AMERICANS for TAX REFORM

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ATR Submission to Senate Finance Committee on the Need for Tax Reform

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The Honorable Orrin G. Hatch
Chairman, Senate Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch:

I write in response to your June 16, 2017 request for feedback on tax reform. As you know, comprehensive, pro-growth tax reform has not been signed into law since 1986.

Today, the code is outdated, complex, and burdensome. U.S. tax policy is also restricting economic growth and impeding the ability of American businesses to compete internationally.

The tax code is more than 75,000 pages long, and has almost tripled in size in the past three decades. Americans spend more than 8.9 billion hours and $400 billion complying with the code every year.[1] This complexity makes it difficult, if not impossible, for Americans to file their taxes by themselves.

In addition, the code suppresses the economy by restricting the growth of new jobs, increasing the cost of capital, and discouraging innovation.

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.[2] The Congressional Budget Office projects that under current policies, two percent growth will continue into the next decade.[3]

While the unemployment rate has stabilized in recent years, labor force participation has continued to drop, indicating that the economy remains weak.[4] Because of this lackluster recovery, families have lost an average of $8,600 in annual income, according to one estimate.[5]

The outdated tax code also places American businesses at a disadvantage relative to foreign competitors. According to one study, the U.S. business climate is so uncompetitive that American companies have suffered a net loss of almost $200 billion in assets over the last decade.

Foreign companies are able to expand at a far greater pace, largely because they are based in countries with tax codes that are more favorable to investment and innovation. If the corporate rate was just ten points lower, U.S. companies would have instead experienced a net gain of $600 billion in assets over the same period.[6]

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[1] Americans Will Spend 8.9 Billion Hours, $409 Billion Complying with U.S. Tax Code in 2016, John Buhl, Tax Foundation, June 15, 2016
[2] Economic Growth by President, Jeffrey H. Anderson, Hudson Institute, August 8th, 2016
[3] The Budget and Economic Outlook: 2017 to 2027, Congressional Budget Office, January 2017
[4] Labor Force Statistics from the Current Population Survey, Bureau of Labor Statistics
[5] The 'New Normal'? Part 1: Economic Stagnation, Congressional Joint Economic Committee, Oct 05 2016
[6] Buying and Selling: Cross-border mergers and acquisitions and the US corporate income tax, Business Roundtable, March 15 2015

Tax reform is an opportunity to address all of these problems, and reach economic growth of at least three percent. Reforms that should be implemented include:

-A 15 percent tax rates for all businesses.

-Tax cuts and simplification for families.

-Moving to a territorial tax system for individuals and businesses.

-Implementing full business expensing.

-Repeal of the death tax and gift tax.

-Lower capital gains taxes.

-Expanding tax-preferred savings accounts.

In addition, it is crucial that tax reform is bold. Congress should not let themselves be needlessly restrained and should look at all available options. If tax reform is passed through budget reconciliation as many expect, lawmakers should consider extending the budget window from ten years out to 15, 20, or 25 years. This option could make it easier to phase in changes to the code, and allow dynamic economic effects to develop. [7]

Reduce the Tax Rate on All Businesses to 15 Percent. A 15 percent tax rate will allow innovative startups and small businesses to thrive and ensure businesses operating overseas are competitive.

Today, the tax rate on American businesses is too high. 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.[8] Businesses organized as pass-through entities face rates even higher – above 40 percent, and even 50 percent when state tax rates are accounted for.[9]

In reality, high taxes on businesses are felt by individuals. Reducing these high rates will have a strong, positive economic effect. Multiple studies have found that lower tax rates on businesses will benefit workers and the economy. For example, 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]

At a minimum, tax reform should reduce the corporate rate to 20 percent, so it is below the average rate in the developed world, and ensure that businesses organized as pass-through entities have a rate that puts them on par with corporations.

Move Towards Immediate, Full Business Expensing of New Investments. Tax reform should move away from the confusing and complex system of depreciation toward a system where businesses can immediately deduct the cost of new investments.

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[7] Tax Cuts That Last—With 51 Votes, Grover Norquist, David McIntosh, The Wall Street Journal, June 13, 2017

[8] Corporate income tax rate, OECD (Organization for Economic Co-operation and Development)

[9] Pass-Through Businesses: Data and Policy, Scott Greenberg, Tax Foundation, January 17, 2017

[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

By removing a restriction to investment, full business expensing will increase economic growth, leading to more jobs and higher wages. While some have expressed skepticism of the merits of expensing, it would have strong, positive economic effects. 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. [12]

While the best solution is implementing full business expensing on a permanent basis, an alternative should be to include it as a temporary provision for several years. In practice, 100 percent expensing for three years would allow strong economic growth until 2020 and, if successful, could be easily be extended or made permanent by lawmakers.

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" as a complimentary provision to expensing. [13] Section 1031 of the code eliminates unnecessary barriers to investment by allowing business owners to replace less productive assets with newer, more economically efficient assets. As such, it promotes stronger growth because it encourages more investment in the economy.

Similarly, the ability to immediately deduct advertising costs should be maintained. Going in the other direction by forcing these costs to be recovered over multiple years would create a new distortion in the tax code that restricts economic growth and investment in the economy. [14]

Middle Class Tax Cuts and Simplicity for Families. In addition to implementing policies that increase economic growth, tax reform must simplify the code and cut taxes for individuals.

The best way to do this is by reducing rates across the board, consolidating and streamlining credits and deductions, and substantially increasing the size of the standard deduction to reduce the number of taxpayers that itemize. Tax reform should also eliminate the Alternative Minimum Tax and the state and local tax deduction. This will result in a simplified, less distortive, fairer tax code for individuals.

