



DID WE TIME WARP TO THE MIDDLE AGES?

A TAX AND ECONOMIC ASSESSMENT (2008-2009)

AN ARTICLE

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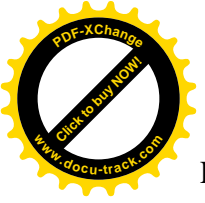
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DID WE TIME WARP TO THE MIDDLE AGES?

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INTRODUCTION

Tax planning requires consideration of all factors that may affect tax laws. Tax laws do not exist in a vacuum. Economics and political issues affect tax laws. In turn, changes in tax laws impact the economy and each person within the economy. In difficult economic times, changes to the tax laws provide an efficient avenue to implement policy. To stimulate the economy there may be tax credits, refunds, as well as grants. If these steps reduce revenue, there may be corresponding increases in some areas of tax law. Such changes should be considered in developing a tax planning strategy.

This a time of uncertainty. There is uncertainty as to the direction of the economy. There is substantial uncertainty with regard to Federal Estate Taxes (FET). This uncertainty applies to credits against FET, estate tax rates, state inheritance tax credits, discount factors for gifting, and techniques used to reduce FET. These rules change drastically from 2009 to 2011 and beyond. The shifting political landscape may be a harbinger of additional changes after 2011. This will need to be addressed in any estate or financial planning.

Your tax planning strategy may include the timing for taking gains, assuming you have any gains to take. Anticipating changes to the tax law, analysis of stimulus bills, and government budgetary decisions may signal the direction for investment and tax planning strategies. These factors are important in making tax planning decisions. Each of the factors are like dots on a page in a coloring book. Connect the dots and you develop an economic picture to aid in making decisions. This Commentary Letter is designed to provide thoughts and ideas within the back drop of the current tax and economic conditions, and outside the tax planning box. Hopefully these thoughts will spawn additional thoughts and view points in each reader to aid in their strategic planning for tax, business, and estate purposes.

DID WE TIME WARP BACK TO THE MIDDLE AGES?

At first this may seem to be an amusing intellectual exercise. After considering it in conjunction with the changes occurring in all segments of the economy and society, and internationally, it is not so amusing.



The reference to the middle ages is to a time of economic stagnation in European history prior to the year 1500. These times included difficult societal issues, and religious dogma, impacting the social and economic landscape and seigniorial and feudal systems emanating from the Monarchy.

Rights to lands came from the monarchy, to the lords and aristocracy, and then from the aristocracy down to the serfs and peasants. This structure was rather rigid and did not provide a basis or incentive for economic growth.

The recent economic crises has affected our country as well as others around the globe. The concern is whether this crisis is a bump in the course of the world economy or a systemic situation that foretells a bleaker economic future. It is worth looking at an historical comparison to see if there is a congruent picture.

The middle ages were a time and place in history when governmental and societal structure was based on a monarchy at the top that distributed lands and privileges to the aristocracy (lord and nobles). From the aristocracy, use of the land eventually filtered down to the serfs and peasants. Much of society during this period was influenced by the church and religious dogma. This simplistic overview is compared to today's dots.

1) ARISTOCRACY

The aristocracy in the middle ages was based on titles and land ownership. This group governed, administered, and directed the flow of all goods and services within their geographical area.

In today's society, the aristocracy would easily be compared to congress with our senators and congressmen. Their role is to pass laws related to taxes, military, and budgets for the country. In essence they govern, administer, and direct to the flow of all goods, services and currencies.

This is much like the aristocracy did during the Middle Ages.

Another candidate for aristocracy are " hedge funds". Congress is regulated by the will of the people. Hedge funds have little if any regulation. A hedge fund is an investment pool which is not governed by the Federal Investment Company Act (FICA). This Act governs mutual funds which are regulated by the Security Exchange Commission. Hedge funds are not so regulated. Many of the hedge funds are quite large with assets, in some funds, in excess of 100 billion dollars. Some hedge funds, economically, are larger than some countries.



Hedge funds received attention in September of 2006 when Amaranth Hedge Fund lost six billion dollars in one day. That marked the end of Amaranth Fund. The first question that arose, is how could you lose 6 billion dollars in one day? Second, what would be the impact on our economy if a larger hedge fund made an irrational decision, not to say what Amaranth did was irrational at the time? A fund that large would have a significant impact on any segment of an economy it touches.

With serious credit crunches affecting real property, hedge funds are moving to acquire large holdings in real estate. A single holder of a billion dollars worth of real property in a particular market, with the funds to manage it, would have a substantial impact on the economic climate in that market. With no regulatory structure have hedge funds become the new aristocracy?

2) MONARCHY

The USA does not have a monarchy in the traditional way of defining a monarch. The president would be comparable to a monarch. In recent years the presidency is almost looked upon as a monarchy. There are a lot of similarities. In controlling the executive branch of the government, the president wields a lot of power over the economy and the flow of currency through it. Very much like the middle ages where the monarchy carried the favor of the aristocracy. In the case of Congress the president must court the house and the senate to pass laws implementing the president's policies. If the actions of the president are contrary to the will of congress, it will affect who he can choose as cabinet members and other very important positions in the executive branch. Congress can pass laws, particularly in relation to tax laws that affect the flow of commerce in this country regardless of what the president wants or feels is in the best interest of the country.

3) CRUSADES

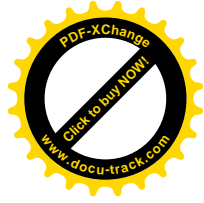
English speaking people are in the middle east fighting Muslims.

Does this remind anyone of the Crusades? Need we say more?

4) RELIGIOUS DOGMA

Churches in our country are enforcing adherence to religious doctrine. Those in a church's congregation not adhering to these orthodox doctrines are being forced from the church's congregation. This also applies to ministers.

Who knew excommunications were back in vogue?



In the Middle Ages, an excommunication was a serious matter. The church and its dogma was ingrained in the entire economic and social structure. When a person was excommunicated from the church, no one in that church could provide aid or comfort to the person excommunicated or their family. That meant nothing, including not doing business. Considering church dogma filtered through the entire society and commerce of the region, for the person and family excommunicated it was a serious survival issue.

Religious dogma filters through our society. It affects political parties, campaigns, and legislation in many areas. It was a factor in impeding commerce during the middle ages. Religious dogma was also a factor in the crusades. Some say it may have been a factor in the invasion of Iraq.

Disagreeing with the dogma of a church does not have quite the economic impact an excommunication had in the middle ages, but it can cause social chasms and splits within families and between friends, in this century.

5) SERFS AND PEASANTS

To make today's picture more congruent with the middle ages we only need serfs and peasants.

The credit crunch has caused "sub-prime" borrowers to lose their homes putting them into an economic status of below sub-prime. Many states and lenders are pursuing laws and rules making it harder for sub-prime borrowers to purchase homes. These two aspects may have created a peasant class reminiscent of the middle ages..

