100 Years Standing Up for American Enterprise
U.S. CHAMBER OF COMMERCE

Statement Of the U.S. Chamber Of Commerce

ON: **ADMINISTRATION TAX PROPOSALS IN FY2013 BUDGET**

TO: **THE HOUSE COMMITTEE ON WAYS & MEANS**

DATE: **FEBRUARY 15, 2012**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

The Chamber's members are businesses of all sizes. Our membership consists of small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are cognizant of the problems and challenges facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 105 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

The Chamber thanks Chairman Camp and Ranking Member Levin for the opportunity to comment on the tax proposals contained in the Administration's FY2013 budget (the "Greenbook"). The Chamber is disappointed with the proposals included in the Greenbook. These proposals are largely a rehash of prior year Greenbooks and once again offer no policies that make our tax code more competitive, fair, simpler, compliance-friendly or more pro-growth. Instead, we see the same policies of prior years and an even greater reliance on raising revenues through the tax code.

The Chamber believes that as the Committee considers policies to drive job creation and economic growth and considers fundamental federal tax reform, it should firmly reject the proposals contained in the Greenbook and seek to undertake comprehensive tax reform to foster growth, competitiveness, innovation, ease of compliance, and job creation. As other countries, and even individual states within our own borders, move to adopt tax policies that foster growth, competitiveness, and innovation, these proposals generally would move the federal tax code[1] in precisely the opposite, and wrong, direction.

IN GENERAL

The Greenbook, in large part, repeats prior year tax proposals of this Administration, levying onerous tax increases on businesses of all sizes and picking winners and losers, while omitting pro-growth tax policy. It levies almost $2 trillion in new taxes, while providing only $146 billion[2] of permanent tax cuts for business, $108 billion of which is comprised of one incentive – making the research and development (R&D) tax credit permanent – which generally is already renewed on an annual basis.

TAX INCREASES

Individual and Small Business Tax Hikes

As in prior years, the Greenbook includes significant tax increases on upper income individuals, totaling over $1.5 trillion. These proposals fail to recognize that these increases hit the most successful U.S. small businesses that pay taxes at individual tax rates, hindering their ability to grow and create jobs.

While this year's budget calls for implementation of a "Buffett" rule that results in a minimum effective tax rate of 30% on those making over $1 million, the rule appears nowhere in the Greenbook. Instead, the Greenbook once again targets those making over $200,000 or $250,000 jointly. The Greenbook ignores that our tax system is already highly progressive (in 2009, according to the IRS, the top 1% of the income distribution controlled about 17% of income and paid almost 37% of federal income taxes). It proposes an even more punitive system on those who save, invest, and create jobs. It proposes increasing the top marginal tax rates, reducing or eliminating itemized deductions, and limiting the rate at which the remaining

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[1] All references to the "code" are to the Internal Revenue Code of 1986, as amended.
[2] All revenue estimates are for 10 year periods and are provided by OMB.

deductions can be taken. Further, it proposes raising taxes on investment – taxing long term capital gains at 20%, up from 15%, and dividends at marginal rates as high as 39.6%, up from 15%. These increased investment taxes are compounded by the Medicare hospital insurance (HI) tax of 3.8% that kicks in next year. Additionally, the failure to maintain lower, synchronized capital gains and dividends rates, a departure from prior year proposals, discourages efficient capital allocation and decreases fairness.

Quite simply, the Committee cannot ignore the negative impacts of these tax increases and must reject such policies in both the near and long term. Over the past 30 years, the number of pass-thru businesses – sole proprietorships, S-corporations, LLCs and partnerships – has nearly tripled. In 2010, the Joint Committee on Taxation determined that a substantial share of new revenue (50% for the increase in the top two rates) was directly attributable to the income reported for pass-thru businesses by their owners. In other words, small businesses would bear a substantial portion of these higher taxes.

Further, increased investment taxes have real and damaging ramifications.[3] Millions of Americans of all income levels would be adversely impacted by these tax hikes. Further, older Americans and those saving for retirement would be disproportionately hurt by investment tax hikes. Raising capital gains and dividends taxes has real adverse effects on the economy. Thus, the Chamber strongly opposes these tax hikes and the negative ramifications on investment, economic growth, and productivity that come with increased investment taxes.

