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Finance hearing delves into international reform options

Continuing its series of hearings on specific issues in tax reform, the Senate Finance Committee March 17 examined the U.S. international tax system and considered recommendations for how revamping the tax code can make U.S. businesses more competitive globally.

Chairman Orrin Hatch, R-Utah, noted in his opening remarks that international tax reform was a "critical step" in a comprehensive overhaul of the tax code and that Congress should work "to make the U.S. a better place to do business and to allow American job creators to more effectively compete with their foreign counterparts in the world marketplace." Hatch said that the current system had failed to keep up with changing technology and markets, which made capital and assets more mobile. He also criticized proposals – including one in the Obama administration's fiscal year 2016 budget blueprint – that would impose a minimum tax on foreign-source income. He said that those proposals would increase the flight of capital and assets out of the United States and also encourage more U.S-based businesses to change their tax residences.

"Many companies have already decided that our current regime of worldwide taxation with absurdly high tax rates is simply too onerous and have opted to locate their tax domiciles in countries with lower rates and territorial tax systems," Hatch said, referring to U.S. companies that have reincorporated overseas in so-called inversion transactions or have been acquired by foreign firms. He argued that Congress should address this by lowering the corporate rate and moving to a territorial system for taxing foreign-source income of U.S. multinationals.

Finance Committee ranking member Ron Wyden, D-Ore., voiced similar concerns, especially about the movement of tax domiciles. He noted that inversions were a hot topic last year, but that the Treasury Department's actions to make these transactions less attractive economically

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– in the form of Notice 2014-52 – appear to have slowed the exodus. (For prior coverage of the Treasury notice, see *Tax News & Views*, Vol. 15, No. 33, Sep. 23, 2014.) The issue now, he said, is "foreign firms circling in the water and looking to feast on American competitors, often in hostile takeovers." Wyden said the only answer was comprehensive tax reform and not incremental patches.
URL: http://newsletters.usdbriefs.com/2014/Tax/TNV/140923_1.html

"The dealmakers will always get around piecemeal policy changes. Nothing short of comprehensive tax reform will end the cycle," he said.

However, Wyden did not endorse territoriality; rather, he called for a lower rate and changes to the current worldwide tax system similar to those he has proposed in prior congresses – most recently in legislation he cosponsored in 2011 with Finance Committee member Dan Coats, R-Ind. (The Wyden-Coats bill would reduce the U.S. corporate tax rate to 24 percent; but rather than moving the U.S. toward a territorial system, it would keep the current worldwide system and tighten the rules by eliminating the ability of U.S. taxpayers to defer taxes on active foreign income earned by controlled foreign corporations. For prior coverage, see *Tax News & Views*, Vol. 12, No. 15, Apr. 8, 2011.)
URL: http://newsletters.usdbriefs.com/2011/Tax/TNV/110408_6.html

Territoriality

Most of the witnesses agreed that the current system poses a competitiveness problem for U.S.-based multinationals and most agreed on the broad outlines of what a reformed international system should look like.

Pamela Olson, who served as assistant Treasury secretary for tax policy during the George W. Bush administration, said that other countries' tax systems had moved ahead of the United States by lowering rates, adopting territorial systems, and providing more incentives for research and development (R&D).

Anthony Smith of Thermo Fisher Scientific also advocated adopting a territorial system, particularly one that would allow companies to repatriate foreign income at a low rate. He said his company would welcome the chance to invest its available cash in the United States, but was hampered by the current system's "lock out" effect. Smith explained that, based on tax factors, his company has been outbid several times by foreign competitors for strategic acquisitions. He suggested a repatriation rate of about 5 percent and said "most U.S.-based companies will value the flexibility to redeploy earnings in the United States rather than having to retain such earnings overseas."

Rosanne Altshuler, an economics professor at Rutgers University, discussed her findings from a paper she co-authored with another witness, Stephen Shay, a professor at Harvard Law School and a former deputy assistant Treasury secretary for international tax affairs. That paper looked at lessons the United States could learn from other countries' experiences with dividend-exemption-style territorial systems. Altshuler said the classification of a tax system as territorial or worldwide was an oversimplification, as all systems are hybrids and have some elements of each regime. She added that the reasons for adopting a territorial system have varied from country to country, and the experiences of other nations may not apply in the U.S.

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context. However, citing the increasing competition for tax residence by countries with lower rates and territorial systems, she cautioned that the United States could not sustain a tax system based on high corporate tax rates and “tougher rules on foreign income.”

Minimum tax?

In his testimony, Shay took a much different position than the other witnesses. He said a competitive tax system should effectively fund public goods, such as education, infrastructure, and income security transfers. He added that the system should be progressive and asserted that the United States taxes its multinational corporations too little.

“The evidence does not support a claim that U.S. [multinationals] are noncompetitive as a consequence of U.S. international tax rules,” Shay said.

Shay said the Congress should rethink the idea of corporate residency and suggested adding a test based on the tax residency of shareholders. He also suggested that there should be fewer U.S. tax advantages for investing in foreign portfolio stock versus domestic stock. His major recommendation, however, was that the United States enact a minimum tax on foreign income that would be “an advance payment against full U.S. tax when earnings are distributed from the foreign business.”

