Statement for the Record –

Ways and Means Committee Hearing: How Tax Reform Will Grow Our Economy and Create Jobs Across America

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Over the past decade, the economy has struggled at just two percent GDP growth as the country has experienced the worst recovery in the modern era.[1] While the post-World War II average remains at three percent GDP growth per year, the Congressional Budget Office projects that under current policies, two percent growth will continue into the next decade.[2] While the unemployment rate has stabilized in recent years, labor force participation has continued to drop, indicating that the economy remains weak.[3] Because of this lackluster recovery, families have lost an average of $8,600 in annual income, according to one estimate.[4]

One reason for the stagnant economy is the fact that the U.S. tax code is outdated, uncompetitive, and complex. The current code restricts the growth of new jobs, increases the cost of capital, and discourages innovation.

It has been more than 30 years since the tax code was reformed, and in that time, the world has changed drastically. Other countries have updated their tax codes and lowered their rates, while the U.S. system has barely changed.

The uncompetitive code means that businesses are unable to compete in the global economy. For instance, our uncompetitive code enables foreign competitors to acquire assets at a far greater pace than American businesses.

Over the past decade, U.S. companies have suffered a net loss of almost $200 billion in assets. Conversely, if the corporate rate was 25 percent (the average rate in the developed world), one report estimates U.S. businesses would have instead experienced a net gain of $600 billion in assets over the same period.[5]

Tax reform is the only way to reverse these trends and enact policies that benefit the economy.

Pro-growth reform should reduce taxes on businesses to a globally competitive rate, reduce taxes on capital gains, and eliminate the death tax and gift tax. Tax reform should also allow for full business expensing for new investments, and enact territoriality for individuals and businesses. Changes to the code should be made with an eye toward simplicity and permanency.

Changes to the tax code should not be constrained by concerns over increasing the deficit. Increasing economic productivity by merely one percent over the next decade

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[1] Economic Growth by President, Jeffrey H. Anderson, Hudson Institute, August 8th, 2016

[2] The Budget and Economic Outlook: 2017 to 2027, Congressional Budget Office, January 2017

[3] Labor Force Statistics from the Current Population Survey, Bureau of Labor Statistics

[4] The 'New Normal'? Part 1: Economic Stagnation, Congressional Joint Economic Committee, Oct 05 2016

[5] Buying and Selling: Cross-border mergers and acquisitions and the US corporate income tax, Business Roundtable, March 15 2015

will strengthen the economy and create $3.15 trillion in additional federal revenue. Enacting appropriate changes to the code both bolsters the economy and works to reduce the deficit.[6]

Tax Reform Should Reduce Taxes on Businesses: Today, American businesses are taxed at rates far above foreign competitors. The average federal/state corporate tax rate in the U.S. is roughly 39 percent, while the average rate paid by foreign competitors is about 25 percent.[7] Businesses organized as pass-through entities face rates even higher – above 40 percent, and even 50 percent when state tax rates are accounted for.[8]

While the U.S. rate remains high, other countries have adapted to the global changes by aggressively reducing their rates. Today, only the U.S. and Chile have higher corporate tax rates than they did at the start of the century.[9]

These outdated rates affect the entire economy. People, not businesses, pay taxes, so high business rates are directly absorbed by employees, consumers, and investors through lower wages, fewer jobs, and stagnant economic growth.

For instance, a 2006 CBO report found that roughly 70 percent of the corporate tax cost is borne by labor alone.[10] Similarly, a report by scholars at The American Enterprise Institute found that every dollar increase in corporate taxes decreases wages by two dollars.[11]

Tax Reform Should Reduce Capital Gains Taxes: The tax on capital gains and dividends is levied on after tax income that has been reinvested in the economy to increase productivity, grow jobs, and increase wages. The U.S. integrated capital gains tax[12] remains one of the highest in the world, which discourages investment, raises the cost of capital, and ultimately suppresses economic growth.

Tax reform should seek to preserve the base of the capital gains tax. Often, the Left argues that the capital gains tax is a "loophole," and calls for eroding the tax bit by bit through increasing taxes on carried interest capital gains. In truth, carried interest is no different from other types of capital gains income. Increasing taxes on carried interest – or any type of capital gain – would not only hinder economic growth, but would directly

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[6] The Budget and Economic Outlook: 2017 to 2027, Congressional Budget Office, January 2017
[7] Corporate income tax rate, OECD (Organization for Economic CO-Operation and Development)
[8] Pass-Through Businesses: Data and Policy, Scott Greenberg, Tax Foundation, January 17, 2017
[9] Tax Reform Advancing America in the Global Economy, Business Roundtable, October 2015
[10] International Burdens of the Corporate Income Tax, William C. Randolph, Congressional Budget Office, August, 2006
[11] Spatial Tax Competition and Domestic Wages, Kevin A. Hassett and Aparna Mathur, American Enterprise Institute, December 1, 2010
[12] Corporate dividend and capital gains taxation: A comparison of the United States to other developed nations, Alliance for Savings and Investment, April 2015

impact pension funds, charities, and colleges that depend on investment partnerships as part of their savings goals.[13]

Tax Reform Should Implement Immediate Full Business Expensing: Under the tax code, business owners cannot immediately expense the cost of purchasing equipment against their taxable income. Instead, they are required to deduct, or "depreciate," these costs over several years depending on the asset they purchase, as dictated by complex and arbitrary IRS tables. These rules create needless complexity and increase compliance costs.