As the Committee considers fundamental tax reform, it is critical to recognize the significant numbers of entities who remit taxes under the individual Code; thus, careful consideration must be given to any reform that addresses the corporate tax rate without properly considering individual rates. Second, given the significant and increasing numbers of these pass-thru entities, the Chamber believes proposals, such as these tax increases, must be rejected, as they thwart the growth of the very businesses that are the backbone of our economy.

Other Business Tax Increases

Also as in prior years, the Greenbook includes tax increases on larger business entities, totaling almost half a trillion dollars, achieved by, among other things, double taxing the profits American worldwide companies earn overseas, levying punitive new taxes on traditional energy producers and reinstating Superfund taxes, repealing longstanding accounting practices, and taxing the carried interest in partnerships as ordinary income.

[3] For more detailed information on the damaging impact of raising investment taxes and the Chamber's opposition to increased investment taxes, please see our September 14, 2011 testimony to the Senate Finance Committee, available at http://www.uschamber.com/sites/default/files/110914testimonysenateFinance.pdf. For a recent detailed study on the international aspects of capital gains and dividends and the adverse economic consequences of high tax rates on this investment income, see E&Y, "Dividend and Capital Gains Taxation: A comparison of the US to other developed nations," (February 2012), available at http://www.theasi.org/assets/EY_ASI_Dividend_and_Capital_Gains_International_Comparison_Report_2012-02-03.pdf.

International Taxation

The Greenbook once again proposes to double tax the profits American worldwide companies earn abroad, by curtailing deferral, limiting foreign tax credits, and attacking the tax treatment of intangibles. The President's own fiscal commission report states that our system of taxing foreign source income is against the norm, and "[t]he current system puts U.S. corporations at a competitive disadvantage against their foreign competitors." His Export Council recommends creation of an international tax system "in which U.S. corporations can compete well with those in other OECD countries," going on to state that a "competitive territorial tax system for the United States should broadly follow the practice of our trading partners… to make the U.S. tax system more competitive with its major trading partners." Despite this, the Greenbook moves in the opposite direction with $148 billion of international tax increases that threaten to put American companies at even greater competitive disadvantage.

The Chamber urges the Committee to reject these proposals and, instead, as it considers fundamental reform, consider ways to level the playing field for American businesses, such as adopting a territorial tax system as recommended by the President's Deficit Commission and Export Council, and proposed by Chairman Camp. The Chamber believes any changes to international tax policy should make American companies more competitive, drive job creation, and stimulate overall economic growth.

Punitive Energy Taxes

The Greenbook also repeats its attack on oil and gas companies and coal companies from prior years, proposing large and onerous tax increases, totaling over $41 billion on these traditional energy producers. This represents continued attacks on oil and gas companies as well as coal companies. In addition to industry-specific punitive taxes, many of these companies also face tax hikes in the form of last-in, first-out (LIFO) repeal and changes to the dual capacity rules. All of these tax increases result in increased energy costs and decreased energy security.

Once again, these proposals punish industries such as oil and gas, who already face some of the highest effective tax rates of any industry sector and who create millions of high-paying jobs. The Greenbook justifies these increased taxes on traditional energy sources to pay for "clean" energy and manufacturing incentives. The Chamber strongly urges the Committee to reject tax policies such as this, which preference one industry or sector to the detriment of another. Instead, the Chamber suggests the adoption of fundamental tax reform that would benefit the entire business community.

Changes to Longstanding Inventory Accounting Methods

In addition to the above tax increases, the Greenbook once again proposes repeal of longstanding accounting methods, solely to raise tax revenues. For example, the Greenbook, as in prior years, would repeal LIFO to raise $74 billion. The Chamber opposes the repeal of LIFO accounting as it would result in a punitive, retroactive tax increase for businesses, placing significant cash constraints on them and limiting their ability to manage inflation. Companies would have to record illusory profits on their books, when no economic activity has occurred that would justify recording any profits.

In addition to the repeal of LIFO, the Greenbook once again proposes repeal of the lower-of-cost-or-market (LCM) and subnormal goods accounting methods to raise $13 billion. The Chamber opposes the repeal of these accounting methods as they provide an important cushion during economic downturns. Without these methods, businesses are precluded from recognizing real economic losses in the year of loss, and, rather, must wait until disposal of inventory.