6) ARE DEBTOR'S PRISONS NEXT?

This is not as far fetched as you might think. With many people having border line credit history, adding a foreclosure puts them further in an economic hole. It makes it difficult to find lodging. Apartment complexes want credit worthy renters. They do not want a new renter who promptly defaults on the rent and it takes months to evict them.

Relatively recent changes in the bankruptcy laws have made it more difficult for people to dig themselves out of financial difficulties. In addition, the Tax Increase Prevention and Reconciliation Act of 2005 in May of 2006, made changes to the IRS's Offer in Compromise Program making it more difficult for a person to get out from under income taxes owed to the IRS. In a subtle way these laws help create a prison without walls.



WHY DO WE CARE?

The reason we study history is to avoid the mistakes of the past. It is incomprehensible we could revert back to a time of total economic stagnation. The stagnation of the middle ages involved total stagnation at all levels of society, including artistic, scientific, philosophical and intellectual endeavors. This is a period of history we do not want to relive. Reviewing the dots discussed above is a sobering exercise.

The other concern is whether current economic turmoil is a bump in economic history or a significant change of direction. If it is the latter, it may signal a change in basic investment and tax planning strategies. There may be investment shifts to commodities and to investments with low risk or tax free income to avoid higher taxes. The next three to five years will provide the answer.

Are we headed towards the middle ages? Life in that period of history was not a life filled with joy and happiness. Since we do not want to go there it would seem logical to look at what techniques pulled those societies and economies out of such horrible economic stagnation. If there is any indication we could be headed there, it behooves us to define how those techniques could be adapted to our current economic structure. We should institute policies and economic structures within our society to derail any movement toward reliving the pain and agony of those times. We do not want to make the mistakes of history again.

The remainder of this article will be devoted to addressing policies, tax structures and other regulatory issues that may impede a strong economy . The purpose being to assure our economy is not retrograding, but is experiencing steady, sustainable growth without wild economic swings.

ECONOMIC LESSONS OF THE MIDDLE AGES

1) CAPITALISM: THE ECONOMIC WHITE KNIGHT

The term “capitalism” means many things to different people. The focus here is on the financial principal of working capital. If a person is to sell goods and commodities, they must first produce the goods or commodities. Producing the goods and commodities for sale or trade requires the expenditure of currency for raw materials plus the efforts of people in producing the goods and commodities. This requires working capital.



With the economic structure of the middle ages these efforts would obviously be coming from the lower end of the economy, since the aristocracy did not work. The upper end of the governmental structure would have to adjust to allow this to occur. The aristocracy at that time had to understand more money could be made from the exchange of goods and commodities than could be made by simply renting land to serfs and peasants. It also required a change in business philosophy at the lower end of the economy over time.

The trade of goods and commodities established an independent value in the goods and commodities and created a merchant class. The flow of trade in goods and commodities provided revenue to both the top and bottom of the economic structure. It took years for both ends of the economy to understand the need for balance between the upper and lower parts of the economic structure. We seem to be reliving the need for such balance.

The current economic crisis from an empirical stand point is an indication of how far our economy is out of balance. It is time to stop pointing fingers and analyze what it takes to re balance the economic structure. As Eldridge Cleaver said in the 1960's, if you are not part of the solution you are part of the problem.

2) CREDIT VERSUS WORKING CAPITAL

Discussing economic and business concerns involves dealing with conceptual issues. There must be a commonality of understanding of these issues. Discussions in this area reflect misunderstandings of principals of finance that are critical to any meaningful debate. One concept is that of working capital. This concept is critical in the management and growth of a business. For simplicity purposes the definition of Working Capital is the assets of a company minus its liabilities. This number is the amount of resources the company has available to conduct its business and still be able to pay its bills. If this number is negative the company has no working capital.

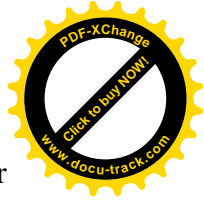
To use the terms credit and working capital in the same sentence is almost an oxymoron. They are completely different. Credit is not working capital!

Credit is debt!

Debt is a liability!

Debt is deducted from the total assets of a business to determine the net worth of the business and its available working capital.

If a business borrows money, the business is gambling it will make sufficient money from the use of the borrowed money to repay the money and have money left over. Credit



should provide the bridge over the time between the expenditure of funds to produce a product or commodity and the receipt of payment for the product or commodity. There is generally a delay between the time money is expended by a business to produce a product and the receipt of payment for that product. Credit provides money to allow the business to pay bills until it receives payment for the product.

The amount of credit needed is determined through capital budgeting. Capital budgeting should be done by an accountant and not a banker. If a business does not properly prepare budget projections, the result could be creating too much debt in the business which may cause a business to collapse. Capital budgeting should be done in conjunction with tax planning.

Credit does not create working capital. If a business's assets and liabilities are equal, there is no equity in the business. If the business then borrows \$10,000 it still does not have equity because the liabilities on the financial statement have increased by the amount of the loan.

There has been an increase in the assets of the business, but there has also been a corresponding increase in liabilities. In essence there has been no working capital created for the business.

Working capital in a business only comes from realizing a profit.

If the business invested the \$10,000 it borrowed and earned back the \$10,000, it did not make a profit. It still owes the lender \$10,000. The business is actually in a worse situation since it would also owe interest on the loan, so its net worth is now negative. This means an assumption in the initial capital budgeting was incorrect.

3) ACCOUNTING: ACCOUNTANTS AS ECONOMIC SUPER HEROES

Some may find it amusing to look at an accountant as a super hero, but a major factor in pulling economies out of the stagnation of the middle ages was advances in accounting and bookkeeping, in particular, double entry bookkeeping. This may seem strange to some, but without bookkeeping and accounting systems, it is difficult to make financial decisions as to the future direction and growth of a business. If a business's financial statements are not accurate, the decisions the business makes will be based on flawed information.

More importantly there can be no comparison of value between businesses where the respective businesses are using inconsistent methods of bookkeeping. This impedes interactions between businesses and trading partners. It is risky to enter into a business venture with another company if you can not determine if the other company is committing assets of equal value to the venture. This impedes economic growth.



Advances in accounting and bookkeeping must keep pace with economic development for there to be economic growth. This is just as important today in our economy as it was hundreds of year ago. The need for competent bookkeeping is necessary for the bottom end of our business economy as well as the upper echelon.

An issue affecting our economy is there are not enough accounts. There are several reasons for this. The first is the passage of the Sarbanes-Oxley Act of 2002. This Act substantially increased regulatory reporting requirements for publicly traded corporations. This resulted in corporate America hiring many accounts out of private practice to deal with the increased financial reporting requirements of Sarbanes-Oxley.

