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The Continuing Saga of Unfulfilled Business Income Tax Reform: The Business Community Has Only Itself to Blame

Rhetoric and Reality

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Agenda

- Introduction
- Breaking News
- Current Status
- Is Tax Reform Necessary?
- Tax Reform – Rhetoric and Reality

Introduction

- **At least 5 years of complaints by the business community**
  - Want U.S. business tax structure to "look like the rest of the world"
- **Many serious policy analyses (mostly ignored)**
- **Much political pontification**
- **No recent legislation other than mindless, expensive extension of existing corporate tax benefits**

Breaking News

- Cong. Renacci (R-Ohio) introduces a 7% boreder adjustable credit-invoice VAT to replace corporate income tax
- Individual income tax
  - Three individual brackets—10 (to 50/100,) 25 (to 750/1,500) and 35
  - Standard deduction of $15, 000 per filer, $5,000 personal exemption
  - Eliminates all itemized deductions except for charitable and mortgage interest to $500,000 mortgage
  - No capital gain or dividend rate preference
  - Repeals AMT

Current Status

- **No comprehensive introduced legislation**
  - “Innovation box” (Boustany/Neal)
  - Cost recovery reform (Wyden)

- **House Republican Blueprint- “A Better Way”**
  - Proposes business cash flow tax to replace corporate tax
    - Expensing of capital investments (Trump—no)
    - Border adjustable
  - Tax rate of 20% (Trump 15%)
    - Maximum tax of 25% on pass-throughs after reasonable compensation
  - Territorial system for off-shore income (Trump-worldwide, no deferral)
  - No current deduction for net interest expense
  - Unlimited carryforward of NOLs with interest
  - LIFO maintained
  - Unrepatriated earnings taxed at 8.75% if in cash or cash equivalents, 3.5% otherwise with tax paid over 8 years

- **Pending international-only proposal from Chairman Brady**
- **Pending integration proposal from Chairman Hatch**
- **Treasury Anti-Inversion and Section 385 Regulations**

Is Tax Reform Necessary?

- **Criteria by which to analyze**
  - Equity
    - A political question of appropriate distribution of tax burden
      - Corporate income tax distribution plainly violates horizontal equity as an empirical matter
      - Effect of tax expenditures in general
  - Efficiency (neutrality)
    - Tax system should not affect economic decisions
    - Current system contains more than 250 “tax expenditures” totaling more than $1.3 trillion
      - Direct outlays in FY 2015 -- $3.5
      - Tax expenditures equal 27% of total annual government expenditures
  - Administrability

Is Tax Reform Necessary?

- Achieve revenue goals
  - Current CBO projection of large deficits
    - Effect on economic growth
      - “Serious negative consequences”
- Maintain U.S. competitiveness
  - Corporate rate
  - Taxation of income earned outside U.S.

Is Tax Reform Necessary?