The repeal of these accounting methods originally was proposed as revenue offsets for unrelated initiatives. As the Committee considers short term policies and fundamental reform, the Chamber urges it to reject changes solely sought to raise revenue without consideration for the wide range of industries and businesses of all sizes that would be adversely impacted by these changes.

Punitive Financial Service Sector Taxes

The Greenbook once again proposes a financial crisis responsibility fee.[4] This $61 billion tax will impede economic recovery by constraining commercial lending and capital investment, including much needed lending to small businesses. This tax also creates situations that may lead to double and excessive taxation. In short, this will be a tax borne by America's job creators and is simply the wrong tax at the wrong time.

The punitive financial service sector taxes do not stop there. To raise another $14 billion, the Greenbook would tax "carried interest" – capital gains paid to managers of investment partnerships – as ordinary income. The Chamber believes that taxing carried interest as ordinary income would deter economic activity, reduce credit flow, and stifle job creation. Further, changing this longstanding law ignores the fact that state pension funds, charitable nest eggs, and universities rely on these partnerships and could face funding shortfalls if this tax hike drove talented management capital into other fields.

Thus, as the Committee considers changes to tax policy, the Chamber urges it to seriously consider both the direct and indirect ramifications of these changes on the economy before adopting policies such as those described above.

<u>PRO-GROWTH TAX INCENTIVES</u>

While the Greenbook is full of tax increases, it provides little in the way of tax incentives to help businesses grow. As noted above, in contrast to the almost $2 trillion in new taxes businesses can expect to face, they would see only $146 billion of tax cuts, $108 billion of which is attributable to making permanent the research and development (R&D) tax credit. The long touted incentives for manufacturing are minute in comparison to the tax hikes.

[4] For further information on the adverse impacts of the proposed financial crisis responsibility fee, please see the 2010 study conducted for the Chamber by Hal S. Scott, Nomura professor of international financial systems at Harvard Law School, "Financial Crisis Responsibility Fee: Issues for Policymakers," that demonstrates the adverse impacts this tax would have upon capital formation, available at http://www.uschamber.com/reports/financial-crisis-responsibility.

Small Businesses and Individual Incentives

For small businesses, the Greenbook contains little in the way of broadly applicable incentives. Summing barely $25 billion in total small business tax cuts, the Greenbook proposes eliminating capital gains taxes on small businesses, providing only $8 billion in tax incentives. Further, it provides for small regional incentives, which add only another $8 billion in incentives.

The Chamber believes that the impact of these provisions is extremely limited. For example, the small business capital gains incentive is diminutive, partially due to its applicability only to the limited number of small businesses operating in C corporation form. The Chamber believes that as the Committee considers proposals in the context of fundamental tax reform, it should avoid narrow incentives that are of value to only one industry, sector, or geographic area. Instead, it should seek policies that broadly benefit the widest possible cross-sections of individuals and businesses.

General Business Incentives

The Chamber supports the inclusion of the proposal to make permanent the R&D tax credit. Longstanding Chamber policy provides that research and development incentives should actually be more expansive, for example, by allowing research and development expenses to be deductible in the year incurred and providing a credit as high as 25% for increases in research expenditures.

As the Committee considers both short term policies and fundamental tax reform, the Chamber believes that it must pay close attention to how taxes impact innovation. The United States continues to lag behind other countries in its treatment of research and development costs. Thus, the Chamber recommends that the Committee seek policies that encourage businesses to conduct research and development within the United States and locate the intellectual property developed as a result of that research within our borders.

Conclusion

The Chamber appreciates the opportunity to comment on the tax proposals contained in the Greenbook. We believe the fact that the Administration proposes to use all of these tax increases in a piecemeal, uncoordinated fashion will actually make it harder to accomplish comprehensive, fundamental tax reform if and when Congress seeks to do so. This piecemeal approach will decrease competitiveness, hurt job creation, and quash economic growth; should Congress undertake fundamental reform it should be comprehensive and should seek to foster growth, competitiveness, innovation, and job growth. We look forward to working with Congress and the Committee to develop tax policies that promote growth and encourage investment in the United States.