

Comments to House Ways and Means Committee 2013 Tax Reform Working Groups



April 15, 2013

Dear Chairman Camp and Ranking Member Levin:

Taxpayers for Common Sense is a national non-partisan budget watchdog that has been working on behalf of the nation's taxpayers since 1995. We applaud Chairman Camp and Ranking Member Levin for tackling comprehensive tax reform. It's been more than a quarter century since the last reform of the code and in that time it has become littered with increased complexity, parochial tax treatments, and revenue giveaways that must be curtailed. We urge the tax reform working groups to be aggressive with their proposals. One of the major lessons of the Tax Reform Act of 1986 was that broader, more sweeping reforms tend to gain momentum, while smaller, more incremental approaches become dragged down by special interests protecting their own provisions.

To that end, we have multiple proposals and comments in various areas, but our over-arching theme is that tax reform must result in a simpler, flatter, fairer code. We believe that the scale of our nation's debt situation is so dire that reform must be revenue positive for a few simple reasons. First, we need to reduce the rate of growth of our debt – and ultimately decrease the overall size of our debt. While economic growth is critical to increased revenue, insisting on revenue neutrality lessens our ability to tackle the overall debt, even if significant spending reductions are also adopted. Second, estimating the revenue impacts of various tax proposals is a notoriously inexact science, and we cannot afford for reform to be revenue negative. Lastly, whatever the final product is, we know the history of tax policy, and in the coming years, like a forest after a fire, the underbrush of various tax expenditures and preferences will build up reducing revenue.

There also has to be a mandated regular review of provisions in both the individual and corporate tax codes to ensure that they are working and provide a significant return on the taxpayer's forgone revenue investment. The existing lack of oversight and scrutiny rewards political inertia, rather than performance.

Individual Tax Reform

On the individual side of the tax code, we believe that while the progressive nature should be retained, the number of brackets should be reduced. Capping deductions, as is proposed in the President's budget request, would preserve progressivity, however it is a pale substitute for comprehensive tax reform. While it limits the total impact of the suite of various tax deductions and credits to high income earners, the President's proposal retains all the complexity of the existing code. Moreover, by reducing the impact of new credits and deductions, this provision

may make the creation of new tax breaks even more likely. Instead, the various tax breaks should be evaluated to determine their effectiveness and return on investment.

The following examples, while not meant to be exhaustive, illustrate the need to evaluate all individual tax provisions for economic, policy, and fiscal effectiveness:

Instead of “marriage penalty relief,” filers should have the option of filing in whatever status would result in the lowest tax burden, whether that is a married couple filing as individuals or jointly.

The purpose of a subsidy, whether tax or otherwise, is to encourage behavior that would not otherwise occur. With that in mind, the child tax credit is just a subsidy for having children, and while popular, is not achieving a larger policy goal.

The most popular tax break, the home mortgage interest deduction, is one of the most regressive and does not achieve its goal of increasing home ownership or making it more affordable. Many homeowners do not itemize and do not take advantage of the deduction; the deduction is actually incorporated into the price of the home, so the buyer is paying more to get the deduction; the deduction is more valuable in tax brackets for wealthier homeowners. We urge the working group to consider reducing the mortgage cap to \$500,000 and converting the deduction into a credit.

By insulating people from the cost of their healthcare the provision excluding employer-provided health insurance as income has helped drive increased health care costs in the U.S. This provision has been critically important in increasing health care coverage, it has also served as an unintended barrier to job mobility. Reforms to this provision should be considered.

Corporate Tax Reform

On the corporate side of the ledger, we believe that there should be a lower, flat corporate tax rate paid for with the elimination of various tax expenditures and preferences. The corporate tax code is littered with a variety of tax expenditures that benefit one industry or another and some of these provisions go back a century. While more of an academic exercise, we would argue for a zero-based approach that would assume all the expenditures are eliminated, the top rate reduced and provisions would have to have significant justification for inclusion.