The Second problem is legislation sponsored by the Bush Administration taking a punitive approach to tax preparer penalties. This means small businesses are not receiving the quality of business planning they need. In many cases they feel it is too expensive and do it themselves which results in poor business decisions.

Congress has not yet recognized the seriousness of this issue. Congress's focus has been on aggressive accounting and tax preparation practices. Instead of concentrating on accountants that have gone over the line, the response has been a shotgun approach against the entire accounting profession.

The IRS is now treating tax preparer penalties as an additional source of revenue. Recent legislation has broadened the area of tax preparer penalties to cover any person that may have contributed in any way to any item on the tax return. Instead of a shotgun it is more like a cannon. It would seem that the IRS should have the capability of determining a balanced approach on this matter rather than a confrontational one.

This means less people are electing to go into the field of accounting.

TOP HEAVY ECONOMY

A theory as to one of the reasons for our recent economy ills is that tax, regulatory polices, and exotic investments financial benefits, flowed primarily to the upper portions of our economy. This resulted in our economy being top heavy. When economic problems occurred with large banking and financial institutions, the remainder of the economy was not strong enough to prevent a downturn, or to pull the economy out of the recession.



1) SUBPRIME MARKET

The seeds of the economic crisis began with the granting of loans to borrowers to purchase homes they could not afford to buy. These borrowers squeezed every dime out of their budget to make the mortgage payments. These borrowers were referred to as “subprime borrowers”. Many of the loans were variable interest loans, meaning they were adjusted based upon the changes in the mortgage loan rates. When the interest rates adjusted upwards it increased the monthly mortgage payments. When that occurred many borrowers then had monthly mortgage payments that increased to more than they could pay. This caused them to default on the mortgage. With their precarious financial situation even an increase in gasoline put a strain on their budgets and increased the risk of a default on the mortgage.

To complicate the situation, many lenders sold off many of the loans to other lenders. These lenders in turn bundled these loans into packages which they sold to various investors and institutions.

Larger investors and institutions acquired these packages of loans as investments then acquired “credit default swaps” from insurance companies to protect themselves against loss. In essence, the creation of a financial chain connecting each company and investor in this process. As such it connected banks, financial services, insurance companies, as well as equities and Wall Street, in addition to individual borrowers. As with any chain it is only as strong as its weakest link. This turned out to be the bottom of the chain, or the subprime borrower. This weak link broke and brought down the entire financial structure connected by this chain of financial transactions.

Subprime borrowing sowed the seeds of the economic crisis but did not cause the crisis. The seeds of the subprime borrowing just landed on economic soil that was ripe for an economic crisis.

The premise is the subprime borrowing was the catalyst leading to the crisis. This would then logically lead to the conclusion the subprime borrowers market did not have enough money to make their mortgage payment. The heart of the matter is the difference between what a subprime mortgagee could pay each month and the amount of the monthly mortgage. If the borrowers in the subprime market could have made their monthly mortgage payment the economic crisis might not have occurred or at least not been that severe.



A simple increase in gas prices would be sufficient to over extend a mortgagee's budget to cause a default on the loan. It is frightening to realize how precarious the financial situation was at that moment in time.

This approach may be simplistic and naive. Considering what has occurred, a little simplicity and naivete might be in order. What ever your view point, this situation was sufficient to put our economy out of wack. The lower end of the economy could not support the weight of the economy. The challenge is to achieve a sustainable economic flow of money into the lower end of the economy to regain this balance.

2) FLAT TAX (FLAT EARTH)

For nearly 25 years a popular proposal for debate was to have a flat income tax for the United States. During The 1980's and 90's many debates occurred over this concept. A participant in one of those debates referred to this proposal as the "flat earth tax".

Interestingly enough the concept crossed political philosophies. It has been touted from conservatives such as William F. Buckley to liberals such as Jerry Brown, the former governor of California. With the recent economic crises, the concept of a flat tax is again being raised.

What many fail to realize is that for the past 23 years the tax rates have been progressively flattened. Beginning with the Tax Reform Act of 1986 through the 2001 tax act the top tax rates have been steadily reduced and adjusted. The Bush administration took it further by flattening the tax rates for capital gains and corporate dividends in 2003. It also flattened the tax rates for Federal Estate Taxes. For all practical purposes we are already operating under a flattened tax structure. According to the glowing generalities touted for the benefits of a flat tax we should be experiencing a growing vibrant economy.

If the current situation is any indication of how a flat tax would benefit our economy, we may not wish to have any more flattening of tax rates. Our economy is flat enough as it is.

The flat tax has been touted as a boost for the economy by shifting wealth to the upper part of the economy. The idea being that the wealth would then trickle down through the economy benefitting all levels of the economy. This is referred to as the "Trickle Down Theory." The Bush Administration touted it like a mantra. It seems nice in theory but it did not work well in application.

The application of a flat tax essentially takes money from the lower end of the economy and allows it to flow to the wealthier part of the economy. There are two possibilities for the use of this money. First, the upper part of the economy would spend more which would help the



overall economy. Second, the wealthier part of the economy would use it to expand businesses in turn benefitting the economy.

These assumptions have several flaws. First, a capitalist society works from the bottom up, not the top down. Second, once a person becomes wealthy, there is no reason to take unnecessary risks so the money stays in the upper part of the economy.

Third, with disposable money in the upper part of the economy, stock brokers, real estate brokers, insurance agents, bankers, as well as Wall Street, now have another market available to sale investment opportunities to. This money also attracted scam artists chasing this money.

This prevented money from trickling down through the economy.

In essence flattening the tax rates was a gamble that did not work. Taking money from the lower part of the economy actually weakened this segment of the economy. It resulted in this segment of the economy not having the resources to maintain the consumer engine our economy relies on.

3) FLAT TAX AND GREED

The simplicity of having a flat rate for all tax payers is attractive. The real selling point of the Flat Tax is Greed. Everyone looks at from their own selfish view point. They assume if a flat tax is instituted they will have more after tax money. What they do not understand is that it is all relative. The problem with this assumption is that with a flat tax, the next person up the income ladder will have even more after tax money, as will the next person up the ladder, and the next. Relative to people above you on the economic ladder you actually have less after tax money under a flat tax.

4) CREDIT BASED ECONOMY

As the flat tax system sucked money out of the economy, businesses and consumers relied more on credit and borrowing, creating a credit based economy. As we have become painfully aware, a credit based economy is an illusion. The availability of credit is based upon perception that assets with illusory values could support the economy when there is no real cash or asset values to support it.

President Bush assumed pulling money from one section of the economy would help bail out a tax structure that did not reward the building of working capital, the corner stone of capitalism.