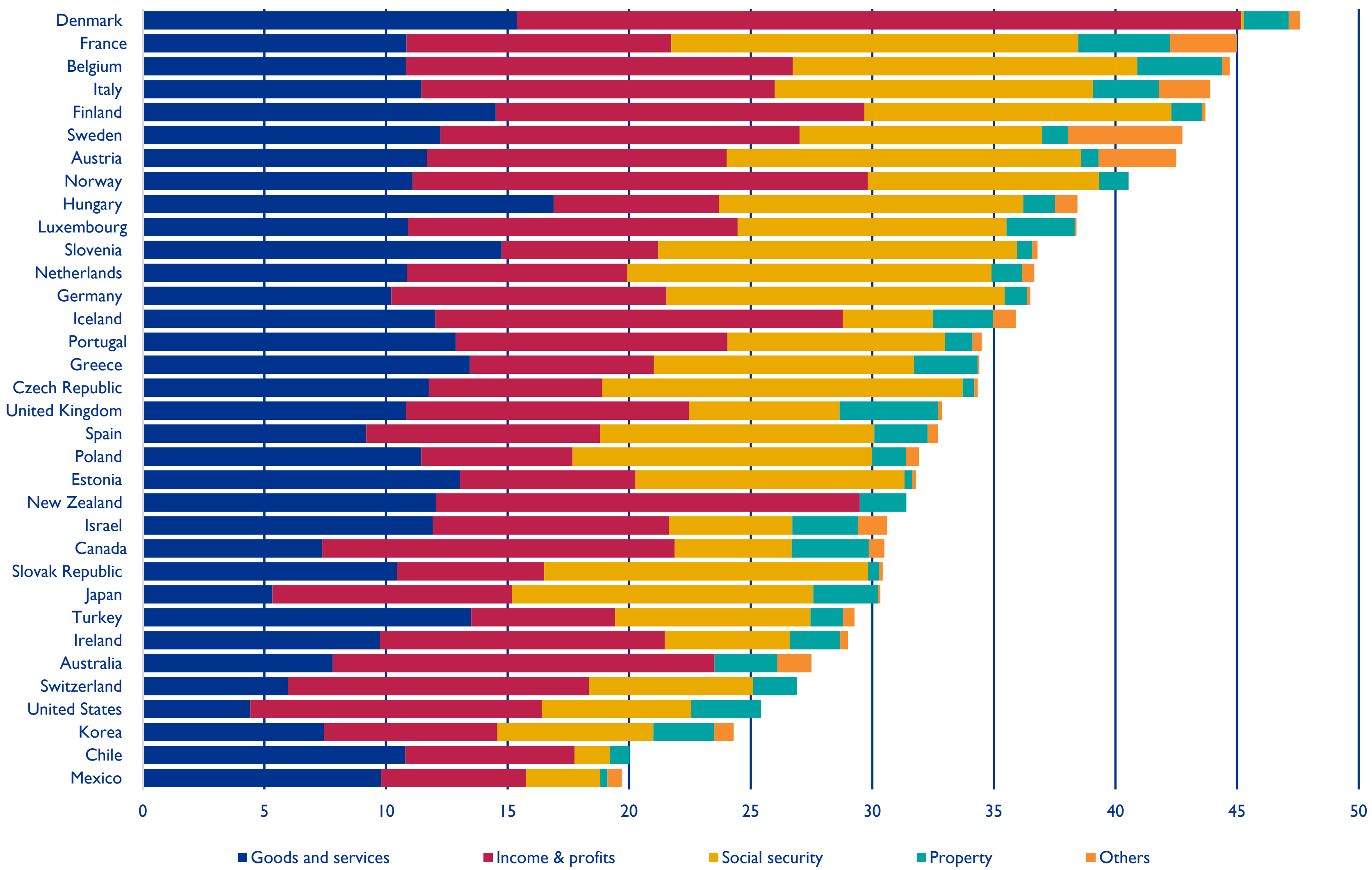
- **Taxation of Income Earned Outside the United States**
  - General consensus that the current system must be changed
    - Highest nominal corporate rate
      - Caveat – Effective tax rates vary significantly depending principally upon product and where tax activity takes place
      - Effect of tax expenditures in general
  - Inversions
  - Earnings stripping
  - Over $2 trillion in un-repatriated earnings
  - What system to adopt
    - Territorial – Off-shore **active** income taxed at source
    - Worldwide – All income taxed at U.S. rate currently with foreign tax credit
  - BEPS

The Economic Outlook

- **The fiscal situation governs the parameters of tax reform**
  - The long-term economic outlook dictates that tax reform has to be at least “revenue neutral”
  - As a practical matter this means that tax reductions (e.g., rates) have to be offset by tax increases accomplished through elimination of tax preferences
    - Corporate rate reduction costs $10b. per point per year
    - As a mathematical matter, there are insufficient tax expenditures to reduce the rate to 25%

OPTION

Types of tax revenue as share of GDP, 2014



Source: OECD, Revenue Statistics 1995-2014 (2015)

Tax Reform – Rhetoric and Reality

"It [tax reform] shouldn't be that hard, actually, given the broad recognition in both parties that exchanging lower tax rates for a reduction in loopholes would be good for both fairness and efficiency."

- Washington Post editorial, May 17, 2014

"Blah, blah, blah, blah."

- House Speaker John Boehner, Feb. 26, 2014

Tax Reform – Obstacles

- Political line-up and process
  - Inability of Republicans to overcome filibuster in Senate
  - Potential Presidential veto
- Lack of agreement on revenue neutrality and how calculated
- Insufficiency of revenue available from elimination of tax preferences for large rate reduction
- Redistribution of tax burden creates winners and losers
- Political need to maintain distributional neutrality among certain categories (silos) of taxpayer
  - Business/Individual (e.g., partnerships)
    - More than 40% of business income earned by pass-throughs and non-farm sole proprietorships in 2012
  - Domestic/Foreign
  - Individual income brackets

Tax Reform – Distribution of corporate tax benefits

Table 2A. Percentage Change in Tax Liability From a Revenue-Neutral Corporate Tax Reform

