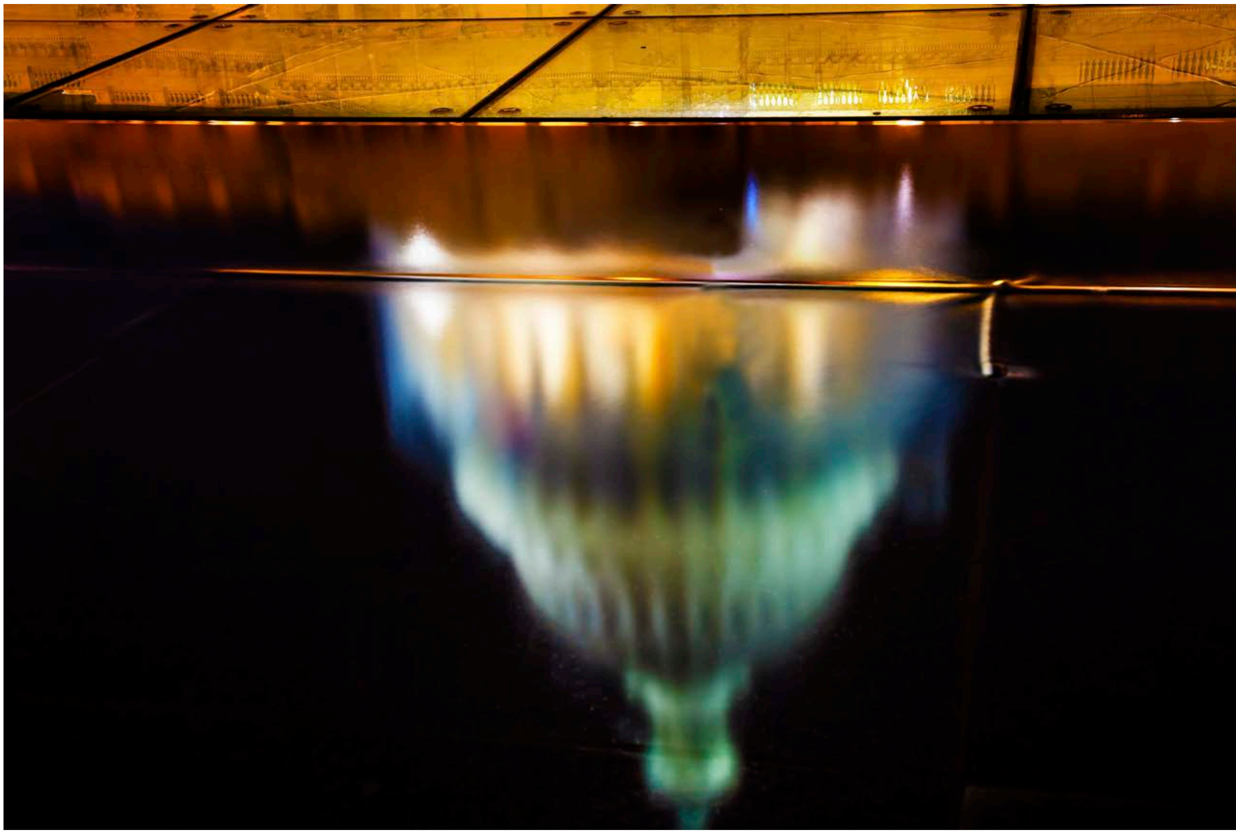

The politics of tax reform in the 114th Congress

April 15, 2015

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Introduction

When voters in the 2014 midterm congressional elections opted to consolidate control of the House and Senate with the Republican party, they arguably gave the GOP a stronger hand in shaping tax policy – including, potentially, reform of the federal tax code – in the 114th Congress, which convened at the beginning of this year.

Although Republicans have long called for an overhaul of the federal tax code, they nonetheless continue to face a number of obstacles in getting tax reform legislation enacted into law. For example, there are no tax reform proposals that are active in either congressional taxwriting committee, and the GOP has yet to coalesce around any of the reform proposals that various lawmakers — including the just-retired Republican chairman of the House Ways and Means Committee — have advanced in recent years. There are new leaders on both the Ways and Means Committee and the Senate Finance Committee, and those new leaders are seeking to put their own stamp on tax reform. Even if GOP lawmakers reach consensus on a specific reform proposal, the Republicans' margin of control in the Senate does not leave them with a large enough majority to avert the threat of a Democratic filibuster that can keep legislation locked in procedural limbo. And even though Republicans have consolidated power in Congress, they still must work with a Democratic president who has his own priorities when it comes to tax reform and could exercise his veto authority if presented with legislation he finds unacceptable.

This publication provides a high-level overview of:

- The make-up of the 114th Congress and its two taxwriting committees, including the new chairmen who will have primary responsibility for shaping tax policy for the next two years;
- The individuals who have had significant influence on the current tax reform debate and whose proposals could provide the building blocks for any tax reform plan that moves forward in the new Congress;
- Major tax reform proposals that have been put forward to date by current and former taxwriting committee leaders and President Obama, with a focus on significant multinational, corporate, and individual provisions; and
- Some of the substantive and political barriers facing tax reform advocates.

Appendices include a listing of House and Senate taxwriting committee members, highlights of the major tax reform proposals that have been unveiled in Congress and the corporate tax reform "framework" released by the Obama administration, as well as a list of links to the text of the proposals and summaries from Deloitte Tax LLP.

The shape of the 114th Congress

Republicans expanded their majority in the House in the 2014 midterm elections to claim 247 seats in the 114th Congress while House Democrats saw their voting bloc shrink to 188. (At the close of the 113th Congress, the House was comprised of 233 Republicans and 199 Democrats, with 3 seats vacant.) Since the 114th Congress convened, however, three vacancies have opened up on the Republican side of the aisle following the resignations of Reps. Michael Grimm of New York and Aaron Schock of Illinois, and the death of Rep. Alan Nunnelee of Mississippi. Grimm's successor will be decided in a special election set for May 5 and Nunnelee's successor will be chosen in a special election on May 12. The dates of a primary and a general election to fill Schock's seat had not been officially announced as this publication went to press.

The 2014 midterms also gave the GOP control of the Senate with a gain of 9 seats for a majority of 54, compared to 46 for the Democrats. (The Democratic headcount includes two Independents — Sens. Bernie Sanders of Vermont and Angus King of Maine — who continue to caucus with the Democrats as they did in the 113th Congress.)

Leadership in the House and Senate

The GOP's continued majority in the House cleared the way for Rep. John Boehner, R-Ohio, to be elected for another term as speaker, although a large bloc of his fellow Republicans attempted to deny him re-election to that post. In the wake of the Republican takeover of the Senate, Mitch McConnell, R-Ky., became that chamber's new majority leader. (McConnell was the minority leader in the 113th Congress.) Nevada Democratic Sen. Harry Reid, who served as Senate majority leader while Democrats controlled the chamber, became the new minority leader. Reid recently announced that he will not stand for re-election next November.

Boehner and McConnell count themselves as supporters of tax reform. In a joint op-ed published in *The Wall Street Journal* just one day after voters turned control of both chambers of Congress over to the GOP, the two leaders identified addressing "the insanely complex tax code that is driving American jobs overseas" as one of their top legislative priorities for 2015, but did not elaborate on a specific vision of tax reform.

In the 113th Congress, Boehner reserved bill number "H.R. 1" for tax reform to underscore its importance to the GOP agenda, although he did not take action to move the tax reform discussion draft proposal that then-Ways and Means Committee Chairman Dave Camp, R-Mich., released in early 2014. In fact, he only permitted Camp to formally introduce the bill as H.R. 1 in the closing hours of the Congress in December of 2014, after the mid-term elections had taken place and long after there was any prospect of Congress voting on the measure. (H.R. 1 officially expired as active legislation when the 113th Congress adjourned.)

For his part, McConnell has not championed a specific tax reform proposal but has consistently argued that tax reform should be revenue neutral. McConnell also has cited the demand by many congressional Democrats for revenue-raising tax reform as a key reason that a tax code overhaul was not an achievable goal in the 113th Congress.

Leadership changes on the taxwriting committees

The 114th Congress also finds new leaders on both the House Ways and Means Committee and the Senate Finance Committee — the two congressional panels that are responsible for writing tax law and generally regarded as the front lines for efforts to reform the tax code.

Ways and Means — Ways and Means Committee member Paul Ryan, R-Wis., has taken over as the House's chief taxwriter, replacing former Ways and Means Chairman Dave Camp, who did not run for re-election last year. Ryan formerly led the House Budget Committee.

Exactly how the tax reform debate will proceed with Ryan at the helm of Ways and Means is unclear; however some clues to his priorities can be found in his previous work as Budget Committee chairman — particularly the fiscal year 2015 budget blueprint that he moved through the House last year. That budget blueprint calls in general terms for revenue-neutral tax reform that would cut the top corporate and individual tax rates (with a goal of 25 percent on the individual side), reduce the number of individual income tax brackets to two, eliminate the alternative minimum tax (AMT), and move toward a "more competitive" system for taxing the income of U.S.

multinationals. Significantly, however, it stopped short of explicitly calling for enactment of the Camp tax reform discussion draft. Instead, Ryan's budget blueprint called on Congress to consider "the full myriad of pro-growth plans" as it contemplates tax reform. While this is by no means a repudiation of Camp's discussion draft, it does suggest that Ryan was providing some cover for fellow Republicans who were nervous about certain aspects of Camp's proposal. It also opens the door for Ryan to put his own stamp on tax reform in the future. Ryan has recently staked out some specific policy positions, expressing support for limiting the mortgage interest deduction and expanding the child tax credit but rejecting a cap on the deduction for charitable giving.

(The fiscal year 2016 budget blueprint drafted by current House Budget Committee Chairman Tom Price, R-Ga., and approved in the House on March 19 of this year likewise calls for tax reform but provides even fewer specifics than Ryan offered in his fiscal 2015 budget proposal. For example, it does not specify top individual and corporate tax rates.)

Finance Committee — With control of the Senate now shifted to the GOP, Republican Sen. Orrin Hatch of Utah replaced Democratic Sen. Ron Wyden of Oregon as the Finance Committee's new leader. (Wyden, in turn, replaced Hatch as the panel's ranking member.)

Hatch is a proponent of tax reform and is expected to work cooperatively with a Republican-controlled House in trying to move reform legislation through Congress; but he has not released a tax reform plan of his own or offered a detailed description of his tax reform priorities. In recent speeches and op-eds, Hatch has identified what he considers to be the seven guiding principles of tax reform: economic growth, fairness, simplicity, permanence, competiveness, promoting savings and investment, and revenue neutrality.

Shortly after taking over the Senate taxwriting panel, Hatch and Wyden announced the formation of five bipartisan Finance Committee working groups to examine specific issues in tax reform as part of the process for developing a legislative proposal for a tax code overhaul. The groups — which will focus on issues related to the individual income tax, business income tax, savings and investment, international tax, and community development and infrastructure — are expected to work with the Joint Committee on Taxation staff to produce an in-depth analysis of options and potential legislative solutions within their specific policy areas, with the goal of having one final comprehensive report featuring recommendations in each of the five categories completed by the end of May. According to Hatch, the report could become the basis for an eventual Finance Committee tax reform bill.

Hatch had previously released a report on December 11, 2014, prepared by Finance Committee Republican staff that "is intended to provide background on where we are and where we have been with regard to our tax system as well as some possible direction on where our reform efforts should go in the near future." The report generally surveys the issues without making specific policy recommendations, though there are exceptions. For example, the report endorses a territorial system for taxing international income.

In 2013, Hatch worked with then-Finance Committee Chairman Max Baucus, D-Mont., to lead the committee members through an examination of a number of discrete policy issues in tax reform that culminated in the release of several "options papers" outlining possible approaches to revamping specific areas of the tax code. He also collaborated with Baucus on a project to encourage members of the Senate to submit detailed policy arguments explaining which current-law tax expenditures should be eliminated and which should be retained in a future tax reform effort.

Committee membership rosters — A complete list of House and Senate taxwriting committee members for the 114th Congress is available in the appendix on page 26; leaders and members of the five Finance Committee tax reform working groups are listed on page 27.

Notable influences in the current tax reform debate

Although moving comprehensive tax reform legislation proved to be an elusive goal in 2014, leaders of the congressional taxwriting committees and President Obama put forward new ideas and plans last year — or dusted off old ones — that could provide building blocks for a future tax code overhaul.

Former House Ways and Means Committee Chairman Dave Camp

As already noted, former Ways and Means Committee Chairman Camp did not seek re-election in 2014 and retired at the end of the 113th Congress. Although tax reform did not become law under his watch, he was a vocal advocate for reform from the time he took over the House taxwriting panel in 2011. Camp led numerous hearings, including several joint hearings with the Senate Finance Committee, to examine various aspects of tax reform and released discussion drafts of proposals to reform discrete areas of the tax code. In 2013, he teamed up with then-Finance Committee Chairman Max Baucus on a series of informal bipartisan lunch meetings to discuss tax reform with small groups of lawmakers, a Simpler Taxes for America Tour to generate support for tax reform among the general public, and a Web site allowing the public to offer comments and suggestions on tax reform.

