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Linking Taxes to Happiness

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The United States has traditionally been a low-tax nation. As a percentage of GDP, American taxes have almost always lagged behind those of Western Europe. This remains true today. According to the latest OECD data, taxes in the United States consume 28.1 percent of GDP, while the ratios for the United Kingdom, France, Germany, and Italy are 36.6 percent, 43.6 percent, 36.2 percent, and 43.3 percent, respectively. However, this might be changing because of a trend in government spending.

U.S. government spending is projected to surpass 40 percent of GDP in 2009, after being around 36 percent in 2008. The recent bailout and stimulus bills are behind this spike, but with President Obama and Congress pushing for climate legislation and healthcare reform, it doesn't seem as though government spending will drop substantially soon. Increases in government spending usually lead to increases in taxes, and although the administration has pledged not to raise taxes on those earning less than $200,000 ($250,000 for couples), it is hard to reconcile promises of progressive social reform with pledges to keep taxes low (especially because Obama's budget contains no real cutbacks in defense or other discretionary spending). If government spending remains above 40 percent, then it is highly unlikely that federal taxes will remain below 30 percent for any length of time. What effect will this have on taxpayer morale in the United States?

Not much, if you agree with the conclusions of David Cay Johnston. In his article this week, Johnston analyzes the link between happiness and the national tax burden (p. 1041). Using OECD data on 11 measures of life satisfaction, Johnston found that American happiness ranks behind that of 10 countries, all of which have heavier tax burdens. In fact, the nation at the top of the satisfaction list, Denmark, has a tax burden measured at 49 percent of GDP, while the nation just above the United States, Sweden, has a burden of 50.1 percent. The higher levels of satisfaction can be explained, according to Johnston, by mitigation of risk factors in the high-tax nations. Because Sweden and Denmark (and most of Europe) provide greater unemployment benefits, wider healthcare coverage, cheaper post-secondary education, and more maternity leave, taxpayers in those countries are more content despite paying more to the government. So, in Johnston's mind, high taxes aren't nearly as important as what taxes are spent on.

Johnston is on to something, but it's not clear that these lessons can be directly transplanted to the United States. For example, if U.S. taxes shot up to 35 percent or even 40 percent of GDP, what new benefits could U.S. taxpayers expect? And doesn't a higher percentage of taxes in the United States go to items such as homeland security and defense than in Europe? Not even an administration as nominally progressive as Obama's has called for cutbacks in those areas, meaning that new spending programs would merely be grafted on top of the already bloated federal budget (in fact, that's exactly what has been done in Obama's budget proposal). If Americans are simply being asked to pay an ever-escalating tax burden to provide benefits to small slivers of taxpayers (those covered by an expansion of healthcare coverage and those lucky enough to benefit from all the targeted tax breaks that Congress is so fond of), how much happier are they likely to be? What new risks are being mitigated by this spike in government spending?

News Analysis

Despite Senate Finance Committee ranking minority member Chuck Grassley's recent comments, the soda tax isn't quite dead. The possibility of raising excise taxes on ''sugary beverages'' appears in a Finance Committee release on healthcare funding options. (For coverage, see p. 978.) Joseph Thorndike thinks Congress is on the wrong path by seeking to permanently fund healthcare reform through excise taxes. In his analysis piece (p. 955), Thorndike provides a convincing case that new sin taxes have trouble surviving persistent opposition and lobbying. He hopes Congress will look at options that have a bit more staying power than regressive excise taxes.

Martin Sullivan takes aim at a piece of Obama's international tax reform proposals, presenting evidence that the pooling of foreign tax credits will further discourage repatriation of foreign earnings. Instead Sullivan believes that taxes should be assessed when profits are earned, and not when dividends are distributed. Sullivan's analysis starts on p. 957.

Obama's international tax proposals largely avoided the contentious issue of transfer pricing. However, many believe that transfer pricing is at

the heart of the erosion of the U.S. corporate tax base. Lee Sheppard looks at how countries that are on the inbound side of transfer pricing adjustments are using these adjustments to beggar their neighbors. Sheppard believes that the real villain behind transfer pricing is the set of rules dealing with separate company accounting. She also looks at how the beneficiaries of current transfer pricing rules are starting to resist the trend for tougher rules from high-tax nations, specifically using Ireland and Switzerland as examples of this resistance. For Sheppard's article, see p. 959.

Tax Notes presents a look this week at the increase in lobbying efforts relating to the Stop Tax Haven Abuse Act, noting that nearly 60 companies have admitted an interest in the bill in the last two sessions of Congress (p. 962). A reasonable guess is that few of the multinational firms and lobbying groups listed are lobbying in favor of passing the bill.

Commentary

Corporate losses will be plentiful over the next few years as the effects of the recession begin to show in corporate tax returns. Using those losses, however, will require profits, and profits are in short supply. In a special report, Robert Willens looks at a technique being used by companies with preacquisition losses to achieve affiliation with companies with current and prospective profits (p. 1013). The technique is complex, and best left to Willens to explain. Despite its cleverness, however, Willens concludes that it does not result in ownership of the amount of stock necessary to create an affiliation in any meaningful economic sense. He hopes that the IRS will scrutinize these transactions and prevent them from becoming "the next great tax avoidance gambit." In Of Corporate Interest, Willens looks at the treatment of security holders in a reorganization, specifically analyzing section 354's operation (p. 1043).

Information sharing and the reporting of foreign accounts have become a major focus of the IRS and Congress over the last few months, especially in the wake of the announcement of Obama's international reform package. The IRS has acted on this focus by changing the instructions to the FBAR form. According to Fred Feingold, the new FBAR instructions have broadened the category of persons required to file the form beyond U.S. citizens, residents, and entities to also include persons who are "in and doing business in" the United States. Feingold's special report discusses some of the considerations relevant to this expanded definition and suggests the need for further guidance beyond the instructions. The report starts on p. 1023.

Returning to the issue of adequately proving the origin of damages claims for tax purposes, Robert Wood offers another look at section 104 this week (p. 1007). Wood believes that the Tax Court is prone to lengthy reviews of the reasons behind a payment and that this requires good documentation and careful wordsmithing in settlement agreements. Although noting that the furor over the AIG bonuses has died down without legislation being passed, Erik Jensen is concerned that proposals were taken seriously enough to require an analysis of their constitutional merits. In his viewpoint, Jensen concludes that the AIG bonus tax bills might have been closer to a confiscation of property and thus a violation of due process (p. 1033). Although Jensen hopes that "the unseemly push to tax the unseemly bonuses will just go away," attacking executive compensation remains on Congress's radar as a means of raising revenue. In Tax Crimes on p. 1047, John Townsend looks at two First Circuit opinions on the essence of a conspiracy in an alleged money laundering ring. Townsend writes that he has serious concerns over the use of conspiracy charges in a money laundering context and the harsh sentences that accompany a conviction.

In a letter to the editor, Prof. Reuven Avi-Yonah criticizes the predictable response of multinational corporations to Obama's May 4 speech on international tax reform (p. 1051). Calling the competitive disadvantage argument "a myth," Avi-Yonah points out that U.S. multinationals earn a third of their overseas profits in three low-tax countries and that 7 of the top 10 multinationals have an effective tax rate of less than 10 percent. Adam Chodorow takes a humorous look at phaseouts after his recent attendance at the Individual and Family Tax Committee's session at the ABA Section of Taxation May meeting. Chodorow's letter is on page p. 1051. ■

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