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Finance hearing focuses on boosting economic growth through tax reform

Witnesses at a February 24 Senate Finance Committee hearing on tax reform and economic growth advocated for a territorial system of international taxation and even suggested that Congress should look at some form of a consumption tax – an idea that is generally viewed as a nonstarter on Capitol Hill.

Chairman Orrin Hatch, R-Utah, opened the hearing by noting that "[m]any of us on the committee believe that tax reform is no longer optional. Rather, it is essential to help get our economy moving again." Although he praised the fact that the president and congressional Democrats agree with Republicans that tax reform is necessary, Hatch criticized several of the tax proposals in the administration's recent fiscal year 2016 budget blueprint as "anti-growth."

For his part, ranking member Ron Wyden, D-Ore., noted that the celebrated bipartisan reform efforts of 1986 had produced a code that equalized the tax rates between capital income and wages. He said that today's system "punishes middle-class wage-earners by taxing their income at a higher rate than investments" and that tax reform should level the playing field as a matter of basic fairness.

Economic distortions, competitiveness

Witnesses agreed that tax reform is badly needed to spur economic growth and worried that the US tax system is falling behind the rest of the world in terms of promoting competitiveness. Michael Boskin of Stanford University told the committee that the US tax system is more in line with the economic world of 1965 than that of 2015.

In his opening statement, Hatch asked the witnesses to explain how the current system distorts economic decision-making or hinders economic growth. John Diamond, a fellow at Rice University, said that many tax preferences in the code are distortive and poorly designed for their purported incentive effect. The deduction for mortgage interest, for example, offers little incentive to lower-income taxpayers because they do not itemize deductions, Diamond said. He urged the committee to eliminate many preferences and not treat any one of them as sacrosanct. In later questioning, he expressed support for a model that he said New Zealand had used to reform its tax system: eliminate everything and then make stakeholders justify which specific preferences should be added back.

Jane Gravelle of the Congressional Research Service presented her work and reviewed that of others on the economics of reform. She told the panel that economic distortion in the current system arises not so much from the system as a whole, but from specific factors such as offshore profit shifting and the differing tax treatment of debt and equity.

In her written testimony, Gravelle noted the macroeconomic modeling used to evaluate the tax reform discussion draft released by then-Ways and Means Chairman Dave Camp, R-Mich., last year, and argued that the Camp proposal would probably lose revenue in the long run and "eventually cause a reduction in [economic] output." This would be attributable to a crowding out effect from low rates, she explained, adding that revenue-neutral reform would produce little impact on output because of the elimination of tax benefits to achieve a lower rate. (A macroeconomic analysis prepared by the nonpartisan Joint Committee on Taxation staff indicates that Camp's plan would boost the size of the economy and therefore also boost federal receipts by between $50 billion and $700 billion over 10 years, depending on which assumptions and models are used to make the calculations.) Gravelle also noted that some research showed that the Tax Reform Act of 1986 had not really altered incentives for growth.
URL: https://www.jct.gov/publications.html?func=startdown&id=4564

Territoriality

Laura D'Andrea Tyson, a professor at the University of California-Berkeley and a former economic adviser to President Clinton, said the code has to be pro-growth, and emphasized that many of the concerns about inversion transactions, base erosion, and profit shifting were really based on defects in the current system. US multinationals are highly disadvantaged, she said, and they are using every tool in the code to make themselves more competitive with foreign rivals who operate under different systems. The United States has to move to a territorial system, she stressed.

Tyson said deferral encourages companies to build up earnings overseas, but they then keep those earnings offshore because the high US corporate tax rate discourages repatriation. She added that concerns about profit shifting under a territorial system can be addressed through anti-abuse rules and do not mitigate the need for adopting territoriality. If the tax rules don't change, she cautioned, there is a danger that the number of foreign acquisitions of US companies will increase. Tyson added that she is also worried about the flow of investment and the location of new companies. Other "tax homes" are more attractive than the United States, she said.

Integration, consumption taxes?

Hatch asked witnesses about integration of the corporate and individual tax systems, an issue that was analyzed heavily in the tax reform report prepared by Republican Finance Committee

staff and released last December. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 39, Dec. 12, 2014.) Boskin said the United States should integrate if it could. Diamond agreed, but he cautioned that any move toward integration would be complicated by the same international concerns that surround other reform options.
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150227_1suppA.pdf
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/141212_3.html

Several of the witnesses advocated a consumption tax because it would be economically more efficient. However, Boskin said a consumption tax could not just be grafted onto the current system; rather, it would need to be a replacement for most of the income tax. Tyson suggested that a carbon tax could help raise revenue for infrastructure projects.