Camp's efforts culminated in February of 2014 with the release of a comprehensive tax reform discussion draft proposal (written in legislative language) that called for reducing the top income tax rate for corporations and individuals to 25 percent and moving the United States toward a territorial system for taxing domestic multinational corporations. But to accomplish those objectives — plus keep the legislation revenue neutral and ensure that the reformed tax code would retain the levels of progressivity in place under current law — the draft proposal includes an array of base-broadening provisions that would have a significant impact on corporations, passthrough entities, individual taxpayers, and tax-exempt organizations. It also includes a 10 percent surtax on most income of certain higher-income individuals, effectively making their top statutory rate 35 percent. That proposal was eventually introduced on December 12, 2014, as H.R. 1, the bill number saved for it by House Republican leaders when the 113th Congress convened almost 24 months earlier.

In the latter half of last year, after it became clear that House Republican leaders would not allow him to bring his proposal up for a vote in the Ways and Means Committee or on the House floor, Camp tried to pave the way for tax reform in a future Congress by moving a series of proposals that would make permanent a number of significant tax "extenders" provisions — most notably, the research credit, bonus depreciation, and increased section 179 expensing, among others — that had expired at the end of 2013. Under Camp's strategy, building extenders into the budget baseline would make tax reform much easier in the future because it would lower long-term federal revenue targets and, in turn, give taxwriters more flexibility as they make decisions about what base broadeners would be necessary to achieve the desired level of rate reduction without further increasing the deficit.

The House ultimately approved several such bills, although those measures were never taken up in the Democratic-controlled Senate. A subsequent extenders agreement that Camp tried to broker with then-Senate Majority Leader Reid in late November that reportedly called for making permanent 10 expired provisions — including the research credit and section 179 expensing — was scuttled by the White House because it was, in the administration's view, too heavily skewed toward corporate taxpayers. (A particular sore point for the White House was the fact that the emerging deal did not include long-term extensions of certain expanded benefits available under the earned income tax credit and the child tax credit.) After the White House threatened to veto the emerging deal, House Republican leaders abandoned plans to try to enact permanent extenders and instead moved legislation that retroactively extended most expired extenders provisions for just one year (through 2014). That legislation subsequently cleared the House and Senate in December and was signed into law on December 19. In the last days of the Congress, House and Senate taxwriters sought to pass a narrower package to make permanent certain extenders designed to encourage charitable giving, but that measure also drew a veto threat from the White House and failed a procedural vote in the House, falling just short of the two-thirds majority it would have needed to pass that chamber and be sent to the Senate. (Ways and Means Chairman Ryan has opted to continue Camp's strategy in the 114th Congress. Several bills that would make permanent certain of the now-expired extenders have already moved through the committee and been approved on the House floor; but they face the prospect of a Democratic filibuster in the Senate and have once again drawn veto threats from the White House.)

Senate Finance Committee ranking member (and former Chairman) Ron Wyden

Sen. Wyden joined the Finance Committee in 2005, took the gavel in February of 2014 after former Chairman Baucus left Congress, relinquished it at the start of the 114th Congress when Republicans formally assumed control of the Senate, and now serves as the committee's ranking Democrat. But he stepped into his leadership roles on the committee with an established tax reform portfolio. Wyden and Indiana Republican Sen. Dan Coats (who, like Reid, has announced that he will not run for re-election next November) introduced comprehensive tax reform legislation in 2011 that generally would: lower the corporate tax rate to 24 percent and compress individual tax rates to three brackets of 15, 25, and 35 percent; provide a temporary tax holiday for repatriated foreign income but eliminate deferral on foreign income; repeal the individual AMT; create new retirement savings incentives; eliminate numerous current-law credits, deductions, and exclusions; and impose new taxpayer compliance provisions. (Wyden introduced similar legislation with then-Sen. Judd Gregg, R-N.H., in 2010.)

Wyden did not attempt to take up his tax reform proposals in the Finance Committee last year, explaining that his top legislative priority for 2014 was extending certain critical temporary tax provisions that expired at the end of 2013 and using that legislation as a "bridge" to broader tax reform thereafter. Although he no longer controls the Finance Committee's agenda, Wyden worked with Chairman Hatch in establishing the panel's five tax reform working groups and coordinating their efforts and is expected to play an important role in advocating the Democratic policy position as the tax reform debate moves forward in the Senate.

Former Senate Finance Committee Chairman Max Baucus

Former Sen. Baucus, who resigned from Congress early last year to become U.S. ambassador to China, was a leading proponent of tax reform during his time as chairman of the Senate Finance Committee. As already noted, the Montana Democrat collaborated with former Ways and Means Chairman Camp on a number of initiatives to educate other lawmakers and the general public on tax reform issues. In late 2013, he also released four staff-level discussion draft proposals for overhauling the tax rules related to multinational corporations, tax accounting and cost recovery, tax administration, and energy policy. Like Camp's proposal, the Baucus discussion drafts are written in legislative language, though unlike Camp's they are incomplete in key ways — notably the lack of detail on what the corporate and individual income tax rates would be — making it impossible for the nonpartisan staff of the Joint Committee on Taxation to provide a revenue estimate of any of the component pieces.

Although Baucus no longer has a direct influence on the tax policy debate, some of the proposals in his discussion drafts conceivably could help shape future tax reform discussions.

President Barack Obama

President Obama has called for tax reform during his time in the White House but has yet to advance a detailed legislative plan for a tax code rewrite. In 2012, he introduced a relatively brief "framework" for corporate tax reform that identifies tax reform goals but offers few details on how to achieve them. (Some specifics around the president's vision of a new regime for taxing foreign-source income of U.S. multinationals emerged in the FY 2016 budget blueprint he sent to Congress this past February, however.) The president's public statements on tax reform generally have focused on targeting "loopholes" that, according to the administration, are being abused by high-income individuals and corporations. More recently he has advocated overhauling the corporate tax rules first and saving individual tax reform for a later date, though again without providing the level of specificity we have seen from Camp, Wyden, or Baucus. Although he has not been as active as taxwriters in Congress in pushing for tax reform, the president remains an important figure in the debate and many believe reform is unlikely to advance materially without his active participation. Recent comments by the president, including remarks last December to the Business Roundtable, a group of CEOs of many of America's largest companies, suggest he sees business tax reform as one area where he hopes to find common ground with congressional Republicans this year.

Building blocks for future discussion

The sections that follow survey the key issues in tax reform and examine how the proposals that have been offered by Camp, Wyden, Baucus, and the president would address them. It is currently unclear the extent to which Ways and Means Chairman Ryan and Finance Committee Chairman Hatch will draw on these proposals as they develop their own tax reform plans. It is also unclear just what role these proposals will play as congressional Democrats and the White House consider their own next steps and develop policy goals for tax reform. Nonetheless, tax reform that lowers rates will include a variety of base-broadening provisions and the proposals that have been put forward to date will be instructive as to the options available to policymakers.

Multinational tax reform

As part of the discussion about tax reform, many have called for the United States to transition from its current worldwide system for taxing international income (which generally taxes a domestic company on its worldwide income) to a territorial system (which generally would exempt foreign-source income from domestic taxation). Most OECD members — including Germany, France, Japan, the Netherlands, and the UK — already have adopted territorial systems, and proponents argue that the United States must follow suit for U.S. multinationals to remain competitive in the global economy.

The major tax reform plans put forward to date propose significant changes to the tax treatment of U.S. multinational corporations, although they do not all move the United States toward a territorial regime.

Camp's tax reform draft: Outbound provisions

Former House Ways and Means Chairman Camp's comprehensive draft, later introduced as H.R. 1, generally follows the draft proposal he released in October 2011, but with significant changes.

Participation exemption for foreign dividends — The draft would change the way U.S. law prevents double taxation of U.S. corporations' foreign income by adopting a participation exemption for certain foreign dividends. The draft would introduce a 95 percent dividends received deduction (DRD) for the foreign-source portion of dividends received by a domestic corporation from a foreign corporation the voting stock of which is at least 10 percent owned by the domestic corporation for a six-month holding period. Neither credits nor deductions would be allowed for any foreign taxes paid with respect to dividends eligible for the new DRD.

Transition rule — As part of the transition to the proposed territorial regime, the draft would generally require any 10 percent U.S. shareholder (whether or not corporate) of a controlled foreign corporation (CFC) or other 10 percent owned foreign corporation to include in income the shareholder's pro rata share of the undistributed and previously untaxed post-1986 foreign earnings of the corporation. This inclusion would occur in the last taxable year before the exemption system begins and would be taxed at present-law rates. Pre-1987 earnings would generally be excluded from this deemed repatriation, but would still be eligible for the new DRD upon actual repatriation after the participation exemption system takes effect.

Camp's draft would impose multiple tax rates on the deemed repatriation, depending on the types of assets that the deferred earnings had funded. The U.S. shareholder would be entitled to a 90 percent deduction for the portion of the deferred earnings that are held in noncash assets and 75 percent for cash or liquid assets. This would result in a 3.5 percent U.S. tax rate for noncash assets and an 8.75 percent U.S. tax rate for cash and cash equivalents, less any deemed-paid foreign tax credits associated with deferred earnings subject to tax. The shareholder could elect to pay the tax under this transition provision in eight installments and would owe no interest on the deferred payments if the payments are timely.

Foreign intangible income — The draft would create a new category of subpart F income for "foreign base company intangible income," which would be the excess of the gross income of a foreign subsidiary over 10 percent of the subsidiary's adjusted basis in depreciable tangible property (but not including income or property from commodity extraction). The draft is intended to have the effect of causing this income to bear what amounts to a minimum worldwide tax rate of 15 percent, and despite how it is labeled by the committee, this would apply to more than just income from intangibles. The worldwide tax rate on such income would be greater than 15 percent only if a foreign government imposed a greater-than-15-percent rate.

Interest expense deductions — The draft includes a provision that would deny interest expense deductions for corporate U.S. shareholders of worldwide affiliated groups that have "excess domestic indebtedness." Thus, if the U.S. shareholders (as a group) fail both a relative leverage test and a percentage-of-adjusted-taxable-income test, their interest expense deductions would be reduced.

Camp's tax reform draft: Inbound provisions

The Camp draft contains several provisions that would primarily affect foreign-based multinational enterprises with investments in the United States.

Earnings stripping — The draft would amend the section 163(j) "earnings stripping" rule that defers or denies a corporate U.S. taxpayer deductions for its "disqualified interest" expense (interest that bears no U.S. tax in the hands of the recipient or that is owed with respect to debt that is guaranteed by a foreign or tax-exempt person) to the extent of the taxpayer's "excess interest expense." Generally, the provision would lower to 40 percent (from 50 percent) the percentage of the taxpayer's adjusted taxable income that serves as the general benchmark for determining whether its net interest expense is "excess interest expense"; the draft would also eliminate recourse to the taxpayer's prior three years' "excess limitation" to increase this threshold.

Statutory limitation on treaty benefits — The draft lifts a proposal (H.R. 1556) offered by House Ways and Means Committee member Lloyd Doggett, D-Texas, in the 113th Congress that would deny treaty benefits for certain payments that are treaty-protected under present law. Under internal U.S. law, the receipt of U.S.-source fixed or determinable, annual or periodical (FDAP) gross income by a foreign corporation (or a nonresident alien individual) is subject to a 30 percent withholding tax, but if the beneficial owner of the income is a resident of a country with a U.S. tax treaty in force, the tax may be reduced or eliminated by the treaty. The draft would statutorily override treaty protection in the case of "deductible related-party payments" between members of a foreign controlled group of entities, unless the tax would have been reduced by treaty if the payment had been made directly to the common foreign parent corporation of the payer and payee. This provision was previously criticized by the Treasury Department in light of the fact that it would violate existing U.S. treaties.

Baucus's multinational draft

Just before leaving the Senate to become ambassador to China, then-Finance Committee Chairman Baucus released a handful of staff-level discussion drafts, including one with proposals to overhaul the tax rules governing U.S. multinational corporations.

Two options for ending deferral — The Baucus draft proposes ending deferral on a class of CFC income as defined under one of two options — referred to as "Option Y" and "Option Z" — and then exempting other foreign income, regardless of whether it is repatriated. Option Y would set a minimum tax on worldwide income at 80 percent of the U.S. domestic rate. (The draft does not specify what the U.S. domestic rate would be after reform). Under Option Z, the U.S. shareholder of a CFC would owe current U.S. tax on the shareholder's pro rata share of 60 percent of the CFC's net "active foreign market income" (AFMI) and on all of the CFC's net "nonactive income" (which would include passive income). The remaining 40 percent of net AFMI would be treated as previously taxed income (and thus tax-free) when distributed.

Previously deferred income — To transition to the new system, the draft would require that the U.S. shareholder of a CFC include in income its pro rata share of the accumulated deferred foreign income. The resulting tax (at what is suggested would be a 20 percent rate) may be reduced by foreign tax credits attributable to the taxable portion of the prior earnings. This tax on deferred income could be paid in installments, without interest, over an eight-year period.