Deferral of taxable foreign income until repatriation has distorted business activity, encouraging more offshore projects to be “parked” in anticipation of a tax holiday to encourage repatriation. Instead of encouraging this activity, deferral should be reformed. Furthermore, greater recognition must be made of the unique position of the U.S. as the world’s largest economy and the advantages of being located (and taxed) here. Instead of simply abandoning worldwide taxation in favor of territorial, policymakers should investigate hybrid approaches and policies such as unitary taxation.

The largest single corporate tax expenditure is the Section 199 manufacturing tax credit. The credit was created to encourage domestic manufacturing after the Foreign Sales Corporation/Extra Territorial Income provisions were found to violate World Trade

Organization rules. It is far from clear if this provision is anything more than a subsidy. Since its creation we have watched American manufacturing to continue to decline and then rebound, all with the tax credit in place. Far greater economic forces than the Section 199 tax credit are at play. This provision should be reformed to strictly limit the manufacturing that is eligible or it should be scrapped altogether.

The energy sector is particularly complicated with antiquated provisions such as intangible drilling costs, percentage depletion, deduction for tertiary injectants, expensing of refinery costs, wind production tax credit, nuclear production tax credit, and a variety of provisions for accelerated depreciation. These should all be scrapped.

Finally, much is made of the research and development/experimentation tax provisions. R&D is the mother's milk of business, it's the economic equivalent of evolve or die. To that end these provisions can often end up subsidizing activities that were already going to occur. In those instances, these provisions are little more than thinly guised corporate welfare and should be reformed or eliminated.

Extenders

Every Congress there is a "caboose" of miscellaneous tax provisions that are cobbled together into a "tax extenders" package. There is very little oversight or scrutiny over this package, which ranges from accelerated depreciation of NASCAR tracks to deductions for contributions of food inventory to rebating some of the rum excise tax cover over to U.S. territories (which has been used to fund a distillery for Diageo – the British-based largest liquor conglomerate in the world – to shift Captain Morgan rum production from Puerto Rico to U.S. Virgin Islands). The various provisions in this package should be reviewed and either included in the tax code, or preferably, eliminated. If they are not important enough for inclusion in the code, then they should not be enacted.

Transportation Trust Funds

The four transportation trust funds: Highway Trust Fund, Airport and Airway Trust Fund, Harbor Maintenance Trust Fund, and Inland Waterway Trust Fund all suffer from either revenue shortfalls or cross subsidy issues or both. The taxes that fund these various trust funds should be reviewed to ensure that they generate adequate revenue for the activities envisioned under the trust funds and serve as true user fees.

New Revenue

Finally, much of the discussion has been about eliminating breaks and reducing rates. At the same time, new provisions should be considered. Taxpayers for Common Sense believes that the policies like the FAIR tax (or other replacement consumption taxes) would require a whole new infrastructure and approach to taxation and represent too great of a shift to be considered simple reform. We are concerned about creating a value added tax (VAT), which is a regressive and not transparent taxation scheme. One potential new source of revenue that should be considered is a tax on carbon. The axiom of tax what you want less of applies, and as a Pigovian tax it would also serve to address externalities such as the long term liabilities from carbon. In

addition, a properly structured carbon tax could serve as a significant source of revenue that could yield even lower rates than simply eliminating tax expenditures alone. Appropriately structured to protect against economically harmful regressivity and accounting for declining revenues as carbon use declines, a carbon tax is too attractive an option to be ignored.

Conclusion

Again, Taxpayers for Common Sense appreciates your leadership on the tax reform issue. We look forward to working with you as the debate and package moves forward. If you have any questions or would like to discuss this further, please contact me or Steve Ellis at 202-546-8500.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Ry Alexander". The signature is fluid and cursive, with the first name "A. Ry" and the last name "Alexander" clearly distinguishable.

Ryan Alexander
President

Copy:
Tax Reform Working Group Chairs and Vice Chairs