Comments for the Record

House Committee on Ways and Means

Hearing on the Interaction of Tax and Financial Accounting on Tax Reform

Wednesday, February 8, 2012, 10:00 AM

By Michael G. Bindner

Center for Fiscal Equity

Chairman Camp and Ranking Member Levin, thank you for the opportunity to submit these comments for the record to the House Ways and Means Committee. Our comments are in the context of our tax reform plan, which has the following four elements:

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure very American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of $100,000 and single filers earning $50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25% in either 5% or 10% increments. Heirs would also pay taxes on distributions from estates, but not the assets themselves, with distributions from sales to a qualified ESOP continuing to be exempt
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital insurance, disability insurance, unemployment insurance and survivors under age 60.

We have no proposals regarding environmental taxes, customs duties, excise taxes and other offsetting expenses, although increasing these taxes would result in a lower VAT. As we have no proposals in these areas, we will ignore the financial accounting implications of these taxes.

The impact of VAT adoption on financial accounting is well documented, with a wealth of working models in every other OECD nation to draw upon. The complexity of any financial accounting depends on the complexity of the VAT itself. Broader based taxes require simpler accounting structures and will be generally more stable, with exceptions yielding complexity in reporting and accounting and inviting more complexity as entrenched interests demand more benefits to further game the system.

Accounting for Employee-paid Old Age and Survivors Insurance will be no more complicated than current law, while accounting for the income surtax will be greatly simplified. The only complexity will be accounting for sales to a qualified ESOP, which will continue to be tax exempt. If surtax rates remain stable, the only source of complexity will be annual adjustments for inflation.

American competitiveness is enhanced by enacting a VAT, as exporters can shed some of the burden of taxation that is now carried as a hidden export tax in the cost of their products. Accounting systems in a VAT system will also have to account for zero rating at the border and the treatment of imports as entirely taxable to the importer. The NBRT will also be zero rated at the border to the extent that it is not offset by deductions and credits for health care, family support and the private delivery of governmental services. As it is similar to a VAT, it will begin with the same base, but will require additional accounting structures to take into account the exclusions which make it more like an income tax and less like a VAT. These exclusions are the reason for a separate tax.

Accounting for a continued health insurance exemption is well developed. Accounting for services to retirees will be more complicated. While purchases for health care would be VAT and NBRT exempt, base medical wage costs would also be exempt for NBRT purposes, but not necessarily for the VAT, unless these services are contracted, in which case VAT would be collected by the vendor and the NBRT would be embedded in their costs. NBRT offsets for employer provision of social and educational services will follow similar rules, although services provided by non-profits will be VAT exempt, although the NBRT will still be embedded in any contribution.

Establishment of personal accounts as an offset for Old Age and Survivors Insurance will require complex accounting rules, however the benefit of such accounts is that the majority of these funds will be invested with the employer and accounting rules should be only slightly more complex than those required to deal with non-employee investors, although procedures to avoid older retirees spending down all of their assets and the creation of annuities for non-employee widows will add complexity.

Consolidation of the child tax exemption, the child tax credit and the EITC, while making them refundable, will aid both taxpayers and employee companies, who will simply report credits paid to each employee with their tax filing, with a copy to each employee, so that the government may also send a copy which employees can compare to verify honest employer reporting and payment. This should be no more complex than current accounting to process W-2 and 1099 forms.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit. The accounting system must be able to capture this event when it occurs. It must also be able to adjust changes to NBRT and VAT rates and for Child Tax Credit adjustments for inflation, as well as expansions used for counter-cycle stimulus.

In testimony before the Senate Budget Committee, Lawrence B. Lindsey explored the possibility of including high income taxation as a component of a Net Business Receipts Tax. The tax form could have a line on it to report income to highly paid employees and investors and pay surtaxes on that income.

The Center considered and rejected a similar option in a plan submitted to President Bush's Tax Reform Task Force, largely because you could not guarantee that the right people pay taxes. If only large dividend payments are reported, then diversified investment income might be under-taxed, as would employment income from individuals with high investment income. Under collection could, of course, be overcome by forcing high income individuals to disclose their income to their employers and investment sources – however this may make some inheritors unemployable if the employer is in charge of paying a higher tax rate. For the sake of privacy, it is preferable to leave filing responsibilities with high income individuals. Relying on a separate personal income surtax for higher income individuals also reduces complexity for employers, who would not have to include systems to calculate surtaxes on higher income employees and dividend payees internally.

Our proposal seeks to bring long term stability to the tax debate, including consensus on who pays the income surtax and by how much. As the invited witnesses stated, stable tax policy is the best way to help firms minimize complexity in accounting for tax reform (although once the national debt is entirely paid off and overseas military commitments either ended or entirely funded by host countries, provisions to collect funds for the income surtax can be suspended when the surtax sunsets.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

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