Entity classification — Baucus's draft would make a significant change to the application of the so-called check-the-box rules for entity classification. Under the proposal, any business entity that could otherwise elect its tax status would be treated as a corporation if it is wholly owned by a single CFC or by two or more members of an expanded affiliated group (and one of them is a CFC). This provision would treat hybrid entities as CFCs. It would not apply to entities wholly owned by one or more domestic entities.

Wyden's reform proposals

Sen. Wyden's tax reform plan, which he introduced in 2010 and 2011 but not during his stint as Finance Committee chairman in the 113th Congress, would reduce the U.S. corporate tax rate to 24 percent; but notably, it would not create a territorial system. Instead, Wyden would keep the current worldwide system and tighten the current rules by eliminating the ability of U.S. taxpayers to defer taxes on active foreign income earned by CFCs.

Repatriation — Wyden's plan includes a provision that would temporarily allow companies to repatriate earnings from their foreign subsidiaries at a reduced effective tax rate of 5.25 percent. The reduced tax rate would be restricted to repatriated income used for worker hiring and training, research and development, capital improvements, business acquisitions to retain or create jobs, or for clean energy initiatives.

Obama's corporate tax reform framework (amplified by FY 2016 budget proposal)

The Obama administration has historically been reluctant to publicly embrace territoriality. When it released its corporate tax reform framework in 2012, the administration argued that a territorial system would "aggravate, rather than ameliorate, many of the problems in the current tax code." Instead, the framework proposed tightening the current worldwide system, mostly by curtailing deferral. Significantly, the framework also called for a new "minimum tax on overseas profits," although it did not specify a rate or provide details on how that tax would operate. In contrast to the administration's public stance, however, there have been strong indications over the years that the White House has privately been open to a territorial system, albeit with strong base erosion safeguards, as part of a broader tax reform package that achieved other goals set out by the president.

With the release of its fiscal year 2016 budget blueprint on February 2 of this year, the administration has taken a significant public step away from the worldwide system it espoused in the framework and toward a system that some might describe as territoriality with strong protections against base erosion and others will see as a repeal of deferral but with a preferential rate for foreign-source income. The budget calls for the fundamental reform of the U.S. international tax rules to eliminate the "lock-out" effect of current law and departs from the primary reliance on foreign tax credits as the means to prevent international double taxation. Specifically, the administration calls for (1) a 100 percent exemption on dividends from CFCs, (2) a 19 percent worldwide minimum tax on foreign earnings, and (3) a 14 percent tax on pre-effective date earnings of CFCs as a one-time transition tax into the new regime (the transition tax).

19 percent minimum tax on foreign earnings — The budget proposal generally would eliminate the U.S. taxation of dividends received by corporate U.S. shareholders from CFCs and in its place would generally seek to ensure that at least a 19 percent worldwide tax (subject to modifications described below) is imposed on CFCs' earnings. This same treatment would generally apply to income of a foreign branch of a domestic corporation. CFC earnings would no longer be taxed to U.S. shareholders on the basis of CFC investments in U.S. property.

The minimum tax rate would not apply to subpart F income, which would continue to be subject to current U.S. tax at the full U.S. tax rate. Thus, for U.S. corporate shareholders all CFC earnings would be subject to immediate U.S. taxation at either full U.S. rates for subpart F income or the residual minimum tax rate (if greater than zero) for non-subpart F income.

Under the proposal, foreign earnings would be subject to current U.S. taxation to ensure a per-country minimum rate of taxation of 19 percent on all current foreign earnings of CFCs and foreign earnings of a U.S. corporation from a foreign branch or the performance of services abroad, less an "allowance for corporate equity" (ACE) that would exempt from U.S. tax a risk-free rate of return on equity invested in active assets. The residual (U.S.) minimum tax rate on earnings assigned to a particular foreign country would be computed by subtracting 85 percent of that country's foreign effective tax rate from the 19 percent tentative minimum tax rate. Interest expense allocated and apportioned to foreign earnings subject to the minimum tax would be deductible at the residual U.S. tax rate applicable to those earnings, if any.

A taxpayer's foreign effective tax rate for a country would be computed on an aggregate basis for all foreign earnings and associated taxes assigned to that country over a 60-month period based on tax residence in that country under foreign law. If the same earnings are subject to tax in multiple jurisdictions, such earnings would be assigned to the jurisdiction with the highest tax rate.

There would be no U.S. tax on the sale of stock in a CFC to the extent the gain reflects undistributed earnings of the CFC already subject to minimum tax, subpart F, or the transition tax.

14 percent transition tax on accumulated foreign earnings — In connection with the transition to the minimum tax, the FY 2016 budget proposal would impose a one-time transition tax of 14 percent (40 percent of the current U.S. tax rate) on earnings accumulated in CFCs and not previously subject to U.S. tax. Foreign tax credits would be permitted to reduce the U.S. tax liability, limited to the amount of credits associated with such earnings multiplied by 40 percent (14 percent/35 percent). The proposal is unclear on whether the transition tax would be imposed on a separate company basis or a pooled basis, and thus whether CFCs with accumulated earnings deficits would be able to offset CFCs with positive accumulated earnings. The tax due on the accumulated earnings would be payable ratably over five years.

The accumulated earnings subject to the transition tax could be repatriated exempt from further U.S. tax.

The transition tax would apply to earnings accumulated for taxable years beginning before January 1, 2016. According to the administration, this proposal would raise $268 billion over 10 years, of which $238 billion would be set aside to fund infrastructure spending and the remaining $30 billion used for deficit reduction.

Comparison to Camp — A similar transition tax introduced in the Camp discussion draft would tax accumulated earnings and profits (E&P) at a 3.5 percent rate, and accumulated E&P held in the form of cash or cash equivalents at an 8.75 percent rate, with an eight-year installment period to pay the tax liability. The administration's proposal imposes a higher tax rate and shorter payback period for taxpayers, while failing (unlike the Camp proposal) to take into account that not all earnings are associated with liquid assets. The administration proposal, like the Camp proposal, does not impose an interest charge on the tax liability of deferred earnings, though it does not specify exactly which deferred earnings would be subject to the tax. (The Camp proposal only applied the deemed repatriation tax to post-1986 foreign earnings.)

The effective tax rate on future CFC earnings proposed by the administration may be more similar than anticipated to rates under the Camp proposal.

Inversions: A possible trigger for multinational tax reform?

Since May of last year, a perceived increase in the number of U.S.-based companies engaged in so-called inversion transactions — mergers with or acquisitions of foreign companies to move their place of residence primarily for tax purposes — has sparked a policy debate in Washington.

On one side, the Obama administration and many congressional Democrats — most notably, Finance Committee ranking member Wyden and House Ways and Means Committee ranking member Sander Levin of Michigan — have argued that inverting companies are "renouncing their citizenship" to get out of "paying their fair share" while enjoying the benefits of operating in the United States and that curbing inversions is a matter of "economic patriotism." Democratic proposals that were introduced (or announced) in the 113th Congress called for addressing inversions through: (1) retroactive legislation intended to curb new transactions by tightening the rules for determining when an inverted foreign corporation would be treated as domestic for U.S. tax purposes and (2) legislation intended to make certain inversions less attractive economically by reducing available tax benefits.

On the other side, congressional Republicans — most notably, former Ways and Means Committee Chairman Camp and newly minted Finance Committee Chairman Hatch — generally contend that corporate inversions are a manifestation of the weaknesses of the current U.S. tax code and that any legislation to address these transactions would best be handled as part of a corporate tax reform process that lowers rates and moves the United States toward a territorial regime for taxing the income of U.S.-based multinationals.

In the 114th Congress, Rep. Levin has reintroduced the anti-inversion legislation he proposed last year but it is still uncertain if Wyden will follow through with plans to release an anti-inversion bill of his own. As the 114th Congress moves forward, observers will no doubt be watching to see if a continued push against inversions by Democrats spurs the development of comprehensive tax reform proposals by Republicans. Evidence from 2014, however, suggests that concerns about the impact of inversions may not compel Congress to either enact targeted tax changes to address the narrow issue nor lead to swifter action on broader tax reform. Thus, much of the attention on inversions shifted to the administration and Treasury Notice 2014-52 attempting through the regulatory process to both limit the ability of companies to invert and curb the tax benefits available to companies that engage in such transactions.

Corporate tax reform

The tax reform plans from former Ways and Means Chairman Camp, former Finance Committee Chairman Baucus, and Finance Committee ranking member Wyden generally have proposed significant changes to certain business tax expenditures in order to pay for a substantially lower corporate tax rate that would put the United States on par with its OECD partners. (U.S. corporate taxpayers face the highest statutory federal corporate tax rate at 35 percent — and an average combined state and federal tax rate of 39.1 percent — while the average corporate tax rate among OECD member nations is 25 percent). But these proposals, and the less detailed corporate tax reform framework from the Obama administration, all demonstrate that reducing the corporate tax rate will involve painful tradeoffs.

Corporate tax rate

The Camp discussion draft calls for lowering the top statutory corporate tax rate from 35 to 25 percent. However, to help meet his self-imposed goal of keeping the plan revenue neutral and ensuring that the reformed tax code would retain the levels of progressivity in place under current law, Camp proposed to phase in the reduction by 2 percentage points a year until the top rate reaches 25 percent beginning in 2019. The overall reduction in rates would be "paid for" by significant base broadening through the repeal of numerous business-related deductions and exclusions.

In his tax reform proposals, Wyden proposes a top corporate tax rate of 24 percent with no phase-in.

The administration's framework generally calls for a reduction in the top statutory corporate tax rate to 28 percent, with a lower rate for income from domestic manufacturing.

Baucus did not provide a top corporate tax rate in any of his four drafts.

Amortization of intangibles

Both Camp and Baucus call for extending the amortization period under section 197 for acquired intangible assets to 20 years (from 15).

Wyden's proposals and the administration's framework do not address this issue.

Domestic production activities

The Camp draft would phase out and ultimately repeal the section 199 domestic production activities deduction. Wyden calls for its immediate repeal with no phase-out, while Baucus's cost recovery draft asked for further comments about the section 199 deduction.

In contrast, the administration's framework wants to effectively cut the top rate to 28 percent for most business income and 25 percent for manufacturing income, with an even lower rate for income from "advanced" manufacturing activities. According to the framework, this effective rate reduction would be accomplished by strengthening the current section 199 domestic production activities deduction and increasing it from 9 percent to 10.7 percent. Advanced manufacturing activities would be allowed a larger deduction, although the rate and the definition of "advanced manufacturing" are not specified.

R&E credit and expenditures

The administration's framework calls for the research and experimentation (R&E) credit, which lapsed again at the end of 2014, to be made permanent and the simplified credit to be expanded to 17 percent.

Camp's draft would modify the R&E tax credit and make it permanent effective for tax years beginning after 2013. Going forward, the draft would make the alternative simplified credit (ASC) permanent and equal to 15 percent of qualified R&E expenses that exceed 50 percent of the average qualified research expenses in the three preceding tax years. The draft also would make permanent the basic research credit but reduce the credit rate to 15 percent. It would eliminate the energy research credit and the credit for research related to computer software. A separate bill (H.R. 4438), which passed the House in May of 2014, would have provided a more generous 20 percent ASC and may be more in line with future tax reform efforts.

Baucus's cost recovery draft asked for further comments about the research credit.

Both Camp's comprehensive draft and the Baucus cost recovery draft would require R&E expenditures under section 174 to be capitalized and amortized over a five-year period rather than currently deducted.

Wyden's proposals do not address research expenditures or the research credit.

Advertising expenses

Under current law, advertising expenses are generally deductible immediately as an ordinary business expense. However, the Camp draft, beginning in 2018, would allow the current deduction for 50 percent of specified advertising costs, but require the remaining 50 percent to be amortized and capitalized ratably over a 10-year period. A transition rule would phase out the deduction with 20 percent amortizable in 2015, 30 percent in 2016, and 40 percent in 2017. The proposal would allow full expensing on the first $1 million of advertising, but that would phase out once advertising costs exceeded $2 million.

The Baucus cost recovery draft would similarly allow taxpayers to deduct only half of their advertising expenses immediately, but provides that the remaining half may be capitalized and amortized ratably over five years.

Neither the Wyden proposals nor the administration's framework addresses this issue.

Cost recovery — Depreciation

The Camp draft would repeal the Modified Accelerated Cost Recovery System (MACRS) and replace it with rules similar to the Alternative Depreciation System (ADS). Class lives would generally be extended and depreciation deductions would be determined under the straight line method. Special depreciation provisions such as bonus depreciation and depreciation of leasehold improvement property would all be repealed. (The draft proposed to implement these changes effective for property placed in service after 2016.)

Baucus's cost recovery draft calls for repealing MACRS and ADS and replacing them with a single set of rules that would apply to all business taxpayers. This new system would use a pooling method rather than requiring taxpayers to calculate depreciation for separate assets.

