait: extremely high budget deficits that show no sign of abatement. The difference is that Greece is finding it can no longer afford those deficits. The question is whether the United States will be far behind.

By now the Greek fiscal crisis and the bailout sponsored by Germany and France is old news. What isn't quite as commonly known is the source of Greece's financial problems. Martin Sullivan writes that the Greek crisis is more the result of rampant tax evasion and weak revenue infrastructure than profligate government spending. In his analysis, Sullivan shows that the Greek tax system is heavily undermined by bribes, failure to collect income taxes from anyone other than government employees, and lax VAT enforcement. Sullivan wonders whether the Greeks will be able to actually collect additional revenue even if they have the political will to raise taxes. (For his analysis, see p. 721.)

The Greek crisis isn't just confined to Europe, as Lee Sheppard writes on p. 741. The Federal Reserve is also involved, engaging in a dollars-for-euros swap. This is part of the European Central Bank's last-ditch efforts to prop up the euro, says Sheppard. Sheppard believes that the Greek problem is very similar to the Latin American financial meltdown of the 1980s — except in this case, the EU can't force the Greeks to delink from the euro. In her discussion of the tax changes to hedge fund compensation, Sheppard draws comparisons between the failure of TARP to boost the U.S. economy and the likely failure of the Greek bailout to save the European monetary union.

ABA Tax Section Meeting

The ABA Section of Taxation recently met in Washington, and government speakers found themselves frequently on the defensive in many panels, forced to defend the IRS's recent uncertain tax position proposal, the lack of guidance on the codification of economic substance, and proposals in Congress to change the treatment of carried interest. *Tax Notes* has full coverage of the event starting on p. 741.

Practitioners pushed hard for an ''angel list'' in economic substance guidance that would bless several transactions that currently aren't subject to much scrutiny. However, they were disappointed by the response. Numerous officials, including William Alexander, criticized the request, calling it contrary to Congress's intentions in the statute. (For coverage of economic substance, see p. 749.) Heather Maloy of LMSB also urged practitioners to cooperate with the UTP proposal, with other government speakers reiterating that the aim of the program is to increase IRS efficiency. (For coverage of Schedule UTP, see p. 758.)

Sheppard covered discussions on total return equity swaps and the reporting of cost basis. According to Sheppard, practitioners are still grieving over the legislative demise of the total return equity swap dividend withholding tax avoidance transaction (p. 745). She finds that Treasury wasn't that eager to excuse some transactions from dividend withholding tax. Sheppard also reports on the government's struggles implementing the cost basis reporting rules (p. 747).

Commentary

The proposal to regulate all return preparers has brought a great deal of attention to the IRS Office of Professional Responsibility. Director Karen Hawkins's plan to require PTINs for all preparers and to subject many to additional testing has earned praise from practitioners, but has also made many return preparers wary. While this has led to considerable commentary on the standards of practice in Circular 230, it has not generated similar analysis of the process that occurs if a practitioner is investigated by OPR, according to Rita Cavanagh and Paul Hynes Jr. (p. 789). In their special report, the authors examine the procedural and legal issues raised during an OPR investigation and adjudication. The authors focus on evidentiary issues and the definition of willfulness under Circular 230. They believe there is much to be learned by analyzing the published decisions rendered by OPR's administrative law judges and the appellate authority. They conclude that although OPR proceedings are a type

of litigation, practitioners should remember that they are not a tax dispute, but rather a disciplinary proceeding.

Executive compensation and bonuses have become the subject of public ire. Bank bonuses in particular have led to so much public outcry that proposals continue to surface in Congress to claw back these payments from TARP recipients or change the tax rules governing them. (For coverage of a withdrawn Senate amendment, see p. 734.) One form of executive compensation already subject to harsh tax rules is golden parachute payments. In a practice article, Andrew Liazos and Daniel Senecoff analyze when an amount paid to a target company's executives in an acquisition transaction will be treated as a golden parachute payment for tax purposes (p. 801). Golden parachute payments are subject to many adverse tax consequences, including a 20 percent nondeductible excise tax on the excess portion of the payment. Liazos and Senecoff present several strategies that are available to companies and their executives to decrease the amounts that are treated as golden parachute payments, thus reducing the overall tax cost of a transaction.

The issue of how much the wealthy pay in taxes has been raised frequently in the pages of *Tax Notes* and in Congress, where increased taxes for high-income taxpayers seem inevitable (either in the form of a surtax or the expiration of portions of the 2001 and 2003 Bush tax cuts). Dorothy Brown looks at the lack of progressivity in the tax code by using the Obamas as an example (p. 805). Brown writes that the first couple earned more than $5 million and paid 32 percent in federal income taxes. According to the most recent IRS statistics, households with an adjusted gross income of at least $5 million paid only 23 percent on average in federal taxes. This problem occurs because of capital gain preferences and the income mix typically earned by wealthier taxpayers, writes Brown. She concludes that no income should get preferential treatment and that addressing this issue is the only way to restore a progressive tax system.

Tax preferences for capital gains are also the subject of this week's Shelf Project. Prof. Calvin Johnson proposes ordinary income treatment for distributions by a corporation that have not been subject to corporate tax (p. 813). In his opinion, this proposal is wise because the bracket system best adjusts the tax rate to the standard of living the distributions are used for when there has been no previous corporate tax paid.

Family limited partnerships have become a major issue in transfer tax litigation before the Tax Court. Over time, the court has become more permissive in allowing these structures to stand, which significantly reduces many taxpayers' overall estate tax burden. This is a major problem that must be addressed by Congress, writes Laura Cunningham (p. 806). FLPs are a tax avoidance strategy that allows an estate to reduce its transfer tax burden even on highly liquid assets, according to Cunningham. She concludes that because the Tax Court has proved unable (or unwilling) to curb the use of FLPs, the problem requires congressional attention or the transfer tax regime will be undermined.

The gasoline tax is no longer adequate to fund the nation's transportation infrastructure — at least not at the federal level. Over the last few years, major transfers of revenue from the general fund have been necessary to cover shortfalls in the Highway Trust Fund. Diana Furchtgott-Roth believes that this problem will only get worse and advocates replacing gasoline taxes with a vehicle miles traveled tax. VMT taxes have been used in Oregon in a pilot program and have become technologically possible. They are not popular in Congress, however, and many industries can be expected to lobby against their enactment. However, Furchtgott-Roth concludes that a VMT tax is the most efficient and fair way to adequately maintain the nation's interstates and road network. (For her analysis, see p. 827. For prior coverage of the VMT tax, see *Tax Notes,* May 10, 2010, p. 635.)

Qualified settlement funds are flexible and tax advantaged, and therefore it is very hard to come up with reasons not to use them when winding up civil litigation. However, using a bit of reverse psychology, Robert Wood has 10 reasons not to form a qualified settlement fund in his column this week (p. 823). ■

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