In the Midst of Famine, Some Have Plenty

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In early June, the Labor Department announced that unemployment reached 9.4 percent, a 25-year high. Although the rate of job losses has slowed, most economists are skeptical that unemployment will begin to fall anytime this year. Instead, some have expressed optimism that the rate of job losses will continue to fall, pointing to this as a sign that the recession's grip might be loosening. Frankly, if we're measuring success by having lost fewer jobs in a month than were lost the previous month, we've really lowered our economic expectations.

Although the pain of the recession is widespread, affecting everything from sports to automakers to retail, not everyone is suffering. Far from it. As Lee Sheppard reports this week, big bonuses are back in vogue among derivatives dealers, AIG, and some banks. According to Sheppard, Goldman Sachs this year will award the largest bonus pool in the firm's history. Morgan Stanley may pay between $11 billion and $14 billion in bonuses if the earnings trend of the first two quarters continues. Even AIG is in discussions with the Treasury Department about paying another wave of bonuses (perhaps this should offend taxpayers most of all, considering they own the largest stake in the troubled insurance company). Where are these profits coming from? From derivatives trading, writes Sheppard. She concludes that ''the crisis is hardly over, but we're setting ourselves up for the next big implosion while the perpetrators go back to business as usual.'' As for all the supposedly stringent compensation limits in the legislation authorizing the Troubled Assets Relief Program, Sheppard finds that these limits are being poorly enforced and are easily circumvented. And, of course, firms like Goldman Sachs have already paid back their TARP funds, leaving them outside the legislation's reach, although Sheppard writes that these companies still benefit from several less visible government assistance programs. For Sheppard's analysis, see p. 99. It's galling that many (if not most) Americans are fearful for their jobs and watching every paycheck, while the government still can't seem to bring executive compensation in line — not even with European levels.

It's time for the government to tax these bonuses. Taxpayers everywhere should be questioning why a Congress desperate for revenue raisers to pay for healthcare reform continues to balk at the idea of limiting or taxing high levels of executive compensation and Wall Street bonuses. How exactly is society or the overall economy hurt by a surtax on people earning these very high levels of income? Surely if Goldman Sachs can afford to pay $20 billion in bonuses in 2009, the earners of those bonuses can afford to pay some of the $300 billion Congress is trying to raise for President Obama's huge increase in healthcare spending. If Sheppard's analysis doesn't convince you that it's business as usual both on Capitol Hill and in the financial industry, then perhaps another look at the tax provisions being considered in the healthcare bill will. Congress continues to look for ways to tax employer-provided healthcare, and the House is even looking at a small VAT. It is borderline ridiculous, but not surprising, that Congress would consider regressive taxes on lower- and middle-income taxpayers before it makes a meaningful effort to curb excessive bonuses paid to some of the very individuals responsible for the financial mess. (For healthcare coverage, see p. 124.)

News Analysis

One industry that isn't suffering much during the recession is the papermaking industry. In fact, many paper companies are reporting very high levels of income. Of course, this relative prosperity is not because of any uptick in demand for paper products, but rather paper companies' use of a tax credit intended to promote the use of biofuels. Martin Sullivan looks at the ''black liquor'' issue and concludes that either Congress or the IRS could have prevented this drain on government revenues (p. 105). Noting that paper companies' use of the alternative fuel mixture tax credit will cost the government $8 billion this year, Sullivan concludes that IRS and congressional action to date has probably made the problem worse.

National Taxpayer Advocate Nina Olson has attempted to make tax penalty reform a priority for Congress and the IRS for several years. As the complex web of penalties has grown more tangled, tax practitioners have begun to agree with her. Recently, in response to congressional pressure, the IRS announced that it would suspend collection of the notorious section 6707A penalty until a legislative fix is devised. According to Jeremiah Coder, however, the broader issue of penalty reform still can't seem to gain traction in either the House or the Senate. In fact, Coder finds that bills like the Stop Tax Haven Abuse Act being considered by Congress still contain strict liability penalties and involve so-called penalty stacking. For Coder's analysis of the state of penalties in the tax code and the prospect for reform, see p. 113.

Commentary

Many practitioners are eagerly awaiting the outcome of the First Circuit's *en banc* rehearing of *United States v. Textron* and the effect that ruling will have on the future of the work product doctrine and tax accrual workpapers. Prof. Dennis Ventry has already expressed in *Tax Notes* his belief that tax accrual workpapers are ineligible for work product doctrine protection. (For Ventry's report, see *Tax Notes*, May 18, 2009, p. 875.) Prof. Steve Johnson agrees in his special report on p. 155. Johnson writes that tax accrual workpapers should never qualify for nondisclosure under the work product doctrine. His focus, unlike Ventry's, is on the purposive dimension. Johnson concludes that disclosure of tax accrual workpapers would not meaningfully undercut any of the core purposes of the work product doctrine and might even advance some of its goals.

Although the SEC under Mary Schapiro has steadily retreated from previous Chair Christopher Cox's IFRS road map, the transition of U.S. accounting rules to international norms remains a hot topic in accounting circles. Many companies in the United States object to the use of IFRS because it would prevent the use of the last-in, first-out accounting method. If the United States required use of IFRS, companies using LIFO would take an immediate tax hit. In a new *Tax Notes* column, George White explores the link between LIFO and IFRS convergence (p. 175). White specifically focuses on the prospects for LIFO repeal, tracking legislative efforts to end what some have termed a "tax holiday." White concludes that LIFO repeal is a political issue and that the outlook for a convergence to IFRS remains unclear.

It is widely believed that Democratic policies tend to favor low-income earners while Republican ideology tends to favor high-income individuals. The recently enacted American Recovery and Reinvestment Act of 2009 supports that axiom. According to Jonathan Foreman, the stimulus bill passed by Congress was "particularly generous to low-income working Americans." Foreman presents data that show that few low-income taxpayers will owe federal taxes in 2009 and that most low-income workers with children will receive substantial subsidies via refundable tax credits. Foreman's analysis is on p. 171.

Robert Wood revisits the topic of punitive damage awards in a practice article and concludes that punitive damages should remain deductible (p. 149). Wood first tackles the common misconception that punitive damages paid to private parties in civil lawsuits are not deductible. He writes that punitive damages paid in the course of a trade or business are in fact deductible and criticizes a proposal in Treasury's 2009 green book that would make them nondeductible. Karen Burke and Grayson McCough look at *Arthur Andersen v. Carlisle*, the first investor suit related to tax shelters in the 1990s to reach the Supreme Court. The two authors analyze the likelihood that any victory in the case might turn out to be hollow (p. 169). Robert Willens analyzes specified liability losses, writing about a recent Third Circuit decision discussing when a net operating loss can be classified as a specified liability loss. Of Corporate Interest is on p. 179.

In a letter to the editor, Marvin Chirelstein praises David Cay Johnston's recent article on Paul Daugerdas. Chirelstein shares Johnston's indignation over the role that law firms played in promoting many egregious and transparent tax shelters. (For Johnston's column on Daugerdas, see *Tax Notes*, June 22, 2009, p. 1473. For Chirelstein's letter, see p. 183.) ■