Wyden's tax reform proposals would repeal depreciation on equipment in excess of ADS.

The administration states in its framework that cost recovery should move "towards economic depreciation" with the resulting savings used to reduce rates; but it otherwise provides no detail on how the cost recovery rules should be modified.

Interest deductibility

Wyden's legislation would index the corporate interest deduction for inflation, while neither Baucus nor Camp provides for any limitation on the general deductibility of interest. (As noted above, however, the Camp discussion draft does have some provisions related to the deductibility of business interest with respect to multinational companies.)

In its corporate tax framework, the administration contends that the current tax code creates incentives for using debt for financing rather than issuing equity and that reducing the corporate rate will help address this problem; the framework also recommends (without going into detail) that policymakers consider reducing the deductibility of interest.

Alternative approach to cost recovery

While reformers generally have looked to depreciation as a source for revenue to offset the cost of paying down rates, an alternative that has been floated recently in a proposal from House Ways and Means Committee member Devin Nunes, R-Calif., and one from Sens. Marco Rubio, R-Fla., and Mike Lee, R-Utah, would permit 100 percent expensing and instead place limits on interest deductibility. It is not yet clear how much support exists in Congress for this approach; however, such a proposal, if enacted, would have a greater impact on some taxpayers than on others.

Accounting methods

Camp, Baucus, Wyden, and the administration offer a number of proposals to repeal or curtail the use of certain methods of accounting.

- **LIFO** — Camp, Baucus, and the administration would disallow the use of the last-in, first-out (LIFO) inventory accounting method. Wyden does not mention eliminating LIFO in his proposals.
- **LCM** — Camp, Baucus, and Wyden propose repealing the lower of cost or market value of inventory rule (LCM). The administration does not call for repealing the LCM in its tax reform framework, but has included such a proposal in previous budget packages.
- **Cash method** — Both Camp's comprehensive draft and Baucus's cost recovery draft call for expanding the use of the cash method of accounting to businesses with up to $10 million in gross receipts; but they would repeal the use of the cash method for businesses with average annual gross receipts exceeding $10 million and would thus require these businesses to adopt the accrual method. Camp's proposal carves out an exemption for farming businesses, but Baucus's draft does not. Similarly, the administration calls for allowing cash accounting for businesses with up to $10 million in gross receipts. Wyden's proposals do not modify the current-law rules for cash accounting.

Although the administration does not explicitly address this issue in its business tax reform framework, the White House has argued that revenue raised from certain timing changes — such as would occur from repealing LIFO and slowing depreciation, for example — or other one-time changes related to the transition to a new tax regime should be used to fund infrastructure and jobs programs rather than being used to offset the cost of lower tax rates. Republicans generally contend that any revenue raised by base broadening should be used for rate reduction rather than additional spending.

Financial institutions and products

Former Ways and Means Chairman Camp's tax reform draft includes several proposals affecting financial institutions and products, including some that would significantly alter the tax treatment of derivatives and impose an excise tax on large financial institutions.

Tax on large financial institutions — The Camp draft would apply a 0.035 percent tax on the excess total consolidated assets of a "systemically important financial institution" (SIFI) at the close of each quarter beginning in 2015. A SIFI is defined as an entity subject to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Excess consolidated assets would be those assets in excess of $500 billion, and that amount would be indexed to changes in gross domestic product.

Derivatives — Camp's tax reform plan would generally require all taxpayers to mark derivative contracts to market and recognize gain or loss as if they were sold for fair market value on the last day of the taxable year. The resulting gain or loss would be treated as ordinary. A derivative would be defined broadly as any contract the value of which (or any payment or transfer with respect to which) is directly or indirectly determined by reference to one or more items including stocks, bonds, debt, partnership interests, certain real property, commodities, or currency. The proposal would apply regardless of whether the derivative or the subject matter is publicly traded. In addition, the draft provides that if a taxpayer enters a straddle with offsetting derivative and nonderivative positions, then both the derivative and nonderivative components must be marked to market, even if the nonderivative component, such as stock, would not ordinarily be marked to market. An exception from mark-to-market treatment would be provided for hedging transactions.

The Obama administration has proposed similar measures in recent budgets regarding derivatives and a fee on large financial institutions, but it has not done so in the context of tax reform. (With regard to the tax on financial institutions, the proposal in the Obama administration's FY 2016 budget would apply to a larger category of taxpayers than SIFIs. Affected taxpayers would include "asset managers" and "financial captives.")

The Baucus drafts and the Wyden proposals generally do not address financial institutions and products. In conjunction with a recent Finance Committee hearing on how tax reform can promote fairness in the tax code, however, 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. 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.

Energy tax issues

Camp's draft would move the tax code in the direction of offering less support for alternative energy sources by eliminating the rate inflation adjustments for renewable electricity and refined coal production under the production tax credit (PTC) effective for existing projects beginning in 2015. The draft also proposes terminating any further PTC benefits after 2024. A number of energy tax provisions, including the qualifying advanced nuclear power facility credit and the exception from the passive loss rules from working interests in oil and gas properties would be repealed. Camp also proposes to repeal a number of temporary energy "extenders" provisions that had expired at the end of 2013 and then were renewed, temporarily, as part of the extenders package in December of 2014, including, among others, the deduction for energy-efficient commercial buildings and the credits for construction of energy-efficient new homes, energy-efficiency improvements to existing homes, and alternative fuel vehicle refueling property.

The Baucus energy discussion draft would repeal or allow to sunset many current-law energy incentives and replace them with two tax credits, one for the production of clean electricity and one for the production of clean fuels. Each credit could be taken either as a production tax credit (claimed each year for the 10 years beginning when the facility is placed in service) or as an investment tax credit (claimed when the facility is placed in service). Baucus claims both credits would be technology neutral and performance based, and the draft proposes that each credit would expire when the cleanliness (measured in terms of carbon emissions) of the respective markets increases significantly.

The administration's framework proposes to permanently extend the tax credit for the production of renewable electricity and to expand it by making it refundable. However, the framework would repeal tax preferences for fossil fuels and cites expensing of intangible drilling costs and percentage depletion for oil and natural gas wells as examples. The framework does not mention other similar proposals, such as repealing the section 199 domestic activities manufacturing deduction for oil and gas companies, which have been included in previous White House budget packages.

Although Wyden has been a long-time supporter of renewable and alternative energy, his tax reform proposals do not call for a major overhaul of energy tax provisions. His proposals would, however, explicitly repeal certain provisions for oil, gas, and coal producers.

Executive compensation

Camp's draft would place further restrictions on the $1 million employee compensation deduction for publicly traded corporations by repealing the exceptions to the deduction limitation for commissions and performance-based compensation. Camp's proposal would also revise the definition of a "covered employee" to include the CEO, CFO, and the three other highest-paid employees. (The Internal Revenue Service currently interprets "covered employee" to mean just the principal executive officer and three highest-compensated officers.) Under the Camp plan, status as a covered employee would continue after termination of employment. Camp would also extend similar rules to the nonprofit/tax-exempt sector by imposing an excise tax on compensation in excess of $1 million paid to the five mostly highly compensated employees.

The administration's corporate tax reform framework, the Baucus drafts, and the Wyden proposals do not address executive compensation.

Individual tax reform

The comprehensive tax reform discussion draft that then-Ways and Means Committee Chairman Camp unveiled in February of 2014 includes what is perhaps the most detailed overhaul of the individual tax rules released to date. Camp's draft would reduce the top individual income tax rate to 25 percent (though with a 10 percent surtax on a broader base of income applied to certain higher-income individuals), significantly expand the standard deduction while limiting or eliminating a number of current-law deductions and credits, and ensure that the reformed tax code would retain the levels of progressivity in place under current law.

Likewise, the tax reform legislation that Finance Committee ranking member Wyden introduced in 2010 and 2011 generally would lower individual tax rates while eliminating numerous current-law credits, deductions, and exclusions.

Former Finance Committee Chairman Baucus did not release a discussion draft on individual tax reform issues.

For his part, President Obama still has not put forward a detailed proposal for revamping the individual tax rules. The administration's fiscal year 2016 budget package, which was released in February of this year, includes two major new revenue-raisers that would reform the taxation of capital gain income for certain upper-income individuals — both during a taxpayer's lifetime and at death. In addition, it re-proposes several revenue-raising provisions from previous budgets aimed squarely at upper-income taxpayers, such as implementing the so-called "Buffett Rule," which would require households with incomes over $1 million to pay at least 30 percent of their income (after charitable giving) in taxes; capping the value of itemized deductions and certain income exclusions for high-income taxpayers at 28 percent; and taxing income from carried interests at ordinary rates. It also revives a proposal from prior years to return the estate tax to the parameters in effect in 2009: a 45 percent top rate and $3.5 million exemption per spouse. (The current-law top rate is 40 percent; the exemption amount, which is indexed annually for inflation, is $5.43 million per spouse in 2015.) But the administration's budget blueprint stops short of proposing changes to individual income tax brackets, or broader changes to the individual tax code. (The administration did, however, succeed in increasing the progressivity of the tax code with the enactment of the American Taxpayer Relief Act in early 2013, which permanently allowed the top rates on earned income, investment income, and estate and gifts to increase from their 2012 levels for more affluent taxpayers while permanently leaving in place lower tax rates on lower- and middle-income taxpayers.)

Given the relative lack of details on individual tax reform from Baucus and the Obama administration, the discussion below focuses on provisions in the Camp and Wyden plans.

Income tax brackets

Former Chairman Camp's tax reform discussion draft would consolidate the current-law seven tax brackets into two new brackets of 10 percent and 25 percent. However, there is also a de facto 35 percent bracket for upper-income filers which comprises both the 25 percent rate and an additional 10 percent surtax, which is applied to modified adjusted gross income (MAGI) in excess of $450,000 for joint filers ($400,000 for all others). The broader MAGI base would not apply to the 10 percent or 25 percent brackets.

For purposes of the 10 percent surtax on higher-income individuals, MAGI is defined as adjusted gross income (AGI) increased by:

- Any amount excluded from income under sections 911, 931, and 933;
- Any amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax (e.g., municipal bonds);
- The value of any employer-sponsored health coverage;
- Amounts paid by a self-employed individual for health insurance deducted under section 162(l);
- Pre-tax contributions to tax-favored defined contribution retirement plans;
- Deductible health savings account contributions; and
- Excluded Social Security and tier 1 railroad retirement benefits.

The resulting amount is then reduced by:

- Charitable contributions eligible for a deduction under section 170 (but only if the taxpayer itemizes); and
- Qualified domestic manufacturing income (QDMI). The full impact of the reduction for QDMI would be phased in over three years, however.

QDMI is generally net income attributable to domestic manufacturing gross receipts. According to a Ways and Means Committee staff summary of the Camp draft, excluding QDMI from the 35 percent bracket "would ensure that small businesses and passthrough entities (such as S corporations and partnerships) engaged in such activity are taxed at a rate no higher than 25 percent, achieving parity with C corporations."

Wyden's tax reform plan calls for three individual income tax rate brackets: 15 percent, 25 percent, and 35 percent. (When Wyden introduced his legislation, the top marginal rate was 35 percent, so it is not clear whether he would propose to retain this level going forward or whether he would keep the top rate equivalent to its post-fiscal cliff level of 39.6 percent.) However, his top tax rate would apply to married couples with taxable incomes over $140,000, a far lower attachment point than the $457,600 of taxable income married couples had to have in 2014 before they were subject to the 39.6 percent rate. Wyden also would substantially increase the standard deduction. According to a press release issued in conjunction with the 2011 proposal, Wyden would allow most individual taxpayers to file a new simplified one-page return (proposed 1040-IRS) instead of complying with the myriad current-law tax rules.

Alternative minimum tax

Both Camp and Wyden would repeal the individual AMT regime. The AMT was designed to tax a small number of wealthy individuals who escaped owing significant regular income tax by using a variety of exclusions, deductions, and credits; but because it was not originally indexed for inflation, it subsequently grew to affect millions of unsuspecting upper-middle-class taxpayers. (The American Taxpayer Relief Act of 2012 permanently controls the growth of the AMT by indexing the AMT's exemption amounts for inflation, thus ending what had become an annual ritual in Congress of approving temporary "patches.")

Capital gains and qualified dividends

Camp's proposal would repeal the current-law top rate for capital gain and dividends and instead provide an above-the-line deduction equal to 40 percent of "adjusted net capital gain" (defined as the sum of net capital gain and qualified dividends, reduced by net collectibles gain). As a result, capital gain and dividend income would be taxed at 60 percent of the taxpayer's marginal ordinary income rate.

Similarly, Wyden's proposals would create a new 35 percent exclusion for capital gain and dividend income but would also establish a progressive rate structure. His plan would reduce the holding period to six months (from one year today) for the first $500,000 of a taxpayer's capital gain income, which is significant because it determines whether capital gain is afforded short-term or more favorable long-term tax treatment.

