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Senate taxwriters explore options to simplify the tax code through reform

Senate Finance Committee members were in general agreement at a March 10 hearing that tax reform should seek to make the tax code simpler and relieve compliance burdens for individuals and businesses; but the discussion also addressed issues on which Democrats and Republicans remain at loggerheads.

Chairman Orrin Hatch, R-Utah, noted in his opening statement that “complexity should be a matter of concern for tax policymakers because it makes it more difficult, time-consuming, and expensive for taxpayers to comply with the law and for the IRS to enforce it.” But Hatch also cautioned that “there is often a tension between fairness and simplicity. Simple statutes may not be fair because they lump together taxpayers who, in fairness, should be treated differently. And statutes that comprehensively address relevant distinctions between taxpayers, leading to fairness, tend to be more complex.”

Hatch focuses on PEP & Pease, president’s foreign minimum tax

In his questioning of the witnesses, Hatch argued that the personal exemption phase-out (PEP) and the so-called Pease limitation on itemized deductions (named after the late Rep. Donald Pease, D-Ohio) create significant complexity for middle- and upper-income taxpayers. He also complained that the income levels at which the two provisions begin to apply ($254,200 and $305,050 for singles and joint filers, respectively, in 2014 as set most recently by the American Taxpayer Relief Act of 2012) disproportionately burden taxpayers in urban areas with comparatively high costs of living.

Witness Carol Markman, a certified public accountant and tax practitioner from Westbury, N.Y., agreed with Hatch, and said that in her experience there is often an “anger factor” when taxpayers learn their income precludes them from receiving the full benefit of their exemptions and itemized deductions.

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Hatch also took issue with the proposed 19 percent minimum tax on future foreign earnings of US multinationals (which would apply on a per-country basis) that was included in the fiscal year 2016 budget blueprint the White House submitted to Congress last month. That proposal is part of a broader international reform plan that would subject active foreign earnings to the minimum tax on a current basis (i.e., without deferral), but also eliminate any residual US tax on repatriations of such income. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 6, Feb. 6, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150206_1.html

Hatch argued that the minimum tax would be anti-competitive and could lead to an increase in the number of US firms that redomicile abroad through so-called “inversion” transactions, an increase in foreign acquisitions of US-based companies, or both. At a minimum, Hatch noted, the plan’s complexity would spark an uptick in tax planning strategies designed to avoid US tax.

Mihir Desai, a professor of law and finance at Harvard University, agreed with Hatch and said the president’s plan is “fundamentally at odds” with the approaches taken by other countries in recent years. Desai argued instead for a simple territorial system that “tries to get at expense allocation and abuse in traditional ways” rather than through a foreign minimum tax regime.

Wyden calls for equal tax rates on wage, investment income

For his part, Finance Committee ranking Democrat Ron Wyden of Oregon focused on a report released March 3 by the committee’s Democratic staff outlining six strategies involving financial products and deferred compensation that it says change the character or timing of income for tax-avoidance reasons. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 9, Mar. 6, 2015.) Wyden said strategies such as these are unfair to taxpayers who receive the bulk of their income from wages; moreover, they create complexity in the tax system when narrow rules are written to block them. He suggested that incentives to pursue such strategies could be largely eliminated by repealing the preferential tax rate on long-term capital gain and qualified dividend income.
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
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150306_1.html

But witness Bruce Bartlett, a former economic adviser to President George H.W. Bush, countered that raising the capital gains rate would – to the detriment of economic efficiency – exacerbate the so-called “lock-in effect” in which taxpayers seek to avoid taxation of capital gains by holding onto appreciated capital assets that they might otherwise sell.

Cardin, witnesses give nod to consumption tax

Finance Committee member Ben Cardin, D-Md., used the hearing to pitch his Progressive Consumption Tax Act of 2014 – legislation he introduced late last year that generally would impose a 10 percent value added tax (VAT) on most purchases of goods and services while at the same time lowering the top corporate and individual rates to 17 and 28 percent, respectively. The plan purportedly would eliminate the filing burden for millions of taxpayers by

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way of a $50,000 exemption for singles and a $100,000 exemption for joint filers, and would retain only a handful of deductions for those who remain subject to the income tax – steps that Cardin argued would greatly simplify the tax system for most Americans.