5) CREATION OF JOBS

Job creation is one of the most nebulous terms politicians use. It sounds so good. George Bush used it because it sounded good. It sounded so good almost everyone uses it now. For a man so vilified it is surprising so many politicians borrow from his repertoire of sound bites and speeches. Perhaps these politicians borrow this phrase because it works.

Now every politician says whatever they are pushing creates jobs. What does that mean? It means somebody came up with some hypothetical method to determine how many jobs an action taken by government would produce. There are so many variables to such a calculation its accuracy is at best nebulous.

What does a job look like? You cannot touch it. Is it a temporary or permanent job? How long does a job have to last for it to be a permanent job? If a job only lasts 4 months was a job really created? If the job ends in 4 months, did the job die?

If a governmental action is under taken which results in people being hired, we say a job was created. If the job ends, it does not exist any more. Was it uncreated? Did it die or was it lost? If a person takes a job in Arkansas, but left a job in New York to take the job in Arkansas was a job really created? Do we look at the creation of jobs from a national, regional, or state standpoint?

What if a company puts employees on a reduced salary with benefits so they are available to return to work when business picks up? If by a governmental action, business picks up and allows the company to put some of these people back on full time, did that create new jobs? Where does that fit into the statistics?

A different situation occurs if a company keeps a number of employees on pay roll even though the business has dropped to 60% of its capacity. If a governmental program causes an increase in that business such that it brings the company up to 110% of capacity, is the company going to hire more people or tell the existing work force to work longer and harder, and not hire more people? How can a method of determining job growth possibly factor this into their determination?

If this method was really accurate, then why doesn't congress apply it to any new legislation to determine if it would result in a loss of jobs. If it would cost jobs, then they would know and not pass the legislation. (Maybe!) Since congress does not seem to know one way or the other, this method must not be that accurate.



What politicians do not seem to understand is that jobs are like apples. Apples come from apple trees. If you want more apples, you need more apple trees.

Jobs come from businesses. If you want more jobs there needs to be more businesses.

Be careful of people bearing numbers and statistics. The only reason the numbers and statistics are touted is they make what ever they are supporting look good. If they did not, we would not hear about them.

LIFE INSURANCE IN OUR ECONOMY

Life insurance is a glue that connects various aspects of our economy. It is the glue that holds together business continuation plans when an owner dies. It provides cash to fund the buy/out of the deceased shareholder's interest in the business, allowing the business to continue to function as a viable business without being saddled with excess debt to fund the buy/out. It provides cash to supplement retirement or other emergencies, or survivor benefits to a surviving spouse or young children.

The recent economic travails also affected life insurance companies. It put some life insurance companies in precarious financial situations requiring government bail out money.

In today's global and high tech economy, nothing in the economic arena is in a vacuum. Every event within our economy has a ripple effect impacting all business entities and individuals with varying intensity.

The focus here is the impact of events in our economy on "pockets of accumulated capital". In the case of individuals, this relates to savings accounts, retirement accounts, IRA's, Health Savings Accounts, and certificates of deposit, etc. It also applies to the cash value of life insurance. Pockets of accumulated capital are important and of concern to all persons in our economy.

A disturbing trend has been the eroding of the benefits of the use of life insurance, particularly in the business setting. The Bush Administrations (Yes, that means both of them!) seemed bent on attacking life insurance. It seemed the Bush family did not like life insurance. In 1992 Bush senior came up with the idea of taxing the internal cash value build up of life insurance. Needless to say that proposal did not get anywhere in congress.

Since then numerous actions have been taken by the recent Bush Administration that can only be viewed as an attack on life insurance. More importantly against the cash value of the insurance. Some of these actions are as follows:



1) 2003 SPLIT DOLLAR

In 2003 Bush junior mounted an attack from an administrative rather than a legislative standpoint. For over 30 years small business benefitted from a method for the purchase life insurance referred to as “split dollar”. Under this method the payment of insurance premiums was split between the business and the employee at advantages rates for the employee. The corporation maintained an interest in the cash value of the insurance policy equal to the premiums paid. This created a pocket of accumulated capital that could be accessed by the business if needed. The Bush administration administratively changed the rules and made the use of split dollar less attractive.

2) SECTION 412 PLANS

Retirement plans are allowed to purchase life insurance in a retirement plan for the purposes of providing incidental benefits. The Bush administration went after the over funding of life insurance policies in 2004. This was based on perceived abuses with regard to IRS Section 412 plans.

Some promoters went totally overboard in the structure of insurance policies in such plans. These policies created a “spring” in cash value of the policy after they were distributed, usually in year five. Clearly, this was contrary to the intent of the long term nature of this type of retirement plan. It would be reasonable to establish rules and regulations to address these abuses.

The IRS response was overboard. They magnified their approach by declaring the perceived abuses as a “Listed Transaction”. A “Listed Transaction” is a list compiled by the IRS of abusive tax schemes and transactions. If a taxpayer was involved in one these they are required to notify the IRS on their annual income tax return. If a taxpayer’s retirement plan was so listed it would have to be noted on their annual tax return. Failing to do so results in serious tax penalties for the taxpayer and the tax preparer. This response applied much stricter rules than was necessary to achieve the desired result.

Essentially those that did not abuse the intent of 412(I) paid for the abusers who do. This has the effect of reducing the amount of capital going into the plan and into the life insurance policy.

Few people would like to draw themselves into a tax audit over a plan. For that reason many people and tax preparers stay away from these plans even though they are permitted under the Internal Revenue Code.



3) SECTION 419 PLANS

Section 419 and 419A provides for employee benefit plans generally referred to as “Welfare Benefit Plans”. These plans allowed employers to fund welfare benefit plans for the benefit of employees and allowed deductions to the employers for the cost of funding the plans. Aspects of the plans allowed the use of life insurance to be able to pay death benefits contracted with employees. The funding of the plans would be tax deductible. Indirectly at least a portion of the funds used to fund the plan would be used to acquire life insurance. Premiums for life insurance are not deductible under IRC Section 264. These payments are deductible, with regard to multiple employer plans, or those with 10 or more employers. With that in mind some plans were skewed to acquire more life insurance. The IRS’s perception of abuses in the plans led to Notice 2007-83 and Revenue Ruling 2007-65 in 2007.

The IRS went after plans under Section 419 to the extent of creating strict requirements to be in compliance and designating the plans as a “Listed Transaction”. This meant it would most assuredly be audited, essentially eliminating the use of Section 419 plans. This action essential usurped the authority of Congress by administratively ending its use.

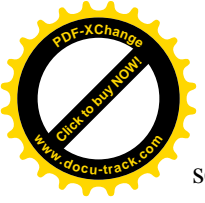
Employer funding of their retired employees medical costs is good public policy. The current health insurance debate certainly reinforces this point. Sadly, the Service has continued its attack on a portion of the Revenue Code it considers contrary to public policy.