Notably, both Camp and Wyden would retain the current-law 3.8 percent tax on net investment income that was enacted under the Patient Protection and Affordable Care Act in 2010. The tax applies to income from interest, dividends, capital gains, annuities, royalties, and rents, other than income derived in the ordinary course of a trade or business and not treated as a passive activity.

Mortgage interest deduction

Camp would reduce the current-law $1 million interest deduction limitation to $500,000 over four years. The provision would not apply to existing mortgages or the refinancing of those mortgages. Wyden would retain the current-law deduction.

Exclusion of gain from the sale of a principal residence

Under current law, a taxpayer may exclude from gross income up to $500,000 (for joint filers) of gain on the sale or exchange of a principal residence as long as the taxpayer owned and used the property as a principal residence for at least two of the previous five years.

Camp's draft would require the taxpayer to own and use the home as the principal residence for five out of the previous eight years to qualify for the exclusion and would permit a taxpayer to use the exclusion only once every five years. The exclusion also would be subject to an income phase-out, with the amount of excludable gain declining, dollar for dollar, as a taxpayer's MAGI exceeds $500,000 ($250,000 for single filers).

Wyden's proposal would retain current law.

Charitable contributions deduction

Camp would make numerous changes to the charitable contribution deduction, such as allowing a deduction only to the extent that contributions exceed 2 percent of the individual's AGI and making the amount of any charitable deduction equal to the adjusted basis of the contributed property. Wyden would retain the current-law deduction.

Limitation on itemized deductions and personal exemption phase-out

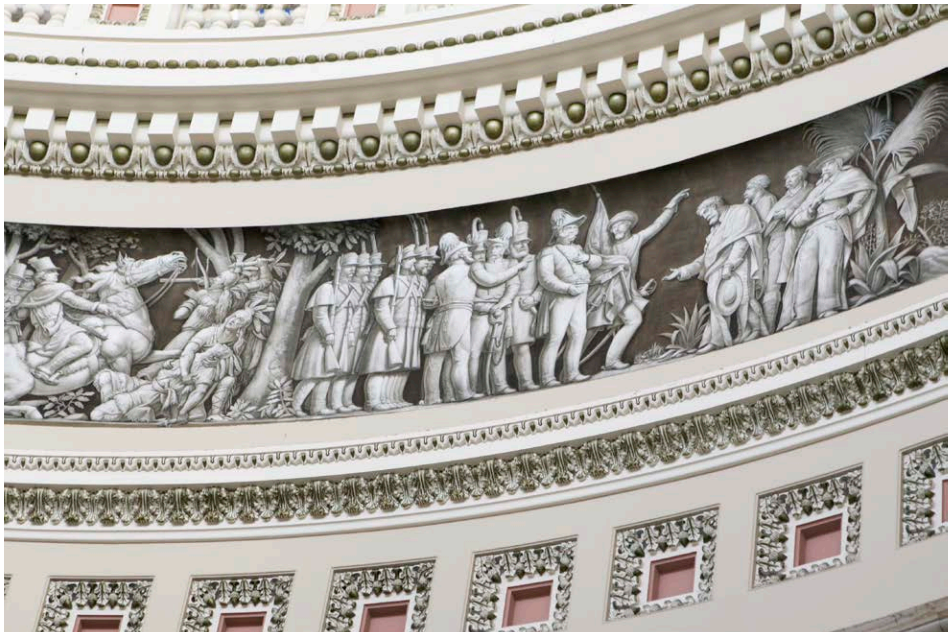
Both Camp and Wyden propose repeal of the personal exemption phase-out (PEP) and the overall limitation on itemized deductions (the so-called Pease limitation) which apply when a taxpayer's AGI exceeds certain thresholds. (In 2015, the PEP and Pease provisions apply to AGI exceeding $309,900 for joint filers and $258,250 for single filers.)

Deduction for state and local taxes

Camp's draft would eliminate the deduction for state and local taxes. The draft does not gradually phase out the deduction or otherwise attempt to mitigate the immediate impact of this change. Wyden's proposals would retain current law.

Other changes

Camp's proposal would repeal a number of current-law provisions such as the deduction for trade or business expenses incurred by an employee, the deduction for unreimbursed medical expenses, the exclusion for employee achievement awards, and the exclusion from income for air transportation provided as a no-additional-cost service to the parent of an employee.



Financial reporting considerations

The various corporate tax reform plans that have been put forward to date generally share two views: (1) a significant reduction in the statutory corporate tax rate is needed to make the U.S. tax system competitive with our trading partners and (2) certain corporate and business tax benefits (referred to as "tax expenditures") will need to be modified or eliminated to prevent the lower rate from significantly adding to the deficit. This combination of a lower rate and related changes to tax expenditures suggests that tax reform could have a significant impact on the balance sheet and income statement (as deferred tax balances are adjusted to reflect the new tax rates) as well as an ongoing impact on effective tax rates (due to the combined effect of lower tax rates and changes to or elimination of existing tax expenditures). When the tax reform debate resumes, businesses should begin to consider the financial statement impact of a tax code overhaul and possibly consider tax planning, such as accelerating deductions and deferring revenue, to take advantage of the transition to a lower rate, actions that should yield both financial statement benefits and real tax savings.

Financial statement impact of tax reform

A reduction in the corporate statutory tax rate and the elimination or modification of certain business tax expenditures could have a substantial impact on businesses. As policymakers debate the merits of various competing tax reform proposals, businesses should begin to develop an action plan to address the reform, including assessing whether the systems used to support the financial reporting process related to taxes are adequate for the challenges ahead. Further, businesses should consider tax planning opportunities to ameliorate the likely adverse cash tax and financial reporting consequences of moving to a lower tax rate and the proposed changes to the taxation of offshore earnings.

Impact of a rate reduction on financial statement reporting — U.S. generally accepted accounting principles (GAAP) require deferred tax accounts to be adjusted for the effect of a change in tax laws or rates in the interim and annual financial reporting period in which such changes are enacted. Deferred tax accounts can be assets (deferred tax assets, or DTAs) or liabilities (deferred tax liabilities, or DTLs).

DTAs generally represent the future reduction in taxes payable that will occur for items that have already been recognized as an expense under financial reporting, but for which the tax deduction has not yet occurred (a bad debt or warranty reserve are common examples). A reduced tax rate diminishes the benefit of the deduction in the future and requires a reduction in the carrying amount of the DTA, with the reduction recognized as a deferred tax expense. DTAs are also recognized for loss carryforwards (also affected by changes in tax rates) and credit carryforwards (which are generally not affected by changes in tax rates).

DTLs represent taxes payable in the future, generally related to either income that has already been recognized for financial reporting but has not yet been recognized for tax purposes (e.g., the sale of an asset reported on an installment method) or for amounts that were allowed as a deduction for tax prior to when the expense is recognized for financial reporting (e.g., when tax law allows accelerated depreciation deductions).

Under current tax laws, most companies have (after netting DTAs and DTLs) a net DTA, principally due to the slowing of tax depreciation and the economic performance rules that generally delay when amounts become deductible. Some companies that are capital intensive still report net DTLs due to bonus depreciation and having depreciable assets for which the tax life is generally shorter than the financial reporting life or for which there is a significant salvage for financial reporting. However, the most common condition is a net DTA, which means that most companies will initially recognize a tax expense when accounting for the enactment of a lower rate that will apply in future periods. (Both DTLs and DTAs will be remeasured using the new tax rate, but if the future tax rate is lower than the current tax rate and the company is in a net DTA position, an expense will be recognized).

The fact that most companies have net DTAs will mean that tax planning should be considered that will defer revenue for tax and accelerate tax deductions. Even a company that has a net DTL and expects to recognize a tax benefit in the financial statements when the DTL is remeasured to a lower tax rate should consider similar planning so as to increase the DTL that will be remeasured and thereby maximize the benefit to be recognized from a future rate reduction.

DTAs are reduced by valuation allowances to an amount (i.e., net of the valuation allowance) that is more-likely-than-not of being realized. If the entire DTA is at more-likely-than-not of being realized, no valuation allowance is required. A lower tax rate will require a reassessment of the realizability of certain DTAs. For example, if the tax rate is reduced, a greater amount of future taxable income will be required to fully realize a DTA related to tax credits.

Common deferred tax assets

- Deferred compensation/employee benefit obligations
- Net operating losses (federal, state, foreign)
- Tax credit carryforwards (i.e., research and experimentation credit, foreign tax credit)
- Deferred revenue
- Prepaid liability/assets
- Accruals and reserves

Common deferred tax liabilities

- Depreciation: Property, plant, and equipment
- Amortization: Intangibles and Goodwill
- Inventory, i.e. LIFO
- Investments in domestic and foreign subsidiaries and unconsolidated affiliates

Impact of elimination of tax expenditures on financial statement reporting — Similar to a reduction in the corporate tax rate, the elimination of specific business tax expenditures (i.e., allowable tax deductions for general business expenses) would generally increase a company's overall effective tax rate (or ETR, which is determined by dividing the total tax expense by pretax income). Changes to business tax expenditures that are of a timing nature generally do not impact the ETR due to the interplay between taxes currently payable and deferred tax accounting. For example, if an item is not currently deductible but will be deductible in the future, current taxes payable will be increased (relative to what they would be expected to be based on the income as measured for financial reporting); but that higher tax expense is offset by the recognition of a DTA for the future reduction in taxes payable that will occur when the deduction is finally allowed. However, when a business tax expenditure is permanently disallowed, there is a direct impact on the ETR. For example, when a financial reporting expense like meals and entertainment is permanently disallowed to the extent of 50 percent, the ETR is increased for the pretax expense for which there is no tax benefit.

Tax expenditures vs. business expenses

Historically, the primary focus for offsetting the cost of lower tax rates has been to eliminate so-called tax expenditures. These are exclusions, deductions, and credits that are aimed at policy goals, similar to government spending programs. However, as we see in the various drafts from Camp, Wyden, and Baucus, tax reform could also eliminate or modify the current-law tax treatment of what are now thought of as typical business expenses — for example, advertising costs or net business interest expenses — that are associated with earning business income.

Any modification of business tax expenditures that are related to the timing of income or deductions — such as bonus depreciation, or limitations on the use of net operating losses — could have a substantial impact on the overall net DTA or DTL, but generally would not impact the ETR.

Some policymakers have even suggested eliminating some or all book-tax differences. Discussions at a House Ways and Means Committee hearing in 2012 questioned whether their elimination would reduce complexity and deter certain "aggressive tax positions" and potentially abusive tax transactions. However, the concept of trying to eliminate most of the existing book-tax differences has yet to gain substantial traction.

Book-tax differences
Not all income and expenses are recognized the same way for financial reporting and tax purposes. Whether permanent or temporary, the difference between how the item is treated in the financial statements versus the tax return is often referred to as a book-tax difference.

Preparing for an uncertain future as the tax reform discussion continues

Although congressional action on tax reform appears unlikely in the short term, it is never too early to begin thinking about the potential impact of a tax code overhaul. There are a number of actions that businesses can take today so they are positioned to move quickly once a comprehensive corporate tax reform plan begins to gain momentum.

Risk management — Many tax departments have already begun to identify the potential financial statement reporting issues that could arise as part of tax reform. These might include the following:

- Modeling alternative tax scenarios;
- Analyzing risk and contingency plans including the impact of a transitional period that precedes a new reformed tax system;
- Strengthening tax forecasting, data analytics, and tax modeling capabilities;
- Developing investor communication plans;
- Reviewing employee recruitment and retention policies, as well as tax and compensation planning for both executives and employees; and
- Evaluating the potential impact of tax law changes on product and service offerings.

Corporate tax departments should also assess whether current internal information reporting is adequate to support these activities and consider making the necessary system improvements to address any identified deficiencies.

Tax processes, data flow, and technology considerations — The potential for tax reform may lead tax departments to consider investing in more sophisticated tax accounting systems in order to undertake the activities noted above. Companies that have already invested in sophisticated and integrated tax accounting systems will likely have access to the data needed to model and plan for proposed tax reform changes.

For example, tax accounting software available today gives companies the means to track a specific inventory of DTAs and DTLs, providing reports that project out deferred tax balances for foreign, federal, and even state-level taxing jurisdictions. They often incorporate an ability to forecast items that will impact the ETR, such as credits, uncertain tax positions, and valuation allowances. In addition, the calculations are connected so that federal changes can flow through to state calculations and the overall result can be presented in many standard current and deferred tax reports.

Management discussion and analysis disclosures — As tax reform proposals are unveiled and legislative activity commences, companies may want to consider whether, and to what extent, disclosures related to the potential effects of tax reform are appropriate in their management discussion and analysis. Companies preparing their financial statements may want to include an assessment of how tax reform could impact current deferred tax assets and liabilities and valuation allowances on the balance sheet as well as how it might impact the ETR in future periods.

Tax planning — When the prospects and timing of tax reform become more certain, tax departments should consider whether to defer income into a lower-rate year and accelerate deductions into what they anticipate will be a higher-rate year. Companies may not have been incentivized to take advantage of available accelerated deductions and revenue deferrals in the past due to low interest rates and the ready availability of other deductions such as bonus depreciation.

