Deloitte.

Tax

Tax News & Views

March 6, 2015

In this issue:

Senate taxwriters look at tax reform and fairness

There was general agreement at a March 3 Senate Finance Committee hearing that a tax code overhaul should promote fairness; but as some on the committee and some of the witnesses pointed out, determining what constitutes fairness is the key question.

Chairman Orrin Hatch, R-Utah, noted in his opening statement that if Americans "do not believe a tax reform proposal is fair, it's hard to see, politically, how it could be enacted." He argued that "fairness, in the context of the tax code, means that similarly situated taxpayers should be treated similarly. The tax code should not pick winners and losers. It should, instead, be crafted to allow people to prosper with as little interference from the government as possible."

Ranking member Ron Wyden, D-Ore., focused in his opening statement on the issue of prosperity, saying that too many Americans feel stuck economically and are concerned that the middle class is shrinking. Because of this, he cautioned against making rate reduction the overriding goal of tax reform and argued that the fairest route to a better tax system would be to "fix the tax code and accomplish our goals more effectively – to build a stronger economy and help more Americans climb the economic ladder."

Income equality v. economic growth

Several of the witnesses discussed the current levels income equality, although they differed on how – or whether – the tax code should try to address this issue.

Lawrence Lindsey, president of the Lindsey Group and a former economic adviser to President George W. Bush, said it would be better to focus on the economic well-being of the typical American rather than the difference in income between those at the top and bottom of the scale. Using the tax code to redistribute income is not the answer, he said, adding that the United States has not "been particularly effective at fostering policies that make American income distribution more equal." Lindsey pointed to Department of Commerce statistics that showed that, when factoring in transfer payments, income inequality had risen under every president since Nixon. This occurred even as the tax code became more progressive, Lindsey said. He told the committee that goal of tax reform should be enacting policies that ensure economic growth.

Journalist Deroy Murdock agreed with Lindsey that the code should encourage growth and global competitiveness, and he suggested that Congress should slash or completely scrap the corporate income tax, as well as adopt a flat tax. In later questioning, Murdock criticized the use of the code as a social policy tool.

In contrast, Heather Boushey, executive director and chief economist at the Washington Center for Equitable Growth, urged the enactment of reforms that would address income inequality – particularly by increasing progressivity in the tax code – and argued that these types of reforms would not hinder economic growth. She stated that economic research suggested that "optimal" tax rates for high-income individuals could approach 80 percent. Boushey also called for increasing the estate tax rate and eliminating stepped-up basis (proposals that are unlikely to find much support in a Republican-controlled Congress).

Steven Rattner, chairman of Willett Advisers and President Obama's former "Auto Czar," was largely in agreement with Boushey. However, he did recommend looking at ways to simplify the tax code, which he likened to a garden in need of "constant weeding" as a result of assorted provisions that have been added in over decades. Rattner was also critical of the differing tax rates for labor and capital income and suggested that the code should tax carried interest as ordinary income.

Wyden releases Democratic report on 'loopholes'

In conjunction with the hearing, Wyden released a report on what he called "some of the most egregious tax loopholes" that "sophisticated taxpayers" can use to reduce their tax liability.
URL:
http://www.finance.senate.gov/imo/media/doc/030215%20How%20Tax%20Pros%20Make%20the%20Code%20Less%20Fair%20and%20Efficient%20-%20Several%20New%20Strategies%20and%20Solutions_FINAL%20cover.pdf

The report, prepared by the committee's Democratic staff, outlines six strategies involving financial products or deferred compensation that it says change the character or timing of income for tax-avoidance reasons. These include the use of collars, wash sales, derivatives, "basket options," and nonqualified deferred compensation plans. The report says these strategies produce inconsistent treatment of income for tax purposes, thus reducing tax equity and economic efficiency, and it recommends legislative or regulatory actions to address them.

"Sophisticated taxpayers are able to hire lawyers and accountants to take advantage of these dodges, but hearing about these loopholes must make middle-class taxpayers want to pull their hair out," Wyden told the taxwriting panel.

Coming next: Tax code simplification

Senate taxwriters will continue their examination of discrete issues in tax reform at a hearing on simplicity in the tax code set for March 10.

"At over four million words, our current tax system confuses taxpayers and forces individuals and businesses to spend hundreds of billions of dollars in compliance costs," Hatch said in a March 3 news release. "A simplified tax code will reduce these costs, increase efficiency, and unleash scarce capital so that it is available for job creation. It will also make tax incentives more easily understood and accessible to taxpayers, especially lower-income taxpayers."