4) INTERNAL REVENUE CODE SECTION 101(j)

The rationale for the passage of Section 101(j) in August of 2006 as part of the Pension Protection Act is suspect. Under the new Section 101(j) when a policy of life insurance is issued on the life of an employee by an employer, a notice has to be issued and signed by the employee prior to the issuance of the policy, regardless of any other paper work, physicals or agreements with the employee. If the notice is not issued and signed prior to the issuance of the policy, upon the death of the employee the policy proceeds would be subject to income tax. The effect is Draconian.

Normally, the receipt of proceeds from a life insurance policy upon the death of the insured is not subject to income tax pursuant to IRC Section 101a. Taxing these proceeds is a harsh consequence bordering on punitive, but who is being punished, the employer or the employee? This could truly be referred to as a “death tax”.

The Pension Protection Act is a very large volume of legislation. The passing of Section 101(j) was not well publicized by the IRS. Most insurance companies were aware of the new



section and had sample notice and consent forms, but some were not implemented for some time into 2007. This means many such policies issued after August of 2006 would not have the required notice and consent and be subject to the harsh consequences of this section.

Considering the consequences, this section was not well thought out. A few of the consequences are as follows:

A. The section does not provide a procedure for removing the “taint” and erasing the punitive tax consequences. The solution seems to be to cancel the policies and start all over. What if the insured became uninsurable after the issuance of the policy? What about new contestability and suicide clauses?

B. Is this income tax on the proceeds in addition to Federal Estate Tax consequences?

C. What if the employer is a nonprofit organization? Would the insurance proceeds be taxed as unrelated business income?

D. Does this apply even if the policy is eventually made payable to the employee? Is the income tax paid by the employer or the employee's estate on distribution?

E. Is this earned income?

In stringing these developments (dots) together it is difficult to determine the purpose of the Bush Administrations in pursuing them. One thought is the purpose was to find additional sources of revenue. It seems there are better ways to do this. An economic reason may be to force money out of these pockets of accumulated capital so that it circulates through the economy. The idea being that circulating capital is beneficial to the over all economy. Others might think this is nothing more than a raid on people and small business savings to remedy flawed economic policies.

NOW WHAT?

CONCLUSIONS AND PROPOSALS

Each person may have differing conclusions and ideas depending upon their position within, and view point of, our economy. Mine is with reference to the clients in my practice and observations of the impact of tax legislation and changing economic conditions on these clients over the past 30 years. In essence it is based upon empirical observations.



1) BASIC CONCLUSIONS

The lesson of the middle ages was that capital is necessary for businesses to expand, to flourish, and create jobs. This was done with the bottom of the economy, the peasants. We know it worked because of the rise of economic wealth from the middle ages and the increase of wealth in our own country over the past 50 years.

A similar situation has occurred in China. By using the bottom end of the economy to foster economic growth, China's economy has nearly doubled in the six years through 2007, exceeding \$2 trillion in 2005, creating a delicate capitalist/communist hybrid.

Other countries around the world have attempted to do the same. In some cases financing has occurred with foreign capital. Again, similar to the middle ages model by taking poor people in the lower end of an economy, and finding a way to channel funds for their use to development, it can develop a new economic base. Any kind of new economic base can be helpful for the economic structure as a whole.

Our philosophy has been to build our economy by strengthening it from the top down. This approach is essentially the myth of the trickle down theory, which has not worked all that well. One of the lessons of the middle ages is that economies are strengthened from the bottom up.

The recent economic struggles have increased the number of people that have been disenfranchised from our work force. Our economic structure must find a way to allow such people to raise themselves back up the economic ladder. Their economic and credit status makes it difficult for them to build capital to regain their status.

2) LIFTING THE TAX RATES/ REVIVAL OF THE C CORPORATION

The key is to target the lower end of the economic structure. The goal is to establish an incentive to create working capital within a business, while creating a disincentive to draw the money out of the business.

The use of an S corporation under the Internal Revenue code does not satisfy this goal. Income in the S corporation flows through to the shareholders for income tax purposes and there is no tax disincentive to withdrawing money from the business. Turning to the old dependable C corporation fits the bill.

Under a C corporation income generated is taxed to the corporation at corporation tax rates. The money does not flow through to the shareholders. Shareholders receive money from



the C corporation through dividends, wages, and employee benefits. The shareholder can also receive money from leasing equipment and real estate to the corporation.

The current tax rates for a C corporation are as follows:

| TAXABLE INCOME | PERCENTAGE | OF AMOUNT UP TO |
|--------------------------|------------|-----------------|
| \$0- \$50,000 | 15% | \$50,000 |
| \$50,000- 75,000 | 25% | \$75,000 |
| \$75,000- 100,000 | 34% | \$100,000 |
| \$100,000- 335,000 | 39% | \$335,000 |
| \$335,000- 10,000,000 | 34% | \$10,000,000 |
| \$10,000,000- 15,000,000 | 35% | \$15,000,000 |
| \$15,000,000- 18,333,333 | 38% | \$18,333,333 |
| \$18,333,333- ∞ | 35% | ∞ |

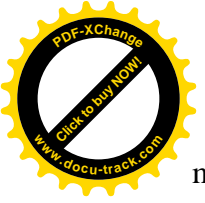
A lower tax rate for corporations for lower taxable income levels, creating a greater incentive to earn more money.

An alternative would be to not raise or lower taxes, but simply lift the tax rates for C corporations. This can be accomplished by a tax rate of 5% on the first \$300,000 of net taxable income, and then start the 15% rate and up at \$300,000.

This would mean more money earned by businesses at the lower end of the economy. The first \$100,000.00 of taxable income taxed at 5%, would mean a corporation that earned taxable income of \$100,000.00 year one, would have an increase in working capital of \$95,000.00 after tax of \$5000.

In the second year, with a \$100,000.00 profit, there would be an additional \$95,000 of working of capital in the business or \$190,000. In year three, working capital would increase to \$285,000. This level of working capital would reduce the need for borrowing. Borrowing to finance growth would not be such a gamble with a greater amount of working capital.

With a 30 to 35% individual tax rate there is a tax disincentive to remove money. As the business continues to build working capital, there is a stabilization point where there is sufficient



money in the business to keep it healthy without additional working capital. At that point in the life cycle of the business the owner and shareholders will begin to pull money from the corporation to improve their life style. Capital budgeting becomes very important. It is necessary to determine what level of working capital is necessary to keep the business healthy. You do not want to take too much money out of the business that it drains the life blood (capital) out of the business and weakens it.

This is like a deferred compensation program for the IRS. The money is eventually going to come out and taxes will be paid on it. In addition with more working capital the value of the business will be greater and subject to Federal Estate Tax.

3) THE DOUBLE TAX??