“As long as we rely solely on income taxes, we’ll never get competitive marginal rates,” Cardin said.

The notion of moving to a consumption tax had support among some of the witnesses at the hearing. Desai noted in his written testimony that “consumption taxes have major simplification advantages over income taxes as the base is more readily identified, particularly given the growing importance of cross-border flows and intellectual property.”

Bartlett, referring to the VAT proposal put forward by Columbia Law School Professor Michael Graetz on which Sen. Cardin’s plan is based, stated that a VAT “deals with a lot of the political problems of moving toward a simpler tax system by simply making so much of the tax system irrelevant for a large portion of taxpayers who would simply pay their taxes by buying things.”

But Bartlett also noted that the political path to a VAT would be extremely challenging: “I’m well aware of the hostility to that in certain quarters,” he said.

Up next – and last: International tax reform

Hatch told reporters on March 10 that the panel’s next hearing will consider how tax reform can make US businesses more competitive internationally. Witnesses at the hearing, which is set for March 17, will include Pamela Olson, who served as assistant Treasury secretary for tax policy during the George W. Bush administration; Anthony H. Smith of Thermo Fisher Scientific Inc.; Rosanne Altshuler of Rutgers University; and Stephen E. Shay of Harvard Law School.

This will be the last in the committee’s series of hearings on discrete issues in tax reform as the panel advances toward its goal of developing a legislative proposal, Hatch said.

“I think we’ve had enough hearings, now it’s time for us to sit down and start doing…what has to be done.” he told reporters. “And we’re going to do that. I just hope we can have some support from the [Obama] administration; but if we don’t, we’re going to do it anyway.”

Working groups seek public comments

In other developments, Hatch and Wyden announced in a March 11 news release that the Finance Committee’s five bipartisan tax reform working groups will take comments from the public as they continue their efforts to analyze current law in their specific issue areas, examine policy trade-offs and available reform options, and develop recommendations and potential legislative solutions to address them. Individuals, businesses, organizations, and advocacy groups interested in submitting comments should send an e-mail to the specific group or groups (addresses below) related to their area of interest:
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150206_3suppA.pdf

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- Individual Income Tax – Individual@finance.senate.gov;
  URL: mailto:Individual@finance.senate.gov
- Business Income Tax – Business@finance.senate.gov;
  URL: mailto:Business@finance.senate.gov
- Savings and Investment – Savings@finance.senate.gov;
  URL: mailto:Savings@finance.senate.gov
- International Tax – International@finance.senate.gov;
  URL: mailto:International@finance.senate.gov
- Community Development & Infrastructure – CommunityDevelopment@finance.senate.gov.
  URL: mailto:CommunityDevelopment@finance.senate.gov

Commenters whose interests span more than one working group should send a separate e-mail to each applicable group. Additional details on how to submit comments are available on the Finance Committee's web site.
URL: http://www.finance.senate.gov/newsroom/chairman/release/?id=3bcf1fcf-9dd8-47d4-9202-21a0870cd8d6

Hatch and Wyden stated that opening the working group process to public comment should give taxwriters "a greater understanding of how tax policy affects individuals, businesses, and civic groups across our nation" and "help guide the groups through the arduous task of putting forth substantive ideas to reform the tax code in each of their areas."

According to a calendar distributed to Finance Committee members and staff that has been circulating in Washington recently, the working groups will wrap up their weekly "tax reform education sessions" by March 20 and will spend the next few weeks preparing for "roundtable presentations" that will take place during 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 last month that "it would be best if [the groups] can produce legislative text," but noted that it is not a requirement.
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150227_1suppB.pdf

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White House FY 2016 budget includes $1.2 trillion net tax hike, JCT says

President Obama's fiscal year 2016 budget blueprint would increase federal receipts on net by just over $1.2 trillion between 2015 and 2025, according to a revenue estimate released March 6 by the Joint Committee on Taxation (JCT) staff.
URL: https://www.jct.gov/publications.html?func=startdown&id=4739

Providing revenue estimates for White House budget proposals is an annual exercise for the JCT. These estimates are notable insofar as they shed light on the budgetary impact of an administration's tax proposals that would be relevant on Capitol Hill should similar proposals be considered in Congress. The JCT's estimates often differ from those provided by the White

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House's Office of Management and Budget due to varying technical and economic assumptions that underlie the projections.