Simplification

Wyden asked witnesses about the importance of simplification as a goal of tax reform, noting that although voters' eyes glaze over when politicians talk about multinationals and profit shifting, they are interested in making the tax rules less complex. He touted the tax reform plans he introduced in 2010 and 2011 as a way to simplify the code for most taxpayers. (For details on Wyden's tax reform proposals, see *Tax News & Views*, Vol. 12, No. 15, Apr. 8, 2011.)
URL: http://newsletters.usdbriefs.com/2011/Tax/TNV/110408_6.html

The witnesses generally agreed that simplification should be one of the goals of tax reform, but Tyson cautioned that if Congress wants to help the middle class by offering tax benefits for things such as education and child care, it will require keeping some complexity in the tax code.

"You can't do that on a postcard," she said, referring to arguments by some lawmakers that a tax code overhaul should result in a radically simplified the Form 1040.

Next up: Tax fairness

Senate taxwriters will next address the issue of fairness in the tax system at a hearing planned for March 3. In a February 25 news release announcing the hearing, Hatch noted that "[o]ur current tax system – with its numerous exemptions, deductions, credits, and exclusions – is incredibly unfair" and that "[w]e need to clean the tax code and reduce the number of tax expenditures to broaden the tax base and lower rates." The upcoming hearing "will give committee members the opportunity to explore how Congress can act to implement a simpler, fairer tax system for the American people," Hatch said.

Witnesses scheduled to appear include Lawrence B. Lindsey of The Lindsey Group, Deroy Murdock of Fox News and National Review Online, Heather Boushey of the Washington Center for Equitable Growth, and Steven Rattner of Willett Advisors LLC.

Tax reform working groups

Behind the scenes, the Finance Committee's five bipartisan tax reform working groups should by now be several weeks into the process of examining issues in their respective policy areas

as they prepare to make recommendations for a tax code overhaul, according to a calendar distributed to committee members and staff that has been circulating in Washington. Another Finance Committee document making the rounds on – and off of – Capitol Hill is a list of specific topics the working groups are expected to consider in their deliberations.
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150206_3suppA.pdf
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150227_1suppB.pdf
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150227_1suppC.pdf

The calendar indicates that the five groups – which cover the individual income tax, business income tax, savings and investment, international tax, and community development and infrastructure – are expected to continue holding weekly "tax reform education sessions" through the middle of March and then prepare for "roundtable presentations" from mid-March through mid-April. Roundtable presentations are slotted for the last half of April. The groups are then scheduled to take the month of May to prepare reports outlining their findings and recommendations. Reports are due to Hatch and Wyden by May 25 and could become the foundation for an eventual Finance Committee tax reform bill. Hatch indicated earlier this month that "it would be best if [the groups] can produce legislative text," but added that it is not a requirement. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 7, Feb. 6, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150206_3.html

In remarks to reporters on February 24, Hatch stated that he has so far been taking a hands-off approach in managing the working groups.

"I've actually been leaving them to themselves, and hopefully they'll come up with some ideas for us that we can utilize. That's the goal," he said.

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House OKs expanded section 529 provisions

The House of Representatives voted 401-20 on February 25 to approve legislation (H.R. 529) that would expand the current-law rules governing section 529 savings plans for higher education expenses by clarifying that computers are a qualified expense for section 529 account funds, permitting plan holders to redeposit refunds from colleges without taxes or penalties under certain circumstances, and eliminating any requirement that the earnings portion of any distribution be determined by aggregating accounts. The bill would be effective for distributions made after December 31, 2014.

The Joint Committee on Taxation staff estimates that the measure, which does not include offsets, would reduce federal revenues by $51 million over 10 years.
URL: https://www.jct.gov/publications.html?func=startdown&id=4727

H.R. 529 was introduced January 26 by House Ways and Means Committee members Lynn Jenkins, R-Kan., and Ron Kind, D-Wis., and gained attention following President Obama's announcement that his fiscal year 2016 budget blueprint would include a proposal to eliminate

the tax-free treatment of certain withdrawals from section 529 plans. The White House subsequently dropped that proposal from the budget package. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 4, Jan. 30, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150130_5.html

Next steps

An identical bill (S. 335) was introduced in the Senate on February 2 by Republican taxwriter Charles Grassley of Iowa, although it is unclear when it will be taken up in the Finance Committee. Grassley's bill has bipartisan support on the taxwriting panel: among its eight co-sponsors are Democratic Finance Committee members Ben Cardin of Maryland, Robert Casey of Pennsylvania, and Mark Warner of Virginia.

For his part, President Obama appears willing to sign the legislation if it reaches his desk, despite his belief that it does little to benefit middle-income taxpayers. White House Press Secretary Josh Earnest told reporters February 25 that the administration does not "oppose the House bill, but we believe that there is a whole lot more that we can do that would be a whole lot more effective and more fiscally responsible to ensure that we're opening up a college education to even more middle-class families."

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