They also force business owners to make decisions based on tax reasons over business reasons. In contrast, a move toward full expensing of assets will streamline business activity by allowing the efficient purchase of new assets. According to estimates by the Tax Foundation, allowing immediate expensing of assets increases GDP by five percent after a decade and increases wages by 4 percent.[14]

Tax reform should also be sure not to change the code in a way that erodes the progress made by moving toward full business expensing. For example, lawmakers should preserve section 1031 "like-kind exchanges," for land assets as a complimentary provision to expensing.[15] Similarly, the ability to deduct advertising costs as a necessary business expense should be maintained. Going in the other direction by limiting this expense would create new distortions in the tax code.[16]

Tax Reform Should Simplify the Code: Tax reform should be made with an eye toward simplifying compliance for taxpayers. Today, the code is more than 75,000 pages long and contains over 2.4 million words. This complexity forces American families and businesses to spend[17] more than 8.9 billion hours and $400 billion complying with the code every year. In the last 30 years, the code has more than tripled in size.

In addition to implementing policies that increase growth, tax reform should cut taxes for individuals. Rates should be reduced, and credits and deductions should be consolidated and streamlined.

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[13] Lawmakers Should Oppose Efforts to Increase Taxes on Carried Interest Capital Gains, Alexander Hendrie, Americans for Tax Reform, May 10, 2017

[14] Long Run Growth and Budget Effects of the Expensing Provision in the House Republican Tax Reform Blueprint, Stephen J. Entin, Tax Foundation, February 2, 2017

[15] Like-kind Exchanges Should Be Preserved as Part of Any Tax Reform Plan, Alexander Hendrie, Americans for Tax Reform, December 6, 2016

[16] Tax Reform Must Preserve the Deduction for Advertising Costs, Alexander Hendrie, Americans for Tax Reform, February 17, 2017

[17] Americans Will Spend 8.9 Billion Hours, $409 Billion Complying with U.S. Tax Code in 2016, John Buhl, Tax Foundation, June 15, 2016

Tax Reform Should Make Permanent Changes to the Code: Where possible, changes to the code should be permanent, not temporary. Permanency should be a goal of tax reform for two reasons.

First, permanency gives certainty for taxpayers who do not need to be concerned that their taxes will rise in a years to come. Certainty means a business owner can plan ahead to invest without concern for their ability to afford the investment and cash flows in the future.

Second, permanent tax policies mean that low-tax advocates do not need to continually devote political capital to ensure tax cuts remain law. Congress already struggles (or fails) to complete its basic annual duties. Relying on federal legislators to renew tax cuts every couple of years is a recipe for disaster.

This does not mean every change in tax reform has to be permanent. However, there is a clear need to make as much of tax reform concrete to ensure stability for Americans.

Tax Reform Should Move to Territoriality for Businesses and Individuals: Today, the U.S. is only one of six modern countries with a worldwide system of taxation. Because of this system, American businesses operating overseas are double taxed on income – once when they earn it in the country they are operating in, and again when they bring this money back into the U.S. economy.

This means that American businesses are faced with a disadvantage relative to their foreign competitors, which endure only one layer of taxation.

The worldwide system has also resulted in an estimated $2.6 trillion[18] in after tax income being stranded overseas. Moving to territoriality with a reasonable one time repatriation as a phase in will result in this money being brought back into the economy to be reinvested in jobs and wages, and providing higher federal revenues.

One way to end this disadvantage would be moving to a border adjustable tax system. This would guarantee that business activity is taxed only where the product is consumed. Exports that are consumed by individuals outside the country are not taxed, while imports consumed by individuals inside the U.S. are.

Just as American businesses operating overseas are forced to comply with the outdated and burdensome worldwide system of taxation, individuals living overseas are forced to comply with the system of citizenship-based taxation. This means that regardless of

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[18] Thomas A Barthold, Letter to Congress from The United States Joint Committee on Taxation, August 31, 2016

where U.S. citizen lives, they must comply with IRS rules and are double taxed on income.

The current citizen-based system effects an estimated 8.7 million Americans that live and work overseas.[19] This system is nearly unique to America – every other country in the world with the exception of Eritrea has residence-based taxation.

Implementing a residence-based taxation system would ensure individuals are taxed based on their location of residence. This would make tax compliance far simpler, and reduce the reach of the IRS. It would also make the extremely burdensome Foreign Account Tax Compliance Act (FATCA) obsolete.

Tax Reform Should Kill the Death Tax and Gift Tax: The death tax is unfair, hurts economic growth, and is extremely unpopular with the American people. It is a tax paid on savings that have already been taxed at least once, and potentially more than once. Furthermore, those who are hit hardest generally are first and second generation small business owners, because the truly wealthy can avoid the tax through an army of accountants, attorneys, and charitable planners.

Repeal of the death tax must also mean repeal of the gift tax. With the death tax gone, the gift tax, which was created as a backstop to the death tax, is no longer necessary. If the gift tax were left in place after repeal of the death tax, it would raise little, if any revenue because a taxpayer would simply wait to transfer their assets until they died. In contrast, repealing the gift tax along with the death tax would serve as a backstop to ensure the death tax is gone for good.

Together, the death tax and gift tax collect very little revenue and suppress economic growth. In 2015, both taxes collectively brought in $19.2 billion. The federal government brought in a total of $3.25 trillion, so coupling these taxes together contributes to less than 0.6 percent of all federal revenue.[20]

Repealing the death tax and gift tax would produce strong growth that would in turn offset this lost revenue. After macroeconomic effects, repeal of both taxes would reduce total revenues by just $19 billion over the entire first decade.[21]

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[19] 8.7 million Americans (excluding military) live in 160-plus countries., The Association of Americans Resident Overseas

[20] Historical Tables, Obama White House Archives, Table 2.5—Composition of "Other Receipts": 1940–2021

[21] Modeling the Estate Tax Proposals of 2016, Alan Cole, Tax Foundation, June 14, 2016