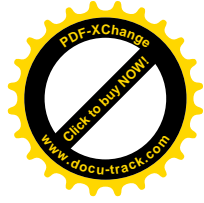
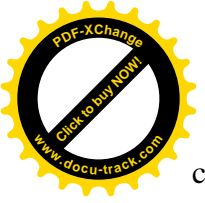
This is about the time when someone raises the issue of a double tax. For a business with a level amount of profit each year there is only a double tax for a C corporation in the last year of the corporation's life cycle. In our example above for year 2, if all the profit of \$100,000 is taken out as salary, there would be a \$100,000 tax deduction to the corporation. This means the corporation would not pay taxes on it. It would then be taxed to the shareholder/ employee, which means it is taxed once.

Where the double tax occurs is in the last year of the corporation's life. For that year when the assets came out of the business, there is no tax deduction. The money coming out will be subject to tax with no corresponding tax deduction which in essence is a double tax. Since it only occurs in the last year of the business, who cares?! That could be 20 year from now or never if the business is sold.

For a business with increasing profits there will be a double tax effect for a least a portion of its profits. The issue is what is best for the economy to achieve a steady sustainable growth.

The discussion of the double tax is really about greed. Government takes steps to create an economy allowing the creation of wealth. After the wealth is accumulated people then want to reduce the tax rates so they can make more. They then want to repeal the estate taxes to keep more in the family. They forget that government created the incentives for wealth formation by sacrificing taxes and providing infrastructure to aid business. This is an investment by government in business and at some point government is reimbursed. Essentially greed comes into the picture.

Greed is not going to go away. The proposal of lifting tax rates for a C corporation is simply using natural greed to aid the economy. It would probably create a shift to more C



corporations. Since the after tax money or working capital of the business would be greater than in an S corporation where all income is taxed to the shareholder at their highest marginal tax rate.

4) ADDITIONAL SUGGESTIONS FOR REVENUE BALANCE

A. REPEAL OF INTERNAL REVENUE CODE #197

This code section was passed in 1993. It allowed corporations to write off all intangibles against income taxes over a 15 year period. Intangibles, in simplistic terms, is “Blue Sky”. You can not touch it, feel it, or smell it. It only exists as an accounting entry on assets that are perceived but do not exist.

This led to the DOTCOM bubble for companies who had soaring values without assets or profits. The DOTCOM’s eventually collapsed because there was no substance to them.

Companies would acquire dotcom companies with inflated prices. Since the interest rates were low it was worth it since tax deductions more than offset the interest costs. In 1993 it was even more beneficial in that Section 197 was applied retroactively to July of 1991. For some companies this resulted in huge deductions.

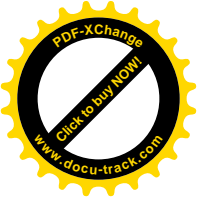
Does this sound familiar. Of course it does! We just went through it again with the real estate industry. Encouraging the valuation of Blue Sky does not help our economy in the long run.

B. RESTRUCTURE LAW FOR TAX PREPARER PENALTIES

We need to encourage more people to go into accounting. Business in the lower end of the economy needs this desperately. Using tax preparer penalties as a revenue source is not good economics. This may include backing off some of the reporting requirements for Sarbanes Oxley. This might result in not as many accountants being sucked up by corporations to comply with Sarbanes-Oxley.

C. DELETE PERSONAL SERVICE CORPORATIONS

Personal service corporations were created in the Internal Revenue Code. It was perceived that C corporations for service oriented businesses were abusing employee benefits. For that reason they were punished by denying them use of the graduated tax rates for C corporations as set out above. With the IRS essentially beating up on IRC 412 I and 419 plans, what is the sense of discriminating against service oriented business now?



D. LIBERALIZE RULES FOR CORPORATE OWNED LIFE INSURANCE

An effort to revitalize the lower end of the business economy will increase the value of these businesses. With that in mind it would be advisable to want to see such businesses create pockets of accumulated capital available to pay Federal Estate Taxes. Life insurance is the vehicle to accomplish this. That seems like a win-win idea for government and business.

E. REVISIT THE REPEAL OF GLASS-STEAGALL

Under Glass-Steagall, banks were limited to the areas of business they could do business in. They could not sell stocks or life insurance. Glass-Steagall was repealed in 1999. Considering banks had a hand in a number of the links in the financial chain that fell when the subprime market collapsed, they did not have a financial incentive to put the breaks on loans to subprime borrowers. This is not to say all of Glass-Steagall should be repealed, but Congress may want to reconsider some of its provisions.

CONGRESSIONAL GOVERNANCE AND ECONOMIC BEHAVIOR

1) ECONOMICS IN A VACUUM

Any action, law, or regulation undertaken by Congress or under its authority, has some impact on our economy. Someone in our economy will be affected by Congressional actions. That person's response to Congress's action in turn impacts someone else, which in turn impacts someone else. Actions taken by Congress do not take place in a vacuum.

Most of the time Congressional actions are undertaken without assessing the economic behavior the action might elicit. There is generally a determination of the impact of congressional action as to whether it will increase revenue, reduce revenue, or be revenue neutral. This analysis assumes there will not be significant changes in economic behavior affecting the amount of revenue generated. Due to the Internet and technology, economic behavioral changes occur much faster and affect more geographical areas.

To add to the complexity of determining economic behavior, is the effect each governmental agency has in dealing with people. How each governmental agency interacts with people also impacts our economy. This interaction may be either positive or negative in its effect on the economy. In good economic times the impact on economic behavior, whether good or bad, may not have a significant impact on the economy. In precarious economic times, however, a minor negative impact on the economy could have drastic impacts. In difficult



economic times, our government needs to assure the conduct and policy of governmental agencies in dealing with its citizenry is not interfering with economic recovery efforts.

Since the early 1940's an area of mathematics called "Game Theory" has been applied to a wide range of social, economic, and scientific disciplines. Game theory came into its own with the book *Theory of Games and Economic Behavior* by John Von Neuman and Oskar Morgenstern, in 1944. John Nash in 1950 developed an equilibrium concept known as the Nash equilibrium, building on the work of von Neuman and Morgenstern. This was based on an equilibrium between competing rivals in an economic setting, occasionally referred to as a "win-win". An equilibrium essentially means a balance of power between two competitors. Instead of destroying each other, they each accept a beneficial result. This result may be a little less than what they might get if they continued the battle. If one of them lost, the loser would have been left with a lot less.

Prior to that time games were more like an "I win, you lose" strategy. Much of the work and break through in this area occurred in the United States, primarily at Princeton University. Many of the Nobel Prize winners in this area are also from the United States. With such home grown knowledge and expertise it would seem logical that it be applied for our own economy and business structures. Although win-win solutions are mentioned frequently, observations of our recent economic problems would indicate the "I win, you lose" approach is more prevalent.

