AMERICANS *for* TAX REFORM

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ATR Submission to the Conference Committee for the Tax Cuts and Jobs Act

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Dear Conferee:

I write in support of H.R. 1, the Tax Cuts and Jobs Act. Both the Senate and House bills are pro-growth and pro-family. Both bills dramatically simplify the code and reduce taxes for Americans of every income level. Both bills also modernize business taxation and offer relief for companies of all sizes.

Both bills will revitalize our stagnant economy, resulting in higher wages and new or better jobs for American workers.

The Tax Cuts and Jobs Act is the result of a long regular order process that has involved dozens of hearings and years of work from both the Senate Finance Committee and the House Ways And Means Committee.

As you move through the conference committee, I write the following recommendations:

- Ensure tax reduction for Americans of every income level while simplifying the code
- Repeal of Obamacare's individual mandate tax penalty
- Tax Reduction for Businesses including a permanent 20 percent corporate rate
- Pro-Growth Cost Recovery including 100 percent expensing and reasonable limitations on deductibility of interest
- Repeal of the death tax
- An internationally competitive territorial system with appropriate base erosion rules

There are a multitude of conservative provisions in each bill. Where differences remain, the conference committee should be an opportunity to make the bill more pro-growth and ensure strong tax relief for American families, individuals, and businesses.

While there are ways both pieces of legislation could be improved, both the House and Senate bills are infinitely better than the status quo. It is imperative that conferees swiftly reconcile differences between the two bills and send it to the House and Senate to ensure tax reform is signed into law in 2017.

As you continue to work toward comprehensive tax reform, please use ATR as a resource. 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
President, Americans for Tax Reform

Individual Tax Reduction and Simplification

While there are minor differences, both versions of the Tax Cuts and Jobs Act ensure tax reduction for Americans of every income level and simplification.

Both bills double the standard deduction to $12,000, or $24,000 for a family. According to IRS data, 70 percent of filers – or 105 million individuals and families currently take the standard deduction, and these families would see strong tax reduction.

While the house bill contains four brackets, the Senate bill maintains the existing seven brackets. However, the Senate bill lowers (almost) every bracket and is a significant net tax cut.

-Current law: 10, 15, 25, 28, 33, 35, 39.6

-Senate bill: 10, 12, 22, 24, 32, 35, 38.5

-House bill: 12, 25, 35, 39.6

Regardless of the number of brackets, the middle class are among the biggest winners under both bills. Under the Senate plan, a family of four earning $73,000 would see a tax reduction of 60 percent or nearly $2,200 per year. Similarly, under the House plan a family of four earning $59,000 per year would see tax reduction of $1,182.

The Senate tax bill also doubles the child tax credit to $2,000 per child, while the House bill creates a $1,600 tax credit per child plus a $300 credit per parent and non-child dependent. Expanding the child tax credit will help millions of Americans across every state. According to the most recent IRS data, more than 22 million Americans used the child tax credit in 2015. These families will see strong tax reduction.

In addition, these changes will ensure strong simplification of the tax code. Today, the tax code is absurdly complex. Since 1985 the tax code has doubled, and it has increased six fold since 1955. In fact, the code currently totals 2.4 million words. This complexity costs Americans millions of hours and billions of dollars per year in lost productivity.

One major difference that the House and Senate should resolve is the treatment of the Alternative Minimum Tax. The House plan fully repeals the AMT, while the Senate plan simply increases the income level at which this tax kicks in. Initially passed to make sure 155 high-income Americans paid federal income tax, the AMT today is paid by almost 4.5 million Americans. Millions more have to calculate their taxes twice to comply with the tax even if they do not pay it. Repealing this tax will ensure simplification for Americans across the country.

Both bills ensure tax simplification and tax reduction at every income level. In addition to maintaining these goals, conferees should ensure the Alternative Minimum Tax is repealed.

Repeal Obamacare’s Individual Mandate Tax Penalty

The Senate’s Tax Cuts and Jobs Act zeroes out Obamacare’s individual mandate tax penalty, granting important tax relief to low and middle income families.

Under Obamacare, anyone not buying “qualifying” health insurance – as defined by the Obama-era Department of Health and Human Services -- must pay an income surtax to the IRS. The tax equals $695 for individuals, while a family of four is required to pay $2,085.

The individual mandate is one of the most regressive taxes in the code today. In tax year 2015, 6,665,480 households paid this tax. 79 percent of these households had annual income below $50,000 and 37 percent of households that paid this tax had annual income below $25,000.

<u>Conferees should include repeal of the individual mandate in the final tax bill.</u>

Tax Reduction for Businesses

Both bills reduce taxes for businesses of all sizes regardless of whether they are organized as pass-through entities or corporations. Importantly, both plans propose a permanent 20 percent corporate tax rate.

