AMERICANS for TAX REFORM

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House Ways and Means Tax Policy Subcommittee

Hearing on Perspectives on the Need for Tax Reform

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1. Introduction

Chairman Boustany, Ranking Member Neal, and Members of the Subcommittee, thank you for the opportunity to submit testimony before you today on the pressing need to reform the tax code. My name is Grover Norquist, and I serve as President of Americans for Tax Reform, a group I founded in 1985 at the request of President Reagan. Americans for Tax Reform advocates on behalf of taxpayers for a system in which taxes are simpler, flatter, more visible, and lower than they are today. My organization also has the role of promoting and monitoring the Taxpayer Protection Pledge, a written commitment made by a politician to his/her constituents promising to oppose any and all tax increases.

There is near unanimous agreement that the existing tax code has to go. Spanning 74,608 pages, it is so complex and confusing that it is virtually impossible for taxpayers to know whether they are properly filing their taxes. Unsurprisingly, this complexity leads to taxpayers collectively wasting more than 6 billion hours and spending $378 billion complying with the code every year.

Not only is the code mind numbingly complex, it is littered with layer upon layer of taxes and cronyist provisions that needlessly pick winners and losers. No sane individual would design the tax code we have today, and its clear we need to start over.

Even though there exists a consensus that drastic change is needed, tax reform remains stubbornly out of reach. For years a stalemate has existed over whether the code should remain revenue neutral, cut taxes for Americans, or serve as a Trojan horse to increase taxes. Similarly, conservative proponents of tax reform have argued over various consumption based tax plans. All the while, the tax code continues to increase in complexity.

Moreover, the code's complexity hurts those least equipped to deal with this complexity the most. Small businesses and lower income families have little way of knowing whether they are properly utilizing all the credits they are entitled to. But just as the code negatively impacts Americans on a day-to-day basis, it broadly impacts American competitiveness in the global economy.

When President Reagan passed the Tax Reform Act of 1986, it cut our corporate tax rates down to 38.6 percent. At the time, the average corporate income tax rate in the developed world was 44 percent, so we were ahead of the curve. Since then, the 33 other developed countries have aggressively cut their tax rates, and today this average is just 25 percent.

95 percent of the world's consumers live outside the U.S. so it is a necessity that American businesses can compete overseas. However, our tax code is one of only a handful that subjects businesses to double taxation of income earned abroad. This worldwide system of taxation was once the norm, but today the majority of the world utilizes a territorial system of taxation, taxing businesses income only if it was earned within that country.

This competitiveness problem is or has forced some of our most iconic businesses to pursue inversions, a merger with a foreign business with the intent of headquartering the new entity overseas. Concurrently, American businesses are unable to expand through acquisition and are instead ripe targets for acquisition themselves because they are operating in a tax code that means they can spend far less in the global merger and acquisition market.

For decades, America has been the world leader in innovative ideas and products, and other countries know this. They are aggressively reforming the tax codes to compete in the modern world, and we can't afford to be left behind.

2. Support for the Tax Code Termination Act

Clearly, our tax code no longer works for American families, or for businesses large or small. Reform is desperately needed.

I believe the solution to this stalemate is by passing legislation to sunset the tax code. The idea here is simple, unite the proponents of the many competing replacement tax schemes to support legislation terminating the existing tax code by a certain time period to force action. Fortunately, there is already legislation to do this, H.R. 27, the Tax Code Termination Act introduced by Congressman Bob Goodlatte (R-Va.). This legislation sunsets the entire tax code by January 1, 2020, and calls on Congress to replace it with a fairer, simpler tax system that cuts tax rates, eliminates the bias against savings and investment, and promotes job creation and growth.

Essentially, this codifies a two-step process for tax reform that allows us to start over with a clean slate and design a tax system that is simpler, fairer, and gets the government out of the way of American growth and prosperity. Given we have not had tax reform since 1986, there is a clear need to kick start this process. Congress should move forward with this proposal and this hearing is an excellent first step in that process.

Once the code is put on the pathway to sunset, the real work can begin. I would like to take this opportunity to highlight some priorities that lawmakers should prioritize when reforming the code.

3. Recommendations on Tax Reform

The ultimate goal of tax reform should be to move to taxing consumed income one time at one rate. At present, Americans are taxed when they earn a dollar, again when they save that dollar in a bank, again when they invest in a company. That dollar is taxed at the corporate rate inside a business, again as a capital gain, and once again if you are foolish enough to die. Consumed income should be taxed once. Not again and again. Savings and investment should build America tax free. Consumed income should be taxed at one rate.

A single rate means that all taxpayers are treated equally before the law. A single rate makes it difficult for politicians to divide Americans into different groups and targeting to them for tax hikes one at a time.

My home state is Massachusetts, aka Taxachusetts. But in the Bay state there is a constitutional requirement that the income tax have one single rate. That has kept the Massachusetts rate lower than any other states that are thought of as less statist than the Bay state. Five times the voters of Massachusetts have voted down efforts to move to a graduated or progressive income tax structure. All reforms should move towards taxing consumed income, one time at one rate, one time.