Hatch weighs in on tax reform prospects

In other developments, Finance Committee Chairman Hatch said in an interview with *The New York Times* March 2 that tax reform is "probably going to take longer than two years," a situation he attributed to increased polarization in Washington and a lack of action by the Obama administration.

Hatch observed that the process leading to the enactment of Tax Reform Act of 1986 took three years even though, in his view, the political environment at the time was less contentious than it is currently. "There's much more bitterness and partisanship [today]. We've got to overcome those things. I'm going to do everything I can to overcome them," he said.

Hatch also noted that President Obama has been slow to act on his stated goal of reforming the business tax rules. "The president said he's interested in a business tax bill. That's easy to say," Hatch remarked. "I've suggested to them, 'send us up a bill that you believe will solve that problem,' So far, nothing."

Camp proposal, consumption taxes: Turning to specific tax reform proposals, Hatch stated that the discussion draft put forward last year by then-House Ways and Means Committee Chairman Dave Camp, R-Mich., included "some very good concepts." He also said he found the idea of a consumption tax appealing "because you determine how much you pay by what you buy"; but he cautioned that "[t]he problem with the consumption tax is that it leads to value-added taxes that can be easily added on by a profligate Congress."

Democratic leaders, taxwriters push low- and middle-income tax cuts

Elsewhere on the tax reform front, a group of nine House and Senate Democrats – all of whom either serve in party leadership positions or on one of the two congressional taxwriting committees – introduced a series of bills on March 4 designed to cut taxes on low- and middle-income workers and families, arguing the proposals should be included in any tax reform or tax extenders legislation that advances through Congress.
URL: http://democrats.waysandmeans.house.gov/press-release/senate-and-house-democrats-introduce-bills-put-more-money-pockets-working-families

The lawmakers did not provide budget offsets for their proposals, but indicated they intend to pay for them through broader changes in tax reform.

The proposals include:

- A permanent and expanded American Opportunity Tax Credit (AOTC) for qualified higher education expenses, introduced in the House by Ways and Means Committee member Lloyd Doggett, D-Texas, and in the Senate by Finance Committee member Charles Schumer, D-N.Y. (The AOTC is scheduled to expire after 2017.)
- Permanent extensions of the stimulus-era enhancements to the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) that are scheduled to expire after 2017, and an expansion of the EITC for workers without dependent children. The House version was introduced by Ways and Means Committee member Richard Neal, D-Mass., and Democratic Steering and Policy Committee Co-chair Rosa DeLauro of Connecticut. The Senate version was introduced by Finance Committee member Sherrod Brown, D-Ohio, and Minority Whip Richard Durbin of Illinois.
- A new tax credit applicable to families with young children in which both parents work, introduced by Senate Democratic Conference Secretary Patty Murray of Washington.
- An expansion of the Child and Dependent Care Tax Credit, introduced by Sen. Murray and Finance Committee member Michael Bennet, D-Colo.

House Ways and Means Committee ranking Democrat Sander Levin of Michigan, who joined the lawmakers in announcing the proposals, stated in a news release that "[w]hile the American economy has made significant strides in rebounding from the Great Recession, many middle class families have been left behind. These tax credits are a priority that should be addressed in tax reform to give families the certainty they need to succeed."

The proposals, which face an uncertain future in the Republican-controlled House and Senate, point to the ongoing partisan dispute over what a "fairer" tax code should look like. Late last year, an emerging agreement between then-Ways and Means Committee Chairman Camp and then-Senate Majority Harry Leader Reid, D-Nev., that reportedly proposed to make the research credit and several other corporate and individual income tax provisions permanent was scuttled in part because of concerns by the Obama administration and many congressional Democrats that it did not include long-term extensions of the stimulus-era enhancements to the CTC and the EITC. At the time, administration officials explained that the proposed deal was, in their view, too heavily skewed toward corporate taxpayers. (For prior coverage, see *Tax News & Views*, Vol. 15, No. 36, Nov. 27, 2015.) The Democratic proposals are expected to serve as a counterpoint to Republican legislation as the tax policy debate moves forward in the 114th Congress.
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/141126_1.html

— Jon Almeras, Alex Brosseau, and Michael DeHoff
Tax Policy Group
Deloitte Tax LLP

Have a question?
If you have needs specifically related to this newsletter's content, send us an email at clientsandmarketsdeloittetax@deloitte.com to have a Deloitte Tax professional contact you.