Also, many multinationals will need to evaluate whether they should repatriate earnings that carry a high foreign tax credit in the event tax reform includes a territorial system of taxing active foreign earnings. Exploring such repatriations will potentially impact the company's assertion regarding whether unremitted earnings continue to be indefinitely reinvested in the foreign entities. Other international provisions of a tax reform law could force multinationals to consider significant changes to their current capital structure, for example, if interest deductions are limited in the United States.

Accelerating deductions or deferring revenue could require hundreds of potential tax accounting method changes. Implementing these method changes such that the cumulative effect of the change is recognized prior to any rate reduction becoming effective achieves the dual benefit of interest savings and a permanent reduction to tax expense. These changes generally require the filing of a Form 3115, either automatic or manual. Companies should pay special attention to the timing of filing the Form 3115 and the timing of recording the tax benefit in their financial statements for automatic versus manual changes. Tax departments should also consider the use of Internal Revenue Code section 1341 for deductions claimed in a lower-rate year for items of gross income included in higher-rate years under a claim of right.

Considerations for the C-suite

As legislation moves through Congress and the substance of tax reform becomes clearer, controllers and CFOs have additional responsibilities. First, companies might want to consider revising public projections of earnings and taxable income for future periods. Such projections could reflect changes resulting from the application of new tax laws to projected income as well as changes in the business model to reflect the impact of reform on markets and business structure. Such projections could assist key stakeholders in understanding the impact of tax reform on future investment decisions and on the company's global tax burden. Second, as previously discussed, changes in tax laws would require deferred tax accounts to be adjusted in the period of enactment. Further, if tax reform results in a significant change in a company's overall net DTA or DTL position, communication with various stakeholders could be required to explain changes to overall compensation plans, loan covenants, or any other business agreements tied to asset values, debt-to-equity ratios, or current earnings.

These changes, in many cases, cannot wait until tax reform is enacted. For example, careful consideration should be given to the date that any final legislation becomes effective, due to the risk that Congress might tie the effective date to the date of some committee action (which could be months before the law is enacted). Such a situation could limit a company's ability to plan effectively.

Planning ahead

Whatever form tax reform takes, the financial statement consideration could be significant. Companies that anticipate change and plan ahead for the financial-statement impact of tax reform will go far to ameliorate adverse cash tax and related financial reporting expenses.

Multistate tax considerations

Many state corporate income tax regimes are affected by federal tax law changes because, for administrative ease, they "piggy-back" off of the Internal Revenue Code (IRC) by either incorporating the IRC in whole or in part, or by using federal taxable income as the starting point. States with automatic or "rolling" conformity generally will adopt such changes unless there is specific state legislation enacted to decouple from federal law. Other states adopt the IRC as of a specific date, do not adopt the IRC provisions in totality, or provide modifications or exceptions to certain adopted provisions.

Rate changes, base broadening

A tax reform plan that changes the topline federal tax rate would not automatically result in a change in state tax rates. On the other hand, base-broadening measures (and changes intended to address corporate inversions) could immediately result in an effective tax increase in those states that have "rolling" conformity or use federal taxable income as a starting point. However, to the extent any reforms have a large-scale impact, states may begin to re-evaluate their taxing schemes.

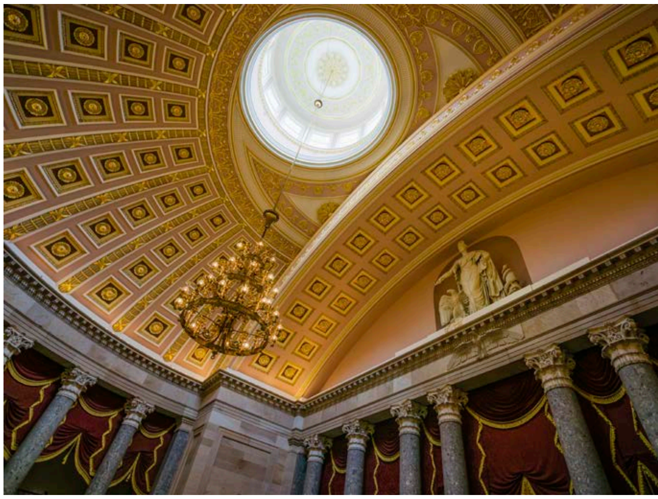
Territoriality, deemed repatriation proposals

Proposals to impose a minimum tax on foreign income of U.S. multinationals and a one-time transition tax on accumulated foreign earnings (such as those included in the Camp discussion draft and the president's fiscal year 2016 budget blueprint) may, if adopted, have a state tax effect that could vary based on whether each of these proposed federal changes is considered a deemed repatriation of income (dividend) or a special surcharge. Because the state tax base and the IRC are often heavily intertwined, deemed dividend treatment may increase both the federal and state income tax base. However, foreign dividends are often fully or partially excluded from the state tax base through a dividends received deduction. As a result, a federal minimum tax and deemed repatriation tax, if treated as a dividend for state purposes, may marginally affect states with automatic or "rolling" conformity. In response, states may seek to limit their dividends received deduction provisions. Such actions could potentially increase the state tax burden of U.S. multinationals.

Alternatively, if a proposed minimum tax and deemed repatriation tax are each considered to be a surcharge, thus having no impact on the federal income tax base for state income tax purposes, then there may not be a state tax effect unless such federal changes serve as impetus for analogous state law changes. For example, fundamental shifts in federal tax policy may cause states to re-evaluate their own tax policy in an effort to address perceived state tax revenue loss resulting from international business structures. In this manner, a proposed federal minimum tax and deemed repatriation tax may, in an effort to impose federal tax on foreign earnings through the adoption of a special tax regime, serve to encourage states to adopt similar state tax schemes directed at imposing tax on foreign earnings.

Planning ahead

Taxpayers planning ahead for federal tax reform should consider the state tax impact of any potential course of action. For example, to the extent that a company plans to repatriate cash or make other capital structure changes in anticipation of a deemed repatriation proposal, it should consider repatriating the capital to an entity located in a favorable state taxing jurisdiction.



Opportunities for action — and inaction — in 2015

With both chambers of Congress now controlled by one party, a major impediment to the passage of tax reform and other significant legislation over the last several years has been removed. Other obstacles remain, however. As already noted, the new leaders on the congressional taxwriting committees need time to develop and build support for their own tax reform proposals; moreover, the complexities of the Senate's procedural rules and ongoing questions about the president's commitment to overhauling the tax code make it difficult to determine whether tax reform can be enacted in the near term.

Still no supermajority in the Senate

In theory, the fact that Republicans now control the House and Senate means that it could be easier for tax reform legislation to clear both chambers and make its way to the White House. But the reality is that even though Republicans now hold 54 of the 100 seats in the Senate, they do not have the 60-vote supermajority that will be necessary to avert the threat of a filibuster and ensure the passage of tax reform — or almost any other major legislation.

Although Senate Republican leaders conceivably could cobble together a supermajority to move tax reform legislation by building a coalition with a few like-minded Democrats, this approach faces its own challenges. First, any attempts by the more conservative wing of the party to pull the GOP Senate majority further to the right would make it difficult to find common ground with Democrats who might otherwise want to work on the issue in a bipartisan way. (And conversely, crafting legislation designed to appeal to some Senate Democrats — and certain Republicans who are up for re-election in Democratic-leaning states — may make it difficult to secure the votes of more conservative-minded Senate Republicans, especially those who are either running for or contemplating a run for the White House in 2016.) Second, congressional Democrats may want to frame the 2016 elections as a discussion about how they believe the GOP is out of step with working class America; that message would be undercut if they support — and if President Obama signs — GOP-produced tax reform and other big ticket legislation.

Limited (and limits of) presidential leadership

Another ongoing source of uncertainty around the prospects for tax reform is the extent to which President Obama wishes to be seen as a leader in debate. Although the White House has come out in support of business tax reform (which may not align with a congressional Republican ideal of comprehensive tax reform), it has not released a detailed, comprehensive proposal of its own nor has it demonstrated a sustained commitment to getting tax reform enacted into law.

The last comprehensive rewrite of the U.S. tax code was enacted in 1986 when Republicans controlled the White House and the Senate, and Democrats controlled the House of Representatives. A key component of the 1986 tax reform effort was then-President Ronald Reagan's willingness to negotiate with congressional Democratic leadership as well as his willingness to use the White House as a bully pulpit to pave the way for tax reform by getting in front of the issue, making the case to the public, and bringing Congress and Treasury together to work out a plan. By the time Congress began to focus on tax reform in 1985, the Reagan Treasury Department had already released hundreds of pages of analysis, distributional tables, and revenue estimates covering various options for tax reform, and the president had sent a nearly 500-page report to Capitol Hill detailing his recommendations.

In contrast, it could be argued that President Obama thus far has not been a strong spokesman for tax reform. Although he has called for tax reform on more than one occasion during his time in office, his administration has not actively sought to negotiate a plan with congressional Republicans and he has not made a sustained effort to engage the public on — and build a base of support for — his vision of a reformed tax code. The corporate tax reform framework President Obama released in 2012 includes proposals for lowering the corporate tax rate to 28 percent while eliminating or revamping many current-law business tax expenditures, creating new incentives to promote domestic manufacturing, overhauling the international tax rules, and imposing a new "minimum tax" on multinationals; but it offers few details on how those proposals would operate. Moreover, aside from offering proposals in his annual budgets to increase taxes on wealthier individual taxpayers (by imposing a minimum tax under a so-called "Buffett Rule," modifying certain estate tax rules, and eliminating or tightening various deductions, credits, and incentives) the administration largely has ignored individual tax reform — something that concerns congressional Republicans.

It is also not clear whether President Obama, facing a Republican-controlled House and Senate, will be more or less likely to engage in an effort to find common ground on tax reform than he has been in the past. Notably, however, the president indicated during a December 2014 press conference that he might be willing to release a more detailed tax reform proposal if he thought it would help spur the Congress to act.

Finally, and perhaps most importantly, America today is far more politically polarized than it was three decades ago. Gallup polling data indicates that President Reagan held an average approval rating of roughly 80 percent among Republicans and 30 percent among Democrats over the course of his two terms in office, and history shows Reagan was able to leverage that support to bring Democrats to the table on tax reform in 1986. In contrast, President Obama's support is far more polarized. A March 2015 Gallup Poll shows the president with an approval rating of approximately 83 percent within his own party and just 12 percent among Republicans, suggesting there may be limits to his ability to use the power of his office to compel Republicans in Congress to compromise with him.

Difficult policy decisions remain undecided

The plans and discussion drafts put forward by former Ways and Means Committee Chairman Camp, Sen. Wyden, and former Finance Chairman Baucus and the corporate tax reform framework released by the Obama administration may provide useful building blocks for tax reform going forward, but they also reveal the hard choices that policymakers need to make before tax reform can be enacted into law. For example:

- Congress must settle the long-standing question of whether reform should produce more overall revenue for deficit reduction or other spending priorities (as Democrats generally want) or whether it should be revenue neutral (as Republicans generally prefer).
- Congress and the White House must come to an agreement on the general parameters of tax reform — specifically, whether tax reform should be "comprehensive" and encompass corporate entities as well as passthroughs and individuals (as Republicans generally want) or whether it should be limited to "business-only" reform that focuses on corporate rate reduction offset by elimination of key expenditures.
- Congress must also decide whether tax reform should be used to address income inequality (as Democrats generally want) or whether the tax code is already sufficiently progressive and doesn't need to be made more so (as Republicans generally contend).
- Congress must decide whether to adopt a territorial system with appropriate safeguards for the U.S. tax base (something most Republicans want and at least some Democrats are willing to consider) or whether to maintain the worldwide system with more stringent rules (as many congressional Democrats — including Finance Committee ranking member Ron Wyden — want).
- Congress must evaluate how tax reform might affect different industry sectors. For example, many of the largest business base broadeners that will be used in tax reform (like slowing cost recovery, repealing the section 199 manufacturing deduction, etc.) hit manufacturing much more heavily than the retail or service sectors.
- Congress has yet to fully explore what sort of transition rules would be necessary to prevent tax reform from creating economic shockwaves.

Presumably, in any deal which has bipartisan support — even if that comes only in the form of the president's signature — Democrats will "get" more than they "give" on some issues and the GOP will "get" more than they "give" on others. But considering the numerous moving pieces, there are many different ways that these issues could get resolved — and plenty of opportunities for gridlock.

Competing legislative priorities

Finally, there are other key legislative issues that Congress and the White House must address, including the debt ceiling and reauthorization of the Highway Trust Fund. Both of these issues fall under the jurisdiction of the taxwriting committees and thus may consume time that taxwriters otherwise might prefer to devote to tax reform. (Highway funding, although it is a competing legislative priority, ultimately could serve as a catalyst for tax reform. Ways and Means Committee Chairman Ryan has indicated that he would support a short-term patch for the Highway Trust Fund, whose spending authority is set to expire on May 31, 2015, in order to give his panel more time to work on a business tax reform plan that also could provide a longer-term solution to the nation's infrastructure spending needs.)