This goal means that a number of taxes must be repealed, such as the capital gains tax, the Death Tax, and the AMT:

Capital gains taxes should be repealed. A key policy goal should be incremental progress toward a consumption base of taxation and therefore cutting the tax rate on capital gains (and dividends, distributed after-tax corporate earnings) to zero. The capital gains tax hits income that has already been subjected to income taxes and has been reinvested to help create jobs, grow wages, and increase economic growth. This double taxation makes no sense from the perspective of encouraging investment and stronger growth.

The Death Tax should be repealed. One of the most intrusive and unfair taxes is the Death Tax, which requires your loved ones to tell the IRS about everything you own at the moment of death – your bank accounts, investments, the value of your home and business, and more. The Death Tax is counterproductive to growth – it is a tax you pay on savings you have already paid taxes on at least once.

The Alternative Minimum Tax should be repealed. First imposed in 1969, the Alternative Minimum Tax (AMT) was established to prevent certain taxpayers from using otherwise available deductions to reduce (and in some cases eliminate) their income tax liability. Over time, the AMT has expanded in scope to hit a far larger percentage of Americans than was ever intended. In 1970, the tax hit just 20,000 taxpayers. As of 2011, it had grown to hit 4.3 million including many upper-middle class taxpayers. Because wages are continuously increasing, the AMT will only continue to impact more taxpayers over time. It should be repealed.

At the same time, tax reform should not be an excuse to create new taxes like a carbon tax or a VAT. This would be a colossal mistake. Any new tax code should not create any new types of taxes like a carbon tax or a VAT, and it should also ensure the government's power is restrained by keeping bureaucrats out of the tax preparation business and ensuring savings accounts are expanded and protected:

A carbon tax would have significant negative impact on every sector of the economy. It would increase energy prices and cause the cost to consumers to rise. Moreover, the tax would hit low-income households at a disproportionately higher level. As mentioned, a carbon tax would impact every sector of the economy, would increase energy prices, and would cause the cost of consumer goods to rise. Further, it would disproportionately hit low-income households who 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 once created.

Similarly, a VAT will inevitably cause taxes to increase in size once imposed. Whenever a Value-Added Tax has been implemented, it is promised as a solution to other taxes being too high. It is simply too easy for politicians to raise a tax that is hidden from citizens. The growth of government spending in Europe since 1970 is directly correlated to the growth in the VAT. VATs started out in Western Europe at about a 5 percent rate, but now average about 20 percent. The experience of Europe should teach us that the imposition of a VAT, even in the pursuit of very worthy ends, is too often the precursor to bigger government.

No government run tax preparation. One annual suggestion for simplifying the tax code is have the IRS prepare and file your taxes for you. The argument here is that it makes things simple for confused taxpayers and the IRS already has most or all of this information anyway. All you would have to do each year is sign off on your government-processed refund. While this may sound appealing, it is a giant conflict of interest for the IRS to determine your tax liability, and then seize your wages and assets in order to collect that tax liability. Taxpayers have little understanding of the tax code and would be left to trust the notoriously inefficient IRS. A mistake means hundreds or thousands dollars less on your tax refund.

Tax-advantaged savings accounts should be preserved and expanded. When used correctly, the existing 15 savings accounts can significantly reduce the tax burden on families. Unfortunately, this system can be so confusing and complex that it is difficult for most Americans to take advantage of and it causes households to under-save. But when used correctly these saving accounts drastically reduce the tax burden on families, so tax reform should promote and simplify the use of savings accounts.

Lastly, tax reform must be done with an eye to American competitiveness. To do this lawmakers must keep in mind a number of principles:

The corporate income tax rate must be reduced. The U.S. has the highest corporate income tax rate in the world, with an average rate of 39.1%. In comparison, the average for the 34 OECD members sits at a much lower rate of 25%. Other countries have significantly cut their rates, while the U.S. has continued to keep a high rate. The high rate puts a significant burden on American businesses and families, as up to 75 percent of the cost of corporate income tax is passed onto labor, so reducing the rate will increase wages and jobs.

Our current worldwide system of taxation should be repealed and replaced with a territorial tax system. This will remove the double tax faced by American businesses operating overseas. 28 of the 34 OECD countries utilize the system of territorial taxation, meaning that income earned abroad by a business is exempt from taxation. The worldwide tax system has led to more than $2 trillion in after tax earnings being kept abroad and unable to be brought back and reinvested in the U.S. economy.

T**ax reform must also ensure that businesses of all size are taxed equitably.** Currently, corporations and pass-through businesses are taxed in entirely different ways, with corporations calculating profits by subtracting expenses from revenue and then paying federal and state corporate income taxes. On the other hand, businesses that are structured as pass-through firms are different – they don't pay taxes themselves. Instead, the profits of the business "pass through" to the owners who pay individual taxes on their 1040 form. While it is of utmost important that corporate tax rates are reduced, it is equally as important to make sure small businesses and startups are not left behind.

Tax reform should create full business expensing. Currently, there is a bias in the tax code that discourages business owners from making investments. Some business investments can be written off immediately, while others are subject to a bizarre patchwork of rules under the depreciation system. Business owners should be allowed to reduce their taxable income dollar-for-dollar by the amount purchased when they invest in business expenses. Encouraging investment back into the business in turn encourages more jobs and stronger economic growth.