Industry	Slower Depreciation	Repeal Domestic Production Credit	Repeal Research Credit	Rate Reduction to 30%	Net Overall Tax Effect	
1. Securities	1.8%	0.1%	0.1%	-14.3%	-12.3%	WINNERS ↑
2. Insurance	1.9%	0.1%	0.4%	-14.3%	-11.9%	
3. Credit intermediation	3.6%	0.2%	0.4%	-14.3%	-10.2%	
4. Retail trade	3.5%	0.4%	0.2%	-14.3%	-10.1%	
5. Bank holding companies	3.7%	0.2%	0.3%	-14.3%	-10.1%	
6. Real estate	5.9%	0.3%	0.2%	-14.3%	-7.9%	
7. Accommodations	5.8%	0.9%	0.8%	-14.3%	-6.9%	
8. Other services	7.5%	0.5%	0.4%	-14.3%	-5.8%	
9. Wholesale	6.1%	2.6%	1.5%	-14.3%	-4.1%	
10. Mining	4.1%	9.1%	0.2%	-14.3%	-0.9%	
11. Construction	7.6%	6.8%	0.2%	-14.3%	0.3%	LOSERS ↓
12. Oil and coal products	4.1%	11.1%	0.3%	-14.3%	1.2%	
13. Food manufacturing	6.1%	9.1%	1.5%	-14.3%	2.5%	
14. Utilities	12.9%	6.4%	0.5%	-14.3%	5.5%	
15. Other manufacturing	8.7%	8.9%	3.5%	-14.3%	6.8%	
16. Publishing	3.4%	10.7%	7.0%	-14.3%	6.8%	
17. Chemicals	5.4%	7.4%	8.8%	-14.3%	7.3%	
18. Metal, minerals, and machinery manufacturing	7.9%	9.3%	4.5%	-14.3%	7.3%	
19. Transportation	23.3%	0.1%	0.2%	-14.3%	9.3%	
20. Internet	17.6%	4.1%	2.7%	-14.3%	10.2%	
21. Agriculture	24.4%	6.0%	0.7%	-14.3%	16.8%	
22. Technical services	9.9%	2.9%	19.0%	-14.3%	17.5%	
23. Computers and electronics	11.4%	10.0%	25.9%	-14.3%	33.0%	
24. Transport equipment	34.4%	10.5%	17.4%	-14.3%	48.1%	
25. Electrical products	48.3%	18.3%	17.3%	-14.3%	69.7%	

Source: Martin A. Sullivan
"Winners and Loser in Corporate Tax Reform" 130 Tax Notes 731 (2011)

Tax Reform – Obstacles

- Transitions, phase-ins, and timing changes obscure true revenue impact
- Lack of agreement on taxation of foreign earnings: Territorial or worldwide taxation
- Foreign response to tax changes blunts competitive benefit
- Macroeconomic benefits are questionable
  - "Dynamic" scoring

Tax Reform Supermarket

Aisle 1	Aisle 2	Aisle 3	Aisle 4
Conventional Income Tax Reform: Broaden the Base to Pay for Lower Rates	**New Revenue Sources to Pay for Lower Income Taxes**	**Corporate Integration: Tax Corporate Profits Once**	**Fundamental Tax Reform: Replace Income Tax with Consumption Tax**
* Tax Reform Act of 1986 * 2005 Bush panel * Simpson-Bowles * Ryan (2011) * Wyden-Coats * Obama (corporate only) * Romney * Camp * Clinton	* Bank tax * Financial transactions tax * Carbon tax * VAT (Treasury 2007) * VAT (Graetz) * VAT (Rivlin/ Domenici) * VAT (Ryan 2010) * VAT (Cardin)	* CBIT (Treasury) * BEIT (Kleinbard) * Mark-to-Market (Toder/Viard) *Hatch-TBD	• Fair Tax • Flat Tax • Nunn – Domenici • 9-9-9 • X-Tax (Bradford) • Cruz • Rubio-Lee • Trump

The Key to the Kingdom

- **Senator Ben Cardin, Progressive Consumption Tax, introduced December 12, 2014**
  - Ten percent credit invoice value-added tax (VAT)
  - Regressivity relief through refundable income tax credits based on income and family size
  - Family income tax exemption of $100,000 for joint filers, $50,000 for singles
  - Maximum income tax rate of 28%
    - Capital income preferences repealed
  - Corporate rate reduced to 17%
    - No other structural changes to corporate tax
  - "Circuit breaker" to limit revenue pickup

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