The other panelists were not as enthusiastic about that approach. Olson said Congress should not adopt a minimum tax on foreign income. No other country has a minimum tax like that on active income, she explained, adding that that building “higher walls” around an already uncompetitive worldwide system would be of no help to the United States.

In later questioning by Sen. Debbie Stabenow, D-Mich., about incentives to retain jobs in or return them to the United States, Shay said that Congress should, to the extent possible, equalize the tax treatment of income between domestic corporations and multinationals.

Patent boxes

Smith advised the committee to look closely at what other countries, such as the UK, are doing with respect to R&D and patent boxes, which generally provide a lower tax rate for income generated by domestically produced intellectual property.

Hatch asked Smith why Congress should add a patent box instead of just increasing the R&D tax credit. Smith replied that a permanent R&D credit would be good for providing incentives for the research but a patent box would create incentives to keep the manufacturing in the United States by applying a low rate to the income stream generated by exploiting the research.

Shay said he thinks patent boxes are bad policy and would not spur innovation. He noted that patent boxes did not create the world-class research institutions around Boston (where he lives).

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BEPS

Sen. Charles Schumer, D-N.Y., posed several questions surrounding the OECD's ongoing Base Erosion and Profit Shifting (BEPS) Project. He said that other countries were not waiting for consensus and were already acting unilaterally to address issues within the project, but that the United States was sitting on the sidelines. Schumer expressed concern that other countries are "gobbling up the field" by "enacting policies that are stealing our tax base and forcing U.S. multinationals to send jobs and assets overseas" – a phenomenon he likened to the game Hungry Hungry Hippo. He noted, for example, that many countries are looking at nexus requirements for their patent box rates, making companies prove that they conducted their research and development activities domestically. He argued that doing something similar would help the United States prevent the shifting of intellectual property into low-tax jurisdictions, but that instead of taking action, the U.S. is just talking.

"This should be a wake-up call," Schumer said.

Olson agreed that Congress should pay close attention to what was happening, giving the example of recent moves by the UK. Smith concurred with Schumer's summation and said other countries' BEPS actions were effectively creating incentives to spur job growth in those countries.

Best plan?

Sen. John Thune, R-S.D., asked the witnesses which of the recent proposals they thought best approximated what they would like to see in a reformed tax code. Olson and Smith both backed – with some caveats – the international tax components of the discussion draft proposal released last year by then-House Ways and Means Committee Chairman Dave Camp, R-Mich. Altshuler backed a generic dividend exemption system but said the administration's proposed rates were too high. Shay said he would prefer the Wyden-Coats approach but, if not that, then something similar to the administration's minimum tax proposal.

Thune also asked about whether tax considerations drove the foreign acquisition of American companies as Wyden had alluded to in his opening remarks. Smith said there was a tax element feeding these decisions. Olson said that companies want to invest in the United States, but other countries are winning when it comes to businesses making the decision about where to domicile. Shay replied that Congress should not be distracted by a possible short-term trend in acquisitions and should focus instead on the long term. Apart from inversions, there is too much risk to base an acquisition on tax considerations, he said.

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House and Senate Budget committees advance 10-year tax-and-spending blueprints

The House and Senate Budget committees on March 19 reported to their respective chambers separate 10-year tax-and-spending blueprints for the federal government. Both plans – which passed on party-line votes – call for putting the budget on a path to balance within the next decade through major reductions in federal spending, and for comprehensive tax reform that neither raises nor lowers taxes relative to the budgets' revenue baselines.

The House budget would pare spending by almost $5.5 trillion in order to achieve a surplus by fiscal year 2024, while the Senate budget would reach balance one year later through spending cuts totaling $5.1 trillion. (Both figures include lower interest payments attributable to a smaller accumulation of federal debt).

The budgets' proposed spending levels for the Department of Defense remain a sticking-point among Republican defense hawks and fiscal hawks. The division is particularly acute in the House, where the committee mark-up was temporarily suspended on March 18 due to the impasse.

House Budget Committee Chairman Tom Price R-Ga., drafted the House budget blueprint and Senate Budget Committee Chairman Mike Enzi, R-Wyo., drafted the budget plan in his chamber. Both Price and Enzi are in their first year as budget committee leaders. They also sit on the taxwriting committees in their respective chambers.

Broad calls for tax reform, Affordable Care Act repeal

Both the House and Senate budgets include general language encouraging Congress to undertake revenue-neutral tax reform. The House budget provides additional policy detail – including a call to lower individual and corporate rates, transition to a "more competitive international tax system," repeal the alternative minimum tax, and close "special interest loopholes." But unlike recent budgets blueprints authored by Rep. Paul Ryan, R-Ill., the panel's former chair who now helms the Ways and Means Committee, this year's House plan calls for tax reform without specifying a target for the top individual and corporate rates.

