KAINE LAYS OUT PRIORITIES FOR COMPREHENSIVE TAX REFORM IN LETTER TO FINANCE COMMITEE

Wednesday, July 31, 2013

WASHINGTON, D.C. – In a letter to Senate Finance Committee Chairman Max Baucus (D-MT) and Ranking Member Orrin Hatch (R-UT), U.S. Senator Tim Kaine laid out his priorities for comprehensive tax reform, citing input he received from stakeholders in Virginia. The letter was in response to their request for input as the Finance Committee prepares to consider comprehensive tax reform potentially later this year.

"To answer the question of how we can make the code fairer and more efficient, I solicited input from many Virginia stakeholders and received numerous recommendations," Kaine wrote in the letter. "We need a tax code that is simpler and more predictable. The code should be pro-growth and make us globally competitive. It needs to produce sufficient revenue to support a smart federal budget and help America deal with a long-term fiscal imbalance."

"I strongly believe that the recently passed Senate Budget offers an excellent template for tax reform," Kaine continued. "The Senate Budget promotes economic growth, stabilizes the debt trajectory, and achieves credible deficit reduction in accord with recommendations made by numerous economists and commissions, including Simpson/Bowles and Domenici/Rivlin. Congress has made some progress in reducing spending and raising revenue, and deficit projections are declining as a result. But there is more to do."

Full text of the letter is below:

Dear Chairman Baucus and Ranking Member Hatch:

Thank you for tackling tax reform. Our nation needs this effort to succeed.

I understand the Finance Committee may take a 'blank slate' approach to tax reform, eliminating all tax expenditures and adding back only some of the current provisions of the tax code. I am not presenting my views in this manner. Thus, you should not assume that because an expenditure is not mentioned in this letter, that I support its elimination.

To answer the question of how we can make the code fairer and more efficient, I solicited input from many Virginia stakeholders and received numerous recommendations. These thoughts were very helpful in helping me formulate the ideas expressed here. And, I also bring to this letter my own experiences – from growing up working in my Dad's small ironworking shop, to serving as managing director of a 130-employee law firm, to working on economic and tax issues as a Mayor and Governor.

Basic Challenge:

We need a tax code that is simpler and more predictable. The code should be pro-growth and make us globally competitive. It needs to produce sufficient revenue to support a smart federal budget and help America deal with a long-term fiscal imbalance.

I strongly believe that the recently passed Senate Budget offers an excellent template for tax reform. The Senate Budget promotes economic growth, stabilizes the debt trajectory, and achieves credible deficit reduction in accord with recommendations made by numerous economists and commissions, including Simpson/Bowles and Domenici/Rivlin. Congress has made some progress in reducing spending and raising revenue, and deficit projections are declining as a result. But there is more to do.

The Senate Budget advocates a plan that would reduce the budget deficit by another $1.85 trillion over the ten-year budget window. Half of this would come from reductions in spending through targeted cuts to discretionary programs, as opposed to the indiscriminate nature of sequestration cuts, reduced debt interest expenditures and reforms to on-books entitlement programs such as Medicare and Medicaid.

Half of the deficit reduction in the budget plan would come from new revenue. I believe the effort to reform the tax code should strive to produce about $975 billion in new revenue over the ten-year budget window and the plan should continue to raise at least this level of revenue when fully phased in. While reform would likely not produce revenue in a straight line fashion, the annualized equivalent of this budget is approximately $100 billion in new revenue.

The Senate Budget makes an assumption based upon our current political dynamic – divided power in Congress and the proliferation of members who have unwisely signed restrictive pledges to never consider any tax increase. The Senate Budget assumes that the new revenue will not generally come from rate increases but instead from the reduction of tax expenditures – the deductions, credits, exemptions and loopholes that populate the tax code. In 2013, we are projected to spend about $1.3 trillion on these expenditures. Thus, a reduction of these expenditures by approximately 8 percent will be sufficient to raise the revenue necessary to help us deal credibly with the deficit. Tax reform should be able to accomplish this goal.

Overall Principles:

The tax code – both corporate and individual – needs to be simpler. The current complexities suggest that the code isn't driven by policy, but instead by the power of special interest lobbying muscle. Since many people – certainly the poor and working families – can’t match the lobbying clout of special interests, the complexities in the individual tax code generally work to benefit others to their disadvantage. Since many businesses also don’t have full-time lobbyists, the complexities in the corporate and individual tax codes generally work to benefit others to their disadvantage. Some small businesses (including the vast majority of farms) are doubly affected – so many are operated by middle class people who organize their businesses in ways (sole proprietorship, partnership, subchapter S corporations) whereby they are taxed at individual income rates.

Simplifying the tax code should help level the playing field for small and large. It will also ease the transaction cost for regular people and small businesses in complying with the code.