The U.S. currently has the highest marginal corporate income tax rate in the developed world. At 35 percent (plus an average state rate of 4 percent), this rate is nearly 15 points higher than the typical developed country which has a rate around 25 percent.

In the increasingly global economy, it is clear that workers are more vulnerable to the high U.S. corporate rate. A high corporate tax rate means that capital will be relocated in a more productive way (i.e. to a country with a lower corporate tax rate). In other words, U.S. capital is mobile, while U.S. workers are not. According to recent studies, workers bear 50 or 75 percent of the costs of the corporate tax. This means that lowering this tax will increase wages and create more jobs.

While both bills lower the rate to 20 percent, the Senate bill implements this lower rate in 2019. Ideally, the 20 percent rate should be effective in 2018. In addition, the Senate bill retains the corporate Alternative Minimum Tax, while the House bill repeals the corporate AMT.

<u>Conferees should ensure the corporate rate is permanently reduced to 20 percent. Ideally, this rate reduction should be immediate. Further, conferees should repeal the corporate AMT.</u>

Transition Rules and Grandfathering in Provisions: By necessity, comprehensive tax reform that overhauls the code involves tradeoffs. Commonly, this involves creating pay-fors that offset the revenue from lower marginal tax rates. These pay-fors need to be carefully considered so as not to undermine the pro-growth aspects of reform. One way to achieve this goal is to have reasonable transition rules and appropriate grandfathering of some provisions.

The House bill proposes eliminating the deductibility on deferred executive compensation employee compensation, such as stock options that have been granted but not yet vested. This would remove an important way that businesses compensate employees, and would subject businesses to taxation based on past stock options granted.

Ideally, full deductibility of employee compensation should be maintained. At a minimum, conferees should ensure this change is grandfathered in so that past compensation granted is not taxed.

Similarly, the Senate bill codifies a long-standing Treasury rule over advanced payments. However, the codification omits existing exceptions to this rule that give businesses flexibility when selling high-value custom products. Sen. Scott's amendment restores this exception which will allow a smoother accounting process by more accurately matching income with costs.

Codifying rules for advanced payments without including long-standing, existing exceptions will harm business flexibility and competitiveness.

Conferees should ensure that existing exceptions to advanced payments are maintained in the Tax Cuts and Jobs Act.

Preserve Tax Treatment of Capital Gains

Carried Interest Capital Gains: Taxes on capital gains and dividend income are taxes on investment. Both the House and Senate bills preserved current law capital gains tax treatment, with one exception – both increase the minimum holding period to qualify for carried interest capital gains from one year to three years.

While the preferable tax treatment would be to maintain this holding period at one year (as all other capital gains are treated under current law), this is an acceptable compromise between those that want higher taxes, and those who support pro-growth policies and low taxes on investment.

Conferees should not increase taxes on carried interest capital gains above what was included in the House and Senate bills.

The standard for capital gains treatment is and always has been based around entrepreneurial investment in a capital asset, whether this is in the form of capital or labor or both. Despite rhetoric from the left, carried interest capital gains income is simply the expert investor’s share of a partnership, and is no different from other types of capital gains income.

Further increasing taxes on carried interest capital gains would impact pension funds, charities and colleges that depend on investment partnership structures in order to meet savings goals. Small businesses would also be badly affected, as investment money available from these partnerships dries up. In contrast, reducing capital gains taxes allows more money to be invested productively into the economy, which increases economic growth, creates more jobs, and leads to higher wages.

FIFO Restrictions on Capital Gains: The Senate version of the Tax Cuts and Jobs Act institutes a “first in, first out” rule for the tax treatment of capital gains. Currently, when an investor purchases shares in any one entity, they are able to choose which tranche of stock should be recognized as taxable. This would increase taxes on investment income. In addition, both House and Senate bills fail to offer any capital gains tax reduction.

Conferees should remove the FIFO restriction.

Pro-Growth Cost Recovery

Expensing: Both House and Senate bills propose five years of 100 percent, immediate full business expensing. After five years, expensing completely expires under the House plan, while the Senate plan phases out the provision over the next five years.

Conferees should adopt the Senate's version of full business expensing.

Moving to a system of immediate expensing for new investments will encourage stronger economic growth. Under current law, businesses must deduct, or "depreciate" the cost of new investments over multiple years depending on the asset they purchase, as dictated by arbitrary IRS rules.

This system of depreciation creates complexity in the code and distorts economic decision making. Ideally, all business expenses (whether it is employee wages and benefits, rent, new investments or advertising) should be immediately deductible under the tax code.