Assumptions about extenders: The annual revenue levels proposed in each budget are consistent with those projected by the Congressional Budget Office (CBO) in January as part of its annual Budget and Economic Outlook. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 4, Jan. 30, 2015.) CBO's projections customarily assume that current laws remain unchanged.
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150130_4.html

As a result, the budgets' proposed revenue levels include amounts associated with the expiration of the so-called "tax extenders," which most recently lapsed at the end of 2014. Some Democrats argued that the assumption that the extenders provisions would remain expired is at odds with House Republican efforts earlier this year to move legislation that would make several tax extenders permanent without offsetting their cost.
http://newsletters.usdbriefs.com/2015/Tax/TNV/150130_4.html

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Affordable Care Act: Both budgets also call for repeal of the Patient Protection and Affordable Care Act and related provisions of the Health Care and Education Reconciliation Act of 2010, including the revenue increases enacted in those laws. Each budget includes reconciliation instructions to relevant committees ostensibly targeted at such a repeal effort. (If included in a congressionally adopted budget resolution, reconciliation instructions provide a fast-track procedure that limits debate in the Senate and allows for passage of legislation in that chamber by a simple majority vote, as opposed to the 60 votes normally required to clear procedural hurdles.)

Senate budget embraces ‘dynamic’ scoring for certain bills

The Senate budget calls on the Joint Committee on Taxation (JCT) and the CBO to produce estimates of the so-called “dynamic” effects of certain bills on federal revenue and spending levels attributable to their impact on the broader economy. Under conventional “static” scoring methods, JCT and CBO incorporate into their cost estimates anticipated behavioral changes at the firm and individual level, but do not factor in the budget effects of anticipated changes in the macro economy.

The provision in the Senate budget generally would require dynamic estimates for tax and spending bills that are projected to have a budget impact in any fiscal year greater than $15 billion, as determined under conventional scoring methods. The estimates would be provided on a supplementary basis (i.e., in addition to the conventional estimates, which generally would remain the official scores). In this way, the Senate provision differs from a rule adopted by the House earlier this year that requires the dynamic effects of certain major legislation considered in that chamber to be incorporated into budget scorekeepers’ official scores. (For prior coverage, see *Tax News & Views*, Vol. 16, No. 1, Jan. 9, 2015.)
URL: http://newsletters.usdbriefs.com/2015/Tax/TNV/150109_1.html

Next stop: House and Senate floor

The two budgets now head to the floors of the House and Senate, where they are expected to be considered during the week of March 23. Provided both blueprints clear their respective chambers, a conference committee would follow with the goal of arriving at a compromise product that could be passed through each chamber by April 15 – a nonbinding deadline spelled out in the Congressional Budget and Impoundment Control Act of 1974.

But the likelihood of no Democratic support and continuing divisions among Republicans as to the proper levels of defense spending means congressional adoption of a budget is not yet assured.

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House taxwriters to mark up estate tax repeal legislation

The House Ways and Means Committee is expected to vote some time during the week of March 23 on legislation (H.R. 1105) sponsored by taxwriter Kevin Brady, R-Texas, that would repeal the estate tax, according to published reports. At press time, the Ways and Means Committee had not posted a formal announcement of the mark-up on its Web site.

According to a report on the federal wealth transfer tax system prepared by the Joint Committee on Taxation (JCT) staff, Brady's bill, which he introduced on February 26, would repeal estate and generation-skipping transfer taxes for decedents dying and generation-skipping transfers made after the date of enactment, but would retain the gift tax with the present-law exemption amount ($5 million, indexed annually for inflation after 2011) and a top gift tax rate of 35 percent (down from 40 percent under current law). As proposed, H.R. 1105 does not include revenue offsets. The JCT has not yet released a revenue estimate for the measure.
URL: https://www.jct.gov/publications.html?func=startdown&id=4744

Brady introduced identical legislation the 113th Congress but it was not taken up in the Ways and Means Committee.

At a March 18 Ways and Means Select Revenue Measures Subcommittee hearing on the impact of the estate tax on family-owned farms and small businesses, subcommittee Chairman Dave Reichert, R-Wash., called the tax "unnecessary" and argued that it "threatens the livelihood of families" and imposes burdensome compliance requirements on taxpayers.

For his part, subcommittee ranking member Richard Neal, D-Mass., noted that "farmers and small businesses have legitimate concerns about the estate tax," but contended that because of the inflation-indexed exemptions in place under current law – $5.34 million for single individuals and $10.86 million for married couples in 2015 – relatively few estates ultimately are subject to the levy.

"As JCT points out, in 2013, there were 2.6 million deaths in the United States, and 4,700 estate tax returns reporting some tax liability were filed. This means 99.85 percent of all estates owe no estate tax at all," Neal said.

Schock's resignation creates vacant GOP committee slot

In other Ways and Means developments, committee member Aaron Schock, R-Ill., announced March 17 that he would resign from Congress in the wake of growing questions surrounding, among other things, his use of campaign funds and his reporting of expenses related to his congressional office operations. His resignation takes effect on March 31. As of press time, House Republican leaders had not publicly announced a timeline for naming Schock's replacement on the taxwriting panel.

Schock was first elected to Congress in 2008 and was appointed to the Ways and Means Committee in 2010.

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