The tax code needs to be more predictable. There are too many parts of the tax code that are short-term, subject to repeated cycles of expiration and reauthorization. This short-term focus hurts the abilities of families and businesses to plan. In simplifying the code, we should also agree that the code becomes easier if we don't tinker with it so often. Let's make reforms and then let the market adjust to it, providing the predictability that the business community and taxpayers have been asking for.

If we make the code more predictable, we'll also address another growing concern. Many believe that short-term tax expenditures are designed to require special interests to return to Congress each year to plead for desirable tax provisions. This practice wastes time and raises troublesome ethical issues.

We should maintain and even enhance the basic progressivity of the tax code. It's good tax policy for wealthier people and larger businesses to pay at higher tax rates. Sadly, we know of too many stories where massive corporations avoid taxation while small businesses pay full freight. And, so many well-off individuals are able to structure their income so that they pay at lower tax rates than working class people. The gap between tax on earnings and tax on salaries has grown too wide.

In making the foregoing comment, I want to be clear that I don't think it's wrong for an individual or business to tax minimize. It's to be expected that all will examine the tax code and act to their advantage. But it's wrong for policymakers to allow such a system to exist without reform. Many notable economists have shown that our widening income inequality is driven by fiscal and tax policy choices. We should embrace policies that allow people and small businesses the upward mobility that has long been characteristic of American life. A progressive tax code can do this.

The foregoing principles – simplicity, predictability and progressivity – bring me back to the Senate Budget. Raising revenue through the reduction of tax expenditures can accomplish all three goals. Fewer tax expenditures make the code simpler. Ending the cycle of short-term tax expenditure debates will make the code more predictable. And, since tax expenditures disproportionately benefit upper end taxpayers, appropriate limits on and reforms to such expenditures can help the progressivity of the code.

Corporate Taxes:

There seems to be a broad consensus that corporate tax reform should strive to dramatically reduce tax expenditures and, in exchange, lower the corporate tax rate to make it more competitive with our international competition. I support this basic approach.

In carrying out this objective, I would generally favor revenue neutrality with two basic exceptions. First, to the extent that we can close the corporate loopholes that allow many companies to shelter income offshore – which have been the subject of scrutiny by Senator Levin's Permanent Subcommittee on Investigations – we should bring that revenue into the budget without requiring dollar for dollar rate reductions. And, since all share the goal of deficit reduction – and our corporate community has been persuasive in making this argument – it would be odd if we were to approach the task without asking corporate revenues to play any part in that effort. So, some reasonable net increase in corporate revenue – one that would to represent an appropriate portion of the approximately $100 billion a year of new annual revenue in the Senate Budget – would be a good idea if directed toward deficit reduction.

Concerning particular tax expenditures, we should eliminate tax subsidies for major oil companies. They are mature industries and will keep doing well without any subsidy. And, I believe it is a good policy to continue incentives for research and development. Such incentives help us be the world's innovators.

Individual Taxes:

Consistent with my earlier comments on progressivity, I do believe that we should examine the rates on certain kinds of income like carried interest that are equivalent to salary but taxed at dramatically lower rates. I would also favor examining the treatment of certain capital gains and other proceeds from investment to determine whether we should provide more favorable tax treatment for long-term investments than short-term speculative investments. I worry that the current code pushes capital into short-term and non-productive speculation rather than long-term investments that grow the economy and create jobs. We can and should correct this.

As we embrace the reform of the individual code, the plethora of tax expenditures – each with its own justification and constituency – makes the task difficult. And some of the largest expenditures – the home mortgage interest deduction, the deduction for charitable contributions, the non-taxability of employer-provided health care (up to reasonable levels), the earned income tax credit, and deductions for educational and child care expenses – do advance important societal goals.

My preference on individual tax reform and how to tackle the expenditure side is to avoid pitched battles about each particular expenditure in favor of an aggregate approach. Using the Senate Budget's $100 billion in annual new revenue as a goal, undertake corporate tax reform and see what new revenue can be gained, primarily from the ending of offshore gimmicks. Then, in order to raise the remainder, apply an aggregate cap to the total amount of tax expenditures that can be claimed on an individual’s tax return. My preference is for the cap to be expressed as a fixed dollar amount or as a percentage of the taxpayer's adjusted gross income. Some tax expenditures could be exempted from the aggregate cap if they were to meet criteria put forth by the committee.

Conclusion:

The task of tax reform will not be easy. But it’s a critical point of overall budget reform.

Congress needs to show again that it can lead on fiscal matters. If we can find a larger budget deal, it will help the economy and dramatically improve our global competitiveness. Plus, we need to show that we can put country first, instead of remaining locked in competing partisan camps.

I look forward to working with you on this important matter.

TIM KAINE

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