Preserving Existing Deductibility of Advertising: Advertising is one of many costs of doing business that firms are properly allowed to deduct under current law. As part of a move toward immediate expensing of all investments, it is important that tax reform maintains the current tax treatment of advertising.

Both the House and Senate bills currently protect the deductibility of advertising.

Conferees should preserve current treatment of deductibility of advertising.

Maintaining 1031 for Certain Assets: Section 1031, also known as like-kind exchanges, should be considered complimentary to this goal.

This provision allows taxpayers to defer paying taxes on certain types of assets when they use those earnings to invest in another, similar asset. Under current law, Sec. 1031 eliminates a potential barrier to investment, which in turn promotes the more efficient allocation of capital resources.

While both bills repeal Section 1031 for many assets, they importantly preserve it for land, which typically does not benefit from full expensing. Because of the exclusion of land, repeal of like-kind exchanges – even with full expensing – may have the effect of impeding otherwise economically productive transactions.

Conferees should maintain Section 1031 for land assets as included in both bills.

Retaining Reasonable Deductibility of Interest: Both the House and Senate bills propose a limitation on the deductibility of net interest. The House bill proposes limiting any deduction for net interest above 30 percent of EBITDA (Earnings before interest, tax, depreciation, and amortization). The Senate bill applies a similar limitation of 30 percent but utilizes a more narrow calculation of EBIT (Earnings before interest and tax.) An EBITDA limitation is more appropriate both from a pro-growth perspective, but also from an international competiveness perspective, as this type of limitation is utilized by the majority of developed countries.

Conferees should ensure that the interest deductibility is calculated with an EBITDA limitation.

Repeal the Death Tax

Tax reform should include full repeal of the death tax. The Senate bill, which doubles the exemption threshold of the tax to $10 million, is a step in the right direction, while the House bill doubles the exemption and then fully repeals the tax after six years.

The death tax hurts the economy, imposes undue burdens on taxpayers, and is extremely unpopular with the American people. The death tax is especially burdensome on family owned small businesses, the core of America's economy. The death tax is also extremely unpopular and a majority of Americans support its repeal.

Conferees should adopt the approach taken by the House and ensure repeal of the Death Tax.

International Tax Reform

Both the House and Senate plans replace America's outdated worldwide system of taxation with a territorial system of taxation. In the global economy, 95 percent of consumers live outside the U.S. and a total of 41 million jobs are tied to business operations overseas. However, the U.S. is just one of six countries in the developed world that still uses the worldwide system of taxation.

In practice, a territorial system of taxation requires base erosion rules to act as guardrails for the system. Base erosion rules must be carefully considered. Overly burdensome rules that create too much of a burden on U.S. based taxpayers would only perpetuate the uncompetitive tax system. Any rules must be developed with an eye to the systems employed by the rest of the world. One way this could be achieved is by excluding from base erosion any payments made under a bilateral advance pricing agreement (APA).

Tax reform should also address the tax treatment of U.S. territories such as the island of Puerto Rico. This should include provisions that promote the free flow of capital between the U.S. mainland and the U.S. territories. In addition, lawmakers should consider implementing opportunity zones to promote economic activity in the territories.

Conferees should ensure that the new, territorial system contains reasonable base erosion provisions that do not inhibit American innovation or foreign investment, such as by excluding payments made under bilateral agreements.

In addition, this international system should not inhibit the free flow of capital from U.S. territories.

Worldwide Interest Limitation
One of the base erosion provisions included in the Senate bill is a global limitation on interest expenses (section 163(n)). This limitation is imposed in addition to the thin capitalization rule.

Other developed countries typically disallow interest solely through a thin cap approach, so the imposition of Sec 163(n) would add complexity to the tax code and ensure the U.S. code does not meet global best practices.

While it is inevitable that tax reform includes base erosion provisions, it is crucial that any provisions included promote a competitive, U.S. tax system.

Conferees should remove the worldwide interest limitation under section 163(n).

At a minimum, conferees should modify this provision so that it is grandfathered in and applies to net interest expense.

Treatment of Financial Services: Almost every country treats cross border financial transactions neutrally. This means that transactions are not subject to foreign base erosion provisions and are treated the same whether they are foreign or domestic transactions. This includes common financing transactions between different countries, but also payments based on reinsurance flows.

In the case of reinsurance, including these transactions in base erosion provisions would not only undermine the competitiveness of the U.S. international system, it would also harm the model of globally spreading risk that reinsurance relies on.

Conferees should ensure that the base erosion provisions are developed in a way that treats financial transactions equitably with the rest of the world.

Conferees should also ensure that reinsurance transactions are treated in a way that matches the tax treatment employed by foreign competitors.