If competing businesses play "I win, you lose", theoretically there is a zero overall impact on the economy. From a practical stand point that is probably the case. In most cases it would logical to assume there would be at least some temporary impact of the economy. If government plays "I win, you lose" with US citizens the impact would be negative since there would not be balance within the flow of goods and services.

2) INTERNAL REVENUE SERVICE

A. POLICIES

No governmental agency has a greater impact on the economy then the IRS. It is dealing with citizens on a one on one basis. What happens in these encounters affects people and businesses. A protracted audit can damage the productivity of a business causing a loss of its customers and money. The fees to hire accountants and attorneys to represent the business in an



audit are expensive. How the IRS conducts such audits over a period of time affects many businesses and people, and in turn affects the economy as a whole.

Over the past eight to ten years, the approach of the IRS has become more confrontational. This is not conducive to resolving audits. It means more audits go to the IRS Appellate Division, and on to U.S. Tax Court. This is an expensive process not only for the taxpayer but also for the IRS. During this period little money is paid toward taxes that may be owed. Interest on taxes owed does not make up for government not having the revenue.

Congress telling the IRS to be more aggressive and collect more money is not good economic policy. It is more like extortion. This is the “I win, you lose” approach. It did not work for the Bush administration so why continue it.

Changes in IRS policies can have an immediate impact on the economy. This applies both from how the IRS handles audits to tax collection. This also applies to the dissemination of information on many tax areas that would be helpful for the economy. This could include information on forming a business. This would encourage taxpayers to form their own business which would help them and in turn benefit the economy as a whole. In addition it would increase tax revenue.

This also applies to beneficial tax changes for taxpayers. With the IRS generating information on such changes it would take a shorter period of time for taxpayers to understand tax changes and how to respond to them. When they understand, the benefits to the economy are lasting.

This may be part of the rationale for reducing withholding. If withholding is reduced each taxpayer has more money in their pocket to spend and help the economy. The problem is that the tax rate was not lowered. Taxpayers will still have the same amount of taxes to pay. Since the withholding was reduced the taxpayer will have to come up with more money at tax time. In addition, there will be less refunds paid out, which may have a dampening effect on the economy. This is really like taking a gamble with taxpayer’s money. This is a bit short sighted and is another example of the “I win, you lose” approach.

The trickle down theory was applied to after tax money from tax cuts trickling down to the bottom of the economic ladder. It also applies to tax laws, flawed policies, and mistakes.



B. AUDIT PROCEDURES

Understanding the impact an IRS tax audit has on a business is important. A good knowledge of the inner workings of a business would help reduce the time and cost for the resolution of an audit. It would also accelerate the receipt of revenue determined by the audit. More money should be budgeted to the IRS for training on business audits. This is to assure an IRS auditor is conversant with how a business operates. Cutting the budget for the IRS is not a good economic decision.

It is expensive for accountants and attorneys for the taxpayer to educate the auditor on how a business operates. This is a major loss of productivity both for the business and the IRS. Finding a method to accelerate the audit process would help the economy, the IRS budget, and accelerate the receipt of revenue.

Finding a faster way to resolve impasses in an audit would be helpful. Current audit procedures allow a taxpayer to request meeting with the supervisor of the auditor if it is not going well. If that does not resolved the audit, the Taxpayer can request an appeal before the Appellate Division of the IRS. The United States Tax Court is thereafter available to the taxpayer.

These remedies, however, are not available until after the audit process has been substantially completed. It may still take years to resolve what might have been handled in months.

There should be an earlier remedy in the audit process to determine if the continuation of the audit is in the best interest of both the IRS and the business. It would be like a “time out” prior to the issuance of a 30 day letter and before going to IRS Appeals.

The IRS person mediating should have the authority to mediate a settlement and resolution and override the audit process. This would accelerate the completion of audits. It would also accelerate the IRS’s receipt of taxes. In addition it would get the business back to conducting business operations to make more money and in turn pay more taxes. The Taxpayer Advocate should have independent oversight on the program to assure it is accomplishing these goals.

C. OFFER IN COMPROMISE (OIC) PROGRAM

An Offer In Compromise is a procedure where taxpayers who owe money to the IRS but do not have the assets or ability to pay, may agree to pay a lesser amount and have the tax liability absolved. When the amount is agreed upon with the IRS, the taxpayer pays the money



and the entire tax liability is satisfied. This frees the taxpayer to return to being a productive member of society.

Having a tax liability hanging over your head severely restricts and impedes financial transactions by a taxpayer. They can not buy a house. They have difficulty getting credit. Starting a business is nearly impossible. They are no longer a fully productive member of society. The more people that are in this situation the greater the negative impact on our economy.

The purpose of the OIC program is to free such taxpayers from this economic prison. With this in mind, it is difficult to understand the legislation passed in May of 2006 making it more difficult achieve an offer in compromise. It appears to be another punitive action by the Bush Administration.

A report issued by the Treasury Inspector General for Tax Administration in July of 2006, indicated the service was running a backlog of 1,100,000 offers in compromises. This means there was 1.1 million taxpayers that wanted to pay money and were not having their OIC processed. This meant the government was not receiving money on these tax liabilities. At first this may not seem like much, but do the math. If these offers averaged \$5000 per offer, this means the OIC program was leaving 5.5 billion dollars in uncollected taxes on the table!

This assumes a low average payment for offers. A more realistic number would be an average of 10 thousand dollars per offer. This would mean the program was leaving ten billion dollars of tax revenue uncollected, to say nothing of the potential economic productivity left dormant because of these policies.

This could be the basis of a “win-win” stimulus program. By simply requiring all these offers to be granted and processed over ninety days, the federal government picks up \$10 billion in revenue and frees 1.1 million taxpayers to be productive members of the economy. Think about it, a stimulus plan where congress gets money back.

A better idea would be to revamp the OIC program. In my experience, as many as 7 different persons touch an application for an OIC. In the early nineties, the OIC program was run through IRS collections. The collection person would have enough information on a taxpayer to be able to determine if an OIC was warranted. The System worked faster and more efficiently. This would then free up many of IRS employees working OIC’s to switch to collections. Then we would not have a need for private firms collecting taxes. There is a budget savings and more revenue.



3) TOO BIG TO FAIL!

This refers to companies that have grown so big their failure would have a catastrophic impact on our economy. The conclusion being that all efforts must be taken to assure such a company does not fail. These efforts have been a major drain on the federal budget and have substantially increased the debt.

Congress's reaction is legislation must be passed to deal with the danger of having too many companies "too big to fail", creating more bureaucracy to regulate this problem.

This is illogical since it was Congress that allowed it to occur!

Over the past seventeen years corporate growth has increased dramatically. Much of this growth occurred through corporate mergers and acquisitions. The rationale for this growth spurt was it was necessary for domestic companies to compete with foreign companies who were also increasing in size. The issue is the policy applied to anti-trust regulation to avoid monopolies.