Congress will also have to decide how to address the dozens of expired tax extenders provisions from 2013 that it renewed retroactively for one year in the Tax Increase Prevention Act of 2014 and that are now expired once again. As already noted, Ways and Means Committee Chairman Ryan has sought to continue the baseline building exercise begun by his predecessor Dave Camp and move permanent extensions of certain significant extenders through Congress as a precursor to future tax reform. For his part, Senate Finance Committee Chairman Hatch has not yet indicated how he intends to approach extenders legislation this year.

And of course this all takes place in the seemingly never-ending cycle of elections that cause Washington to focus more on the next campaign than on what some would see as more pressing policy matters. For example, even before the last ballots had been cast in the 2014 midterm elections, pundits (and potential candidates) were surveying the landscape in early presidential proving grounds like Iowa and New Hampshire ahead of the 2016 elections. That near-constant campaigning offers only limited windows for policymakers to dive deep into complex and contentious issues like tax reform.

Ignoring tax reform would be a mistake

Despite the pressing need for tax reform, there is at present no single roadmap for getting it enacted into law. Whether tax reform can happen in 2015 or 2016 or whether it will have to wait until after President Obama leaves the White House is unclear. Despite this uncertainty, however, there are several important reasons why it would be a mistake for taxpayers to ignore the ongoing debate:

- Everyone across the political spectrum believes that our current tax system is broken and in desperate need of reform. Our current tax rules are too complex for taxpayers to comply with and too difficult for the regulatory agencies to administer.
- Given our high marginal tax rates and narrow tax base (caused by the array of credits, deductions, exemptions, and exclusions in the code), tax reform is likely to be on the agenda for Congress until it is actually enacted — regardless of how long that takes.
- Our high corporate statutory rate coupled with an outdated set of international tax rules results in a tax system out of step with those of our global trading partners.
- The work that the taxwriting committees have done so far and the work they do in the 114th Congress is likely to form the basis of future reform efforts. Stakeholders who fail to come to the table risk being left out of the discussion — or, even worse, finding themselves poorly positioned when Congress decides which tax preferences to reduce or eliminate.

As the debate moves forward, businesses and individuals would be well served by analyzing and understanding all of these developments as part of their efforts to prepare for a transition to a revised tax code.

Appendices

Appendix 1. Taxwriting committee rosters for the 114th Congress[1]

House Ways and Means Committee	
Republicans	**Democrats**
Paul Ryan, Wis. (Chairman)	**Sander Levin, Mich. (Ranking member)**
Sam Johnson, Texas	Charles B. Rangel, N.Y.
Kevin Brady, Texas	Jim McDermott, Wash.
Devin Nunes, Calif.	John Lewis, Ga.
Pat Tiberi, Ohio	Richard E. Neal, Mass.
Dave G. Reichert, Wash.	Xavier Becerra, Calif.
Charles W. Boustany Jr., La.	Lloyd Doggett, Texas
Peter J. Roskam, Ill.	Mike Thompson, Calif.
Tom Price, Ga.	John B. Larson, Conn.
Vern Buchanan, Fla.	Earl Blumenauer, Ore.
Adrian Smith, Neb.	Ron Kind, Wis.
Lynn Jenkins, Kan.	Bill Pascrell Jr., N.J.
Erik Paulsen, Minn.	Joseph Crowley, N.Y.
Kenny Marchant, Texas	Danny Davis, Ill.
Diane Black, Tenn.	Linda Sánchez, Calif.
Tom Reed, N.Y.	
Todd Young, Ind.	
Mike Kelly, Pa.	
Jim Renacci, Ohio	
Patrick Meehan, Pa.	
Kristi Noem, S.D.	
George Holding, N.C.	
Jason Smith, Mo.	
Vacancy[2]	

Senate Finance Committee	
Republicans	**Democrats**
Orrin Hatch, Utah (Chairman)	**Ron Wyden, Ore. (Ranking member)**
Chuck Grassley, Iowa	Charles E. Schumer, N.Y.
Mike Crapo, Idaho	Debbie Stabenow, Mich.
Pat Roberts, Kan.	Maria Cantwell, Wash.
Michael B. Enzi, Wyo.	Bill Nelson, Fla.
John Cornyn, Texas	Robert Menendez, N.J.
John Thune, S.D.	Thomas R. Carper, Del.
Richard Burr, N.C.	Benjamin L. Cardin, Md.
Johnny Isakson, Ga.	Sherrod Brown, Ohio
Rob Portman, Ohio	Michael F. Bennet, Colo.
Patrick J. Toomey, Pa.	Robert P. Casey, Jr., Pa.
Dan Coats, Ind.	Mark R. Warner, Va.
Dean Heller, Nev.	
Tim Scott, S.C.	

[1] Members listed in order of seniority.
[2] House Republican leaders have not yet filled the Ways and Means Committee slot vacated by former Rep. Aaron Schock of Illinois, who resigned from Congress on March 31, 2015.

Appendix 2. Senate Finance Committee tax reform working groups

Republicans	Democrats
Individual Income Tax	
Chuck Grassley, Iowa (Co-chair)	**Debbie Stabenow, Mich. (Co-chair)**
Michael B. Enzi, Wyo. (Co-chair)	Charles E. Schumer, N.Y.
Mike Crapo, Idaho	Bill Nelson, Fla.
John Cornyn, Texas	Robert Menendez, N.J.
Patrick J. Toomey, Pa.	Michael F. Bennet, Colo.
Business Income Tax	
John Thune, S.D. (Co-chair)	**Benjamin L. Cardin, Md. (Co-chair)**
Pat Roberts, Kan.	Debbie Stabenow, Mich.
Richard Burr, N.C.	Thomas R. Carper, Del.
Johnny Isakson, Ga.	Robert P. Casey, Jr., Pa.
Rob Portman, Ohio	Mark R. Warner, Va.
Patrick J. Toomey, Pa.	Robert Menendez, N.J.
Dan Coats, Ind.	Bill Nelson, Fla.
Savings & Investment	
Mike Crapo, Idaho (Co-chair)	**Sherrod Brown, Ohio (Co-chair)**
Richard Burr, N.C.	Benjamin L. Cardin, Md.
Johnny Isakson, Ga.	Robert P. Casey, Jr., Pa.
Dean Heller, Nev.	Mark R. Warner, Va.
Tim Scott, S.C.	Robert Menendez, N.J.
International Tax	
Rob Portman, Ohio (Co-chair)	**Charles E. Schumer, N.Y. (Co-chair)**
Pat Roberts, Kan.	Sherrod Brown, Ohio
Michael B. Enzi, Wyo.	Thomas R. Carper, Del.
John Cornyn, Texas	Mark R. Warner, Va.
Community Development & Infrastructure	
Dean Heller, Nev. (Co-chair)	**Michael F. Bennet, Colo. (Co-chair)**
Dan Coats, Ind.	Maria Cantwell, Wash.
Tim Scott, S.C.	Bill Nelson, Fla.

Appendix 3. Comparison of major business tax reform provisions

The table below offers a side-by-side comparison of major business provisions in the tax reform proposals that have been put forward by current and former leaders of the congressional taxwriting committees and the tax reform framework released by the White House. Similarities and differences among the four proposals are discussed in greater detail in the body of this publication.

Issue	Camp draft	Baucus drafts	Wyden	White House framework
Top tax rates				
Corporate	25 percent	Unstated	24 percent	28 percent (lower for manufacturing)
Passthrough (Individual)	25 percent, plus a 10 percent surtax on nonmanufacturing income	Unstated	35 percent, though with a far lower attachment point than current law	Unstated
International provisions				
Implement territorial tax system	Yes; 95 percent dividends received deduction; includes strong base erosion prevention provisions	Yes; would end deferral on a class of CFC income as defined under one of two options ("Option Y" and "Option Z") and then exempt the rest, regardless whether it is repatriated	No; would repeal deferral instead and reinstate per-country foreign tax credit	Calls in general terms for a new "minimum tax on overseas profits"; proposal in FY 2016 budget blueprint calling for a 19 percent minimum tax is seen by some as repeal of deferral and by others as a form of territoriality with very strong base erosion safeguards
Deemed repatriation	Yes, with differential rates for cash (8.75 percent) and noncash assets (3.5 percent); tax on accumulated earnings payable ratably over eight years	Yes, at a hypothetical 20 percent rate; tax on accumulated earnings payable ratably over eight years	Yes, at 5.25 percent rate, subject to certain restrictions	No provision; however, FY 2016 budget proposal calls for deemed repatriation at 14 percent rate with tax on accumulated earnings payable ratably over five years
Limits on inversion transactions	No provision (Camp indicated inversions should be addressed as part of a corporate tax reform process that lowers rates and moves the United States toward a territorial regime for taxing the income of U.S.-based multinationals)	No provision	Proposal as released in 2011 calls for rolling back effective date of current-law anti-inversion rules to apply to transactions occurring after March 20, 2002; however, in 2014, Wyden argued that tax reform should include retroactive provisions that would curb new transactions by tightening the rules for determining when an inverted foreign corporation would be treated as domestic for U.S. tax purposes	No provision; however, the White House budget proposals for FY 2015 and FY 2016 include provisions that would tighten rules for determining when an inverted foreign corporation would be treated as domestic for U.S. tax purposes
Depreciation and accounting methods				
Depreciation	Repeal MACRS and replace with rules similar to ADS; generally extend class lives and determine depreciation deductions under straight line method; repeal special depreciation provisions such as bonus depreciation	Repeal MACRS and ADS and replace with a single set of rules applicable to all business taxpayers; new system would use a pooling method rather than require taxpayers to calculate depreciation for separate assets	Repeal depreciation in excess of ADS	States that tax reform should consider changing depreciation schedules because current schedules "generally overstate the true economic depreciation of assets"; otherwise provides no detail
LIFO accounting	Repeal (with some allowance for delaying payment of resulting tax liability)	Repeal (with some allowance for delaying payment of resulting tax liability)	No provision	Repeal
LCM accounting	Repeal (with some allowance for delaying payment of resulting tax liability)	Repeal	Repeal	No provision, but administration has called for repealing LCM in previous budget proposals

Issue	Camp draft	Baucus drafts	Wyden	White House framework
Cash-method accounting	Allow for taxpayers with up to $10 million in gross receipts; repeal for businesses with average annual gross receipts exceeding $10 million	Allow for taxpayers with up to $10 million in gross receipts; repeal for businesses with average annual gross receipts exceeding $10 million	No changes to current rules	Allow for taxpayers with up to $10 million in gross receipts
General business provisions				
Section 199 deduction	Repeal (phased out)	No provision (cost recovery draft requests further comments)	Repeal (immediate)	Retain and increase to 10.7 percent with a higher (unspecified) rate for "advanced" manufacturing activities
Research credit	Make permanent (but in a more limited manner than current-law credit, including a denial of credits for the cost of developing software either for internal use or external sale)	No provision; cost recovery draft asked for further comments	No provision	Make permanent and expand the simplified credit to 17 percent
R&E expenses	Require R&E expenditures under section 174 to be capitalized and amortized over five years	Require R&E expenditures under section 174 to be capitalized and amortized over five years	No provision	No provision
Advertising expenses	Allow current deduction for 50 percent of specified advertising costs; require remaining 50 percent to be amortized and capitalized ratably over 10 years	Permit current deduction for 50 percent of advertising expenses immediately, with remaining 50 percent capitalized and amortized ratably over five years	No provision	No provision
Interest deductibility	No limitations on general deductibility of corporate interest; includes some limits on deductibility of business interest with respect to multinationals	Some limits on deductibility of interest with respect to multinationals	Index corporate interest deduction to inflation	Recommends (without going into detail) that policymakers consider reducing the deductibility of interest
Executive compensation	Place new restrictions on the $1 million employee compensation deduction for publicly traded corporations; expand the definition of "covered employee"; apply similar rules to nonprofits	No provision	No provision	No provision
Carried interests	Tax a portion as ordinary income	No provision	No provision	Tax as ordinary income

Issue	Camp draft	Baucus drafts	Wyden	White House framework
Financial institutions and products				
Financial institution tax	New bank excise tax on certain assets of very large "systemically important financial institutions"	No provision	No provision	No provision; however, the FY 2016 budget proposal and previous budget blueprints have included a fee on large financial institutions
Derivatives	Require all taxpayers to mark derivative contracts to market and recognize gain or loss as if they were sold for fair market value on the last day of the taxable year; treat the resulting gain or loss as ordinary	No provision	No provision	No provision; however, the FY 2016 budget proposal and previous budget blueprints have proposed mark-to-market treatment for derivatives
Energy provisions				
Treatment of fossil fuel vs. alterna-tive energy sources	Generally would reduce tax code support for alternative energy and energy-efficiency incentives by repealing certain permanent tax provisions and allowing other temporary energy extenders provisions to expire	Repeal or allow to sunset many current-law energy incentives and replace them with two tax credits: one for the production of clean electricity and one for the production of clean fuels	Repeal certain provisions for oil, gas, and coal producers	Permanently extend tax credit for the production of renewable electricity and make it refundable; repeal tax preferences for fossil fuels