Some have proposed simplifying tax compliance by increasing the role of the government over tax filing. Having the federal government file taxes for taxpayers would represent a conflict of interest, and would likely result in the IRS collecting more taxes from confused individuals who are actually overpaying. If tax reform addresses tax compliance, it should do so by promoting the Free File tax preparation program, a public-private partnership currently available to 70 percent of taxpayers.[15]

Territoriality for businesses and Individuals. Today, the U.S. is one of the few countries in the modern world with a worldwide system of taxation. This affects both businesses operating overseas and citizens living in foreign countries. For businesses, this has created a competitive disadvantage with foreign competitors, due to double taxation and overly complex rules. For individuals, this system

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[12] 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

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

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

means they must continue to comply with IRS rules, in addition to the rules of the country they reside in, even if they left the U.S. years or decades ago.

Tax reform should move to territoriality for both businesses and individuals. Not only will this result in a far simpler code and reduce the size and scope of the IRS, it will also have tremendous economic benefits; the U.S. worldwide system has resulted in an estimated $2.6 trillion[16] in after tax income being stranded overseas. Moving to territoriality with a reasonable one-time, single digit repatriation rate will result in this money being brought back into the economy to be reinvested in jobs and wages, consequently providing higher federal revenues.

Moving to a competitive tax system should also promote the free flow of capital between the U.S. mainland and the U.S. territories, which are often an afterthought in policymaker's minds. While in practice, a territorial system must include robust rules to prevent against base erosion of certain incomes, these rules must be developed with an eye toward simplicity and in a way that ensures American businesses are not held back from competing overseas.

Lawmakers should also ensure a system that is internationally competitive and equitable. For instance, some propose eliminating the deductibility of premiums for foreign reinsurers, despite the fact that almost every other country treats foreign and domestic reinsurance the same. This proposal moves the code in the wrong direction because it arbitrarily distorts economically equivalent decisions.[17]

Promote Retirement Savings by Expanding Tax-Preferred Savings Accounts. Depending on how you count them, there are about fifteen different tax-advantaged savings accounts—mostly for retirement but also for health care and education. They come in the form of a confusing alphabet soup of acronyms, such as IRSs, SEPs, 301(k)s, 529s. This complexity means many Americans simply give up, and therefore haven't saved at all in these accounts and are not prepared for retirement.

One of the easiest things we could do is streamline and consolidate many of these accounts. In 2003, the Treasury Department drafted a proposal to simplify tax-free savings for all Americans based around the creation of a Retirement Savings Accounts (RSAs)**,** Lifetime Savings Accounts (LSAs), and Employer Retirement Savings Accounts (ERSAs).[18]

Repeal 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. 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.

The gift tax, which exists as a backstop to the death tax, should also be repealed. In a world without the death tax, there is no reason for the gift tax. If the gift tax were left in place after the repeal of the death tax, it would raise little, if any, revenue. Taxpayers 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.

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

[17] Association of Bermuda Insurers and Reinsurers, EY, January 18, 2017

[18] General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals, Department of the Treasury, February 2003.

Lower Capital Gains Taxes. Taxes on capital gains and dividends are taxes on investment. Repealing or lowering the capital gains tax allows more money to be invested productively into the economy, which increases economic growth, creates more jobs, and leads to higher wages.

The U.S. has some of the highest taxes on investment in the developed world, so the capital gains tax should be reduced.[19] At a minimum, the Obamacare 3.8 percent capital gains tax should be repealed.

Lawmakers should also not increase taxes on “carried interest” capital gains. Carried interest is no different from other types of capital gains income and should be taxed as such. Higher taxes on investment income will hinder economic growth and directly impact pension funds, charities, and colleges that depend on investment partnerships as part of their savings goals.

One other option policymakers can take to reduce the capital gains tax is changing the calculation of the tax to disregard any gain that is due to inflation. This could be done by Congress passing legislation or Treasury reinterpreting the term “cost” through executive action.[20]

No New Taxes. Tax reform should not be an opportunity to create new taxes. Even if a new tax is offset with lower taxes elsewhere, the creation of a new tax inevitably leads to higher taxes and bigger government in the future. Some have suggested imposing a carbon tax in tax reform, but this is bad tax policy.

A carbon tax would impact every sector of the economy, would increase energy prices, and would cause the cost of consumer goods to rise. Furthermore, it would disproportionately hit low-income households - which expend a greater share of their income on energy and consumer goods. While it may start small, like the AMT and the income tax, a carbon tax would inevitably increase in size.[21]

2017 represents an important opportunity for comprehensive, pro-growth tax reform. It is crucial that Congress uses this opportunity to implement polices that reduce the tax burden on businesses and individuals, reenergize the economy, promote American innovation and competitiveness, and simplify the tax code. Thank you for your work on this important issue.

If you have any questions, please contact ATR’s Director of Tax Policy Alex Hendrie at 202-785-0266 or by email at ahendrie@atr.org.

Onward,

Grover Norquist

Cc: All members of the Senate Finance Committee

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[19] Corporate dividend and capital gains taxation: A comparison of the United States to other developed nations, Alliance for Savings and Investment, April 2015

[20] The Legal Authority of the Department of The Treasury To Promulgate a Regulation Providing for Indexation of Capital Gains, Charles J. Cooper, Michael A. Carvin, Vincent J. Colatriano, Shaw, Pittsmen, Plotts and Trowbridge, August 17, 1992

[21] Top Five Pitfalls of a Carbon Tax, James Morrone Jr., Americans for Tax Reform, February 5, 2016