There were two basic policy tests. The First test, "Did it reduce competition?"

The second test, "Did it benefit the consumer?"

In the USA the policy to foster competition was replaced with the philosophy of "did it benefit the consumer". The problem with this policy is any business pursuing a merger or acquisition increasing its size could argue it would result in lower prices thus benefitting the consumer. This ignores the fact the consumer would have less options and is now controlled by the larger company.

The European approach was mergers and acquisitions would not be allowed if it reduced competition. This difference became apparent in July of 2001, with the decision of the European Commission to block the merger of General Electric and Honeywell, and to fine Microsoft for violating European competition laws in 2004. Obviously Congress and the U. S. Justice Department disagreed with the European Commission.

The current concern over the "too big to fail" problem might have been avoided with a philosophy based on fostering competition. There is no need for more regulation, just change the governing philosophy from the former Bush administration approach.

4) GLOBAL INTERACTION

Actions taken by our federal government while impacting economic behavior for the USA also affected other countries. A global economy and efficient technology have magnified the impact of our actions on other countries. If we mismanage our economy, the problems created affect our trading partners as well as countries that have invested in the USA.



Many countries are connected to our economy through the exchange of currencies. The wide swings of our economy requires other countries to respond economically to problems created by the USA.

This issue has been addressed in the international community. Angela Merkel the Chancellor of Germany alluded to this during her campaign for reelection as Chancellor of Germany over the past two years. Her message stressed the need for “steady, sustained growth”. Wild economic swings cause internal turmoil and economic uncertainty, not only for the USA but for other countries as well. The uncertainty these swings create, cause businesses to be more cautious which slows economic recoveries. This message struck a responsive cord with the German people who elected her.

Angela Merkel’s comments are a subtle message to the USA. There can not be sustainable, steady growth for Germany and Europe if the USA’s economy is a bouncing ball. We have been chided by other countries over our economic management or more accurately, mismanagement.

This approach seems logical as an economic goal. Having wide economic swings has not been beneficial for our economy. Why have we not heard similar language from our elected representatives, economic advisors, and financial leaders? We have the greatest minds and Nobel Prize winners in the economic arena in this country, so why are we not using them?

This issue should not be ignored. At some point, if it has not already started, other countries may develop strategies to decouple the economic effect of USA downturns from their country. Such strategies may not be to our benefit.

5) FEDERAL ESTATE TAX REPEAL

The Federal Estate Tax (FET) should not be repealed for a number of reasons. First and foremost, we can not afford to repeal it. With the spending of the Bush Administration and the Stimulus Bills passed to pull us out of a recession, the Government needs the revenue.

Another aspect of this same reasoning is the studies by the Boston College, Center on Wealth and Philanthropy (formerly Social Welfare Research Institute)of the amount of wealth in our country that will transfer by 2055.

The studies by Boston College estimated between 41 and 136 Trillion dollars of wealth will change hands by 2055. These are serious numbers and should not be ignored in any Federal Estate Tax legislation to address current FET issues. Numbers like those would go a long way



towards putting our budget back in balance, assuming we stop overspending. More recent follow up studies indicate the actual number may be on the higher side of that range.

It is important to not ignore the above discussion in relationship to hedge funds. Large pools of capital should not be ignored in this discussion. Not only can these pools of capital provide a substantial boost to our budget from FET, but it avoids the amassing large pockets of wealth that may create an independent aristocracy affecting all countries. This may not be in the best interest of a vibrant economy when financial behemoths can crush competition and become too big to fail. This is another reason to not repeal the FET.

Another reason to not repeal the estate tax is based on the presumption income tax rates and regulations may be structured to promote capital formation similar to that discussed above. It would seem unreasonable to make it easier to build capital without having a payback at some point.

An issue raised for the repeal of the FET, is its disruption on a successful business. In most cases this is due to the neglect on the part of management to develop a business succession plan. It is not the role of congress to legislate estate and business planning for private citizens.

By liberalizing the rules for corporate owned life insurance money would be available to pay estate taxes and allow the business to continue in a profitable manner. Most other businesses do so.

Others say the FET is punishing success. NO! Success is its own reward.

As a side note, although I have not had the experience, I am quite certain taxes hurt more when you are alive then when you are dead.

6) LEGISLATIVE DANGER ZONE

There is a hidden issue lurking in the shadows of stimulus plans, bail outs, administrative changes, and tax changes. This is a fear factor related to major changes in tax laws. No matter which way money is headed, whether to the government or to the taxpayer, it is as the result of a tax change. If it is a stimulus plan it is a refund. If it is increased costs as in health care it is a tax increase.

Over the past 30 years, there has been a recession within one to three years after any major change in the tax laws. The 1976 tax act spawned double digit inflation and interest rates approaching 20%. The 1984 Tax Act had a faster impact on the economy. The effect of the act hit the economy within one year.



The 1986 tax reform act was phased in over three years. The phase in did not stop the next recession. The recession started in the spring of 1989, when the total act was finally phased in.

The 2001 tax legislation contained major changes to the tax laws and the economy took a dive. Some say it was due to other factors, but the fact remains, it did happen.

The Pension Protection act of 2006 was passed two years before the current problems occurred. This is not say the Pension Protection Act caused this recession, but after the same result occurs repeatedly, whether the tax legislation caused each following down turn or not, it is hard to ignore the correlation.

We have just had huge economic and tax changes. Many see signs of improvement in the economy. Some are forecasting sunny days ahead. This is an easy forecast to make after the storm has already hit. Even with hope and evidence of some economic improvement, this economy is like a patient recovering from a serious illness. It is in a weakened condition and can ill afford another traumatic economic episode.

We can not say the economic crisis is over. The ghost of past tax legislation lurks and may reemerge in 2011 or 2012.

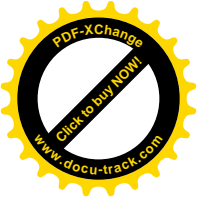
This same sentiment is being echoed by German Chancellor, Angela Merkel. The issue she is addressing is to break the cycle of bubbles and crises by tempering economic growth. This is essentially the same concern.

It is apparent, a credit based economy is too volatile. When problems occur there is no stabilizing force within the economic structure to balance the economy. The solution has been to throw money at the problem. The fear is it will not work. In past recessions it has generally been the small business sector that has lead us out of recessions. A structure where small businesses develop working capital provides a more stable structure.

FINAL THOUGHTS

This Article is not an effort to establish a definitive solution to our economic woes. It is an effort to place situations in our economy on paper in such a manner to provide a basis of discussion of economic and tax issues both for tax planning, and for thought and discussion.

Connecting the dots set forth in this paper does not result in many happy thoughts with regard to the future of our economy. The lack of concrete debate on these issues is a concern both domestically and internationally.



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