Appendix 4. Highlights of Camp's tax reform discussion draft

Notable provisions affecting individuals

- Two tax brackets: 10 and 25 percent, plus a 10 percent surtax on upper-income individuals (generally individuals with adjusted gross income over $400,000 and married couples above $450,000)
  - Surtax applied to a very broad range of income, including municipal bond interest that is currently tax free and the value of employer-provided health benefits
  - Tax base for surtax also requires taxpayer to add back into income the value of itemized deductions (especially mortgage interest) other than charitable contributions, which has the effect of capping the value of these deductions at 25 percent
- Standard deduction expanded
- Capital gains and dividends taxed at ordinary rates (but 40 percent exclusion applies)
- Alternative minimum tax and other hidden rate increases (that claw back the benefit of itemized deductions and the personal exemption) are repealed
- Mortgage interest deduction capped at $500,000 of principal (phased down from $1 million today)
- Deduction for state and local taxes paid is repealed — a major issue for residents of high-tax states
- Exclusion of gain on sale of principal residence reduced, on a dollar for dollar basis, as MAGI exceeds $250,000 ($500,000 for married couples)
- Charitable contributions deductible only to the extent they exceed 2 percent of a taxpayer's AGI

Notable business provisions

- 25 percent top corporate rate (reduction phased in over five years)
- Tight caps on the deductions companies can take for compensation paid to senior executives
- Repeal of accelerated depreciation (beginning in 2017)
- Phased-in repeal of the section 199 manufacturing deduction
- Limits on deductibility of interest expense of domestic corporations financing global operations
- Mandatory capitalization of some or all of certain currently expensable items (especially R&E, advertising)
- Limit on NOL deduction; repeal of several special NOL carryback provisions
- Repeal of LIFO and lower of cost or market methods of accounting (with some allowance for delaying payment of resulting tax liability)
- Repeal or modification of industry-specific benefits (energy tax credits, low-income housing credits, etc.)
- Research credit made permanent (but in a more limited manner than the previous credit, including a denial of credits for the cost of developing software either for internal use or external sale); most other "extenders" allowed to remain lapsed (New Markets Tax Credit, Nascar race track depreciation) or even explicitly expunged from the tax code (subsidies for alternative energy and conservation, oil and gas items, Work Opportunity Tax Credit)

Notable passthrough provisions

- Carried interest generally taxed as ordinary income (rather than capital gain which is partially excluded from tax)
- Publicly traded partnership exception narrowed, as is the ability of businesses to operate in REIT form
- Audit procedures changed
- Self-employment tax imposed on limited partners; similar rule applies for S corp shareholders
- Cash method accounting repealed for many personal service corporations including large accounting and law firms (although impact delayed until 2019)

Notable international provisions

- Moving toward territorial regime with 95 percent participation exemption for foreign dividends
- One-time deemed repatriation tax, with differential rates for cash (8.75 percent) and for noncash assets (3.5 percent)
- Includes expansion of CFC rules resulting in a minimum tax on earnings derived from low-taxed offshore operations
- Extends subpart F active financing exception (for five years, with modifications) and CFC lookthrough (permanent)
- Tightens earning stripping rules
- Limits treaty benefits for certain payments

Notable provisions affecting financial institutions and products

- New bank excise tax imposed on certain assets of very large "systemically important financial institutions"
- Mark-to-market treatment of derivatives at ordinary income rates
- New restrictions and rules applied to life insurance and to tax-favored bonds

Appendix 5. Highlights of Baucus's tax reform discussion drafts

Multinational taxation

- End deferral on a class of CFC income as defined under one of two options — "Option Y" and "Option Z" — and then exempt the rest, regardless whether it is repatriated: Option Y would set a minimum tax on worldwide income; Option Z would partially exempt from U.S. tax "active foreign market income"
- Major changes to international rules under both options would, among other things:
  - Require U.S. shareholder of a CFC to include in income its pro rata share of the accumulated deferred foreign income; the resulting tax (at what is suggested would be a 20 percent rate) may be reduced by foreign tax credits attributable to the taxable portion of the prior earnings
  - Require any business entity that could otherwise elect its tax status to be treated as a corporation if it is wholly owned by a single CFC or by two or more members of an expanded affiliated group (and one of them is a CFC); hybrid entities would be treated as CFCs

Cost recovery

- Repeal Modified Accelerated Cost Recovery System (MACRS) and Alternative Depreciation System (ADS) and replace them with a single set of rules that would apply to all business taxpayers
- Repeal section 1031 like-kind exchange rules
- Allow taxpayers to deduct only half of their advertising expenses immediately; the remaining half would have to be capitalized and amortized ratably over five years
- Repeal section 174 and require research and experimentation expenditures to be capitalized and amortized ratably over five years (would apply to software development and certain extraction expenditures such as tertiary injectant expenses, oil or gas geological and geophysical expenses, intangible drilling and development costs, and mining development and exploration expenditures)
- Increase the amortization period for intangible assets under section 197 from 15 years to 20 years

Tax accounting

- Repeal LIFO method of accounting; taxable income from this change would be included in income ratably over eight years at a new — unspecified — tax rate
- Repeal the lower of cost or market method including deductions for subnormal goods, and the completed contract method with an exception for small construction contracts
- Allow businesses with average annual gross receipts of $10 million or less (based on the prior three years) to elect either the cash or accrual method of accounting; require all other businesses — including farming, personal service businesses, and large service providers who operate as partnerships or S corporations — that do not meet the gross receipts threshold to adopt the accrual method

Energy

- Repeal multiple energy tax incentives and replace them with two tax credits — one for clean electricity production and the other for clean fuels — that could be taken either as a production tax credit (claimed each year for the 10 years beginning when the facility is placed in service) or as an investment tax credit (claimed when the facility is placed in service)
- Repeal the sections 48A, 48B, and 48C credit for investment in clean coal and advanced energy projects where project-related property is placed in service after December 31, 2016
- Allow the section 45L credit to sunset for the construction of energy-efficient new homes
- Eliminate certain oil and gas tax provisions such as the enhanced oil recovery credit under section 43 and the marginal well production credit under section 45I

Tax administration

- Close the gap between the amount of taxes owed to the government and the amount actually collected by imposing a variety of new information reporting requirements on banks, mortgage lenders, life insurance companies, colleges and universities, and other businesses
- Strengthen tax delinquency enforcement provisions
- Revise tax return due dates and filing requirements for various classes of business taxpayers to simplify the filing process

Appendix 6. Highlights of Wyden's 2011 tax reform proposal

Multinational taxation

- Temporarily allow companies to repatriate earnings from their foreign subsidiaries at a reduced effective tax rate of 5.25 percent
  - Reduced tax rate would be restricted to repatriated income used for worker hiring and training, research and development, capital improvements, business acquisitions to retain or create jobs, or for clean energy initiatives

Corporate tax provisions

- Repeal existing corporate tax rate structure and replace it with a single flat rate of 24 percent
- Offset the cost of rate reduction by, among other things:
  - Repealing the section 199 deduction for domestic production activities
  - Repealing deferral of active financing income and active income for CFCs
  - Repealing depreciation of equipment in excess of alternative depreciation system
  - Repealing the lower of cost or market value inventory rule
  - Modifying foreign tax credit rules for large integrated oil companies
  - Rolling back the effective date of the leasing provisions in the American Jobs Creation Act of 2004
  - Rolling back the effective date of current-law anti-inversion provisions
  - Modifying the deduction for travel on corporate aircraft

Individual tax provisions

- Reduce the number of tax rate brackets to three — 15 percent, 25 percent, and 35 percent — and eliminate the AMT
- Create a new 35 percent exclusion and progressive rate structure for income from dividends and long-term capital gains, and cut the holding period to six months for the first $500,000 of a taxpayer's capital gains income
- Retain current-law deductions for mortgage interest and charitable contributions
- Permanently extend the expanded earned income tax credit, the expanded dependent care credit, and the child tax credit
- Repeal the current-law phase-out of itemized deductions and personal exemptions
- Substantially increase the individual standard deduction
- Promote long-term savings by consolidating existing individual retirement accounts and creating two new accounts: the Retirement Savings Account and the American Dream Account
- Repeal a variety of individual tax expenditures including:
  - The exclusion for income earned abroad by U.S. citizens
  - The exclusion for certain allowances for federal employees working abroad
  - The exclusion for employee meals and lodging
  - The exclusion for cafeteria plan benefits
  - The exclusion for premiums on group term life, accident, and disability insurance
  - Miscellaneous itemized deductions subject to the 2 percent floor

Appendix 7. Highlights of President Obama's corporate tax reform 'framework'[1]

Corporate tax provisions

- Calls for reduction in top statutory corporate tax rate from 35 percent to 28 percent, offset by elimination of many tax expenditures benefiting specific industries
- Provisions that "should be part of any reform" include:
  - Disallowing the use of the LIFO inventory accounting method
  - Repealing tax preferences for fossil fuels (specific examples include expensing of intangible drilling costs and percentage depletion for oil and natural gas wells)
  - Tightening section 264 rules for corporate-owned life insurance, as well as other proposals that would affect insurers or their products.
  - Taxing income from carried interests at ordinary rates
  - Increasing the depreciation recovery period for general aviation airplanes that carry passengers from five years to seven years
- Options that "should be under consideration" in reforming the tax code and meeting the 28 percent rate target include:
  - "Moving towards economic depreciation" and using the savings to reduce rates
  - Reducing the deductibility of interest (to reduce current-law incentives for using debt for financing rather than issuing equity)
  - Establish greater parity between tax treatment of large corporations and large noncorporate entities
  - Increasing corporate transparency and reducing the differences between what is reported for book and tax purposes
- Incentivize domestic manufacturing by cutting the top rate on manufacturing income to 25 percent (even lower for income from "advanced" manufacturing activities)
  - Would be accomplished by reforming current section 199 domestic production activities deduction and increasing it from 9 percent to 10.7 percent; advanced manufacturing activities would be allowed a larger (unspecified) deduction
- Permanently extend research and experimentation credit; expand the simplified credit to 17 percent
- Permanently extend tax credit for the production of renewable electricity and expand it by making it refundable

International tax provisions

- Outlines policy objectives without going into specifics
- Major objectives include:
  - Tightening the current worldwide system, mostly by curtailing deferral
  - Setting a minimum rate of tax for income earned offshore by the subsidiaries of U.S. companies: ***Fiscal year 2016 budget blueprint calls for a minimum rate of 19 percent on worldwide income plus a one-time transition tax at a rate of 14 percent***
  - Disallowing deductions for expenses related to moving operations offshore and providing a 20 percent credit for returning operations to the United States
  - Taxing excess profits associated with shifting intangibles to low-tax jurisdictions
  - Deferring interest deductions for expenses attributable to foreign-source income until that income is subject to U.S. tax

Small business tax provisions

- Make bonus depreciation permanent for small businesses by allowing them to expense 100 percent of qualified investments up to $1 million
- Increase the threshold for small businesses to use the cash method of accounting from $5 million in gross assets to $10 million
- Urges Congress to enact recent budget proposals, such doubling the deduction for start-up costs and expanding the health insurance tax credit for small businesses, as part of reform

[1] President Obama's framework outlines major tax policy objectives but does not include legislative language or detailed descriptions of proposals.

Appendix 8. Links to source documents & Deloitte Tax materials

The links below provide access to the text of the tax reform plans cited in this report:

- House Ways and Means Committee Chairman Dave Camp's comprehensive tax reform discussion draft
- Former Senate Finance Committee Chairman Max Baucus's discussion drafts on multinational taxation, cost recovery and tax accounting, energy, and tax administration
- Senate Finance Committee Chairman Ron Wyden's 2011 comprehensive tax reform proposal
- President Barack Obama's corporate tax reform framework

These links provide access to summaries, prepared by Deloitte Tax LLP's Tax Policy Group, of the Camp, Baucus, and Wyden tax reform plans and the Obama corporate tax reform framework:

- Camp tax reform draft achieves 25 percent top rate for corporations, individuals — but revenue tradeoffs abound (*Tax News & Views*, Vol. 15, No. 9, Feb. 27, 2014)
- Baucus tax reform discussion draft takes on international tax rules (*Tax News & Views*, Vol. 14, No. 45, Nov. 19, 2013)
- Baucus releases discussion draft on tax administration (*Tax News & Views*, Vol. 14, No. 46, Nov. 20, 2013)
- Baucus proposes significant changes to cost recovery, tax accounting rules (*Tax News & Views*, Vol. 14, No. 48, Nov. 21, 2013)
- Baucus releases tax reform draft on energy incentives (*Tax News & Views*, Vol. 14, No. 52, Dec. 18, 2013)
- White House corporate tax reform 'framework' long on ideas, short on details (*Tax News & Views*, Vol. 13, No. 8, Feb. 22, 2012)
- Wyden reintroduces comprehensive tax reform proposal (*Tax News & Views*, Vol. 12, No. 15, Apr. 8, 2011)

Acknowledgements and Contacts

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