Highlights of Obama's budget blueprint

President Obama's budget proposal for fiscal year 2016 would raise nearly $529 billion over 10 years through various reforms to the international tax rules – including a move toward a territorial system for taxing foreign earnings of US multinationals that would provide for a 100 percent exemption on dividends from controlled foreign corporations (CFCs), a 19 percent worldwide minimum tax on foreign earnings, and a one-time 14 percent levy on pre-effective date earnings of CFCs as a transition tax into the new regime. According to the JCT, the 19 percent minimum tax would raise more than $262 billion over 10 years and the 14 percent transition tax would raise just over $217 billion. (When the budget blueprint was released in February, the administration had estimated that the 19 percent minimum tax would raise $206 billion over 10 years and the 14 percent transition tax would raise $268 billion.)

Other notable corporate revenue raisers include a fee on large financial institutions (estimated 10-year revenue gain: nearly $110 billion); changes to the tax treatment of financial and insurance industry products ($31 billion); and the elimination of various tax incentives for the fossil fuel industry ($47 billion). Another $142 billion in revenue would come from proposals to tighten or eliminate a number of assorted business tax expenditures, including nearly $105 billion from repealing the last-in, first-out (LIFO) method of accounting for inventories. (The administration had estimated that LIFO repeal would increase receipts by $76 billion over 10 years.)

On the individual side, the JCT estimates the budget blueprint would boost federal revenues by more than $800 billion over 10 years – below the administration's estimate of $846 billion – through proposals targeting upper-income taxpayers that would reform the tax treatment of capital gain income, reduce the value of certain tax expenditures, and implement the Buffett Rule by imposing a new "Fair Share Tax." Proposed reforms to the estate and gift tax regime would increase revenues by more than $152 billion over 10 years, down from the administration's estimated 10-year revenue gain of $214 billion.

The revenue increases on businesses in the administration's budget proposal generally would offset the cost of tax incentives to promote domestic manufacturing, research and development, and alternative energy, as well as a small portion of the cost of another White House priority – reducing the corporate tax rate to 28 percent. According to the Treasury Greenbook released in conjunction with the president's budget, revenue from the administration's proposed 14 percent transition tax on US multinationals' deferred foreign earnings would be set aside mainly to help finance a six-year highway bill. Meanwhile, the revenue increases on the individual side would be dedicated in part to deficit reduction, as well as to paying for incentives to advance the president's "middle-class economics" agenda, such as an expanded Earned Income Tax Credit.
URL: http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2016.pdf

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For details on the tax provisions in the administration's budget blueprint, see *Tax News & Views*, Vol. 16, No. 6, Feb. 6, 2015.
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150206_1.html

CBO weighs in

In a related development, the Congressional Budget Office (CBO) on March 12 released its own estimate of the administration's budget blueprint. Among other things, the CBO concluded that the president's proposed reserve fund for business tax reform would net $134 billion in additional revenue over the 10-year budget window, enough to reduce the top corporate tax rate by about 1 percentage point. The administration had projected a 10-year net revenue gain of just over $141 billion.
URL: http://www.cbo.gov/sites/default/files/cbofiles/attachments/49979-Analysis_Of_Presidents_Budget.pdf

The reserve fund, which the White House intends to be revenue neutral over the long term, includes revenue-raising proposals such as the new regime for taxing foreign-source income of US multinationals and new rules to discourage corporate inversions; but it also includes incentive provisions such as permanent extensions of the research credit, the subpart F exemption for active financing income, and lookthrough treatment of payments between related CFCs under the foreign personal holding company rules.

The CBO also estimates that, overall, the policy changes proposed in the president's budget would increase federal revenues by $1.8 trillion over 10 years.

Congressional budget season approaching

Congressional Republicans leaders generally have been dismissive of President Obama's budget package since its release and are focusing instead on their own tax and spending plans for fiscal year 2016 and beyond. The congressional budgeting process formally kicks off on March 17 when the House Budget Committee is expected to mark up a budget resolution identifying its tax and spending priorities for the 10-year period beginning October 1, 2015. The Senate Budget Committee will likely hold a two-day mark-up of its own budget resolution beginning on March 18.

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