Hearing on Fundamental Tax Reform Proposals

HEARING

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SUBCOMMITTEE ON TAX POLICY

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COMMITTEE ON WAYS AND MEANS

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C O N T E N T S

WITNESSES

Hearing on Fundamental Tax Reform Proposals

U.S. House of Representatives,
Committee on Ways and Means,
Washington, D.C.

The subcommittee met, pursuant to notice, at 3:40 p.m., in Room 1100, Longworth House Office Building, Hon. Charles W. Boustany, Jr. [chairman of the subcommittee] presiding.

*Chairman Boustany. The subcommittee will come to order, and welcome to the Ways and Means Subcommittee on Tax Policy. And today we are going to have a Member Day, where we will hear a number of bills from Members regarding fundamental tax reform proposals.

This is really the first in a series of hearings on fundamental tax reform, and we are honored to have three of our esteemed colleagues join us today so we can learn about the bills they have developed to take the tax system in a new direction, by moving away from income as the tax base and instead looking to cash-flow or consumption as a tax base that is more conducive to economic growth. These are important ideas, in which our colleagues have invested an enormous amount of time and energy. It shows the seriousness of their commitment to the effort to develop a pro-growth tax system for the 21st century.

It is abundantly clear that our current tax code is broken. We are saddled with a code that is littered with exclusions, deductions, and special rules, a code that has grown to more than 4 million words, and that doesn't include all the forms, schedules, worksheets, and instructions that are required for Americans to comply with the law. The code is so complex that Americans devote billions of hours a year to tax compliance, and they also spend tens of billions of dollars a year on tax preparation software or professional services. Imagine if all that time and money could be put to more productive use, -- instead, jump-starting our lackluster economy.

As we focus on tax reform, we want to take a fresh look and consider all ideas and proposals, including the three important proposals being presented today. Ultimately, the Ways and Means Committee must weave the most pro-growth concepts and ideas into a bold plan that fundamentally and comprehensively reforms our tax system: a tax reform plan that suitably marks this year's 30th anniversary of the last overhaul of the tax system.

This hearing is just the beginning. The subcommittee will continue to solicit and evaluate all ideas. We will be holding our next hearing on April 13th to examine Member bills that make fundamental reforms within the context of an income-based tax system.

So I thank you again to each of our witnesses for taking time from your busy schedules to be with us today, and we look forward to hearing about your bold proposals.

*Chairman Boustany. And now I yield to the distinguished ranking member of the subcommittee, Mr. Neal, for the purposes of an opening statement.

*Mr. Neal. Thank you, Mr. Chairman, for calling his hearing and considering once again fundamental tax reform proposals. We are all aware of the great need to reform our broken and inefficient tax code, while replacing it with a code that promotes job growth, lifts wages for all workers, and grows the middle class.

One of the challenges, I think, for all of us today is to make sure we are not sitting here for the 35th anniversary of 1986. And the truth is that this is very difficult work, it is very complex work. There is broad agreement on what needs to be done; there is less agreement on how to do it. And that is the challenge we face.

We all know that tax reform cannot wait. The economy, clearly, cannot wait. And certainly the American people cannot wait. Today's hearing is yet another in a long line of hearings that we have had on this matter when both sides were in the Majority. I express my frustration at this hearing because often times, even with the best proposals that step forward, they get caught up in partisan politics and we end up going backwards, rather than forwards.

So, I want to take a moment to commend my friend and former chairman of the committee, Dave Camp. He put out a very earnest effort at reforming our tax code, the best effort since Chairman Rostenkowski in 1986. There were parts of his plan that I disagreed with, but I want to tell you the way that it was done with methodical bipartisanship is a very important model, as we go forward. The bipartisan effort included Members and stakeholders alike. We heard from everybody over the course of three years.

Now, rather than building on this effort, we are instead holding another hearing on tax reform, instead of trying to roll up our sleeves and actually doing the hard work that reform invites. As time passes, the code gets older, more inefficient, less competitive.

Mr. Chairman, we are now on the verge of the opportunity to really do something to get to work and put out a meaningful draft. Now is the time to reform the code. And I thank you.

*Chairman Boustany. I thank the gentleman. Without objection, other Members' opening statements will be made part of the record.

Today's witness panel includes three of our fellow Members of the House of Representatives: the Honorable Devin Nunes, representing the 22nd District of California, and a member of the Ways and Means Committee. He will be testifying about H.R. 4377, the

American Business Competitiveness Act of 2015, -- which would tax businesses based on their cash-flow, rather than based on their income.

We will also hear from the Honorable Michael Burgess, representing the 26th District of Texas. He will be testifying about H.R. 1040, the Flat Tax Act, which would provide businesses and individuals with an election to be taxed at a flat rate, and to be taxed on a cash-flow basis for business activities.

And we will also hear from the Honorable Rob Woodall, representing the 7th District of Georgia. He will testify about H.R. 25, the Fair Tax Act of 2015, which would impose a national sales tax on gross payments for the use or consumption of taxable property or services.

Each of your tax reform bills will be made part of the formal hearing record. Traditionally, the committee allots five minutes to each witness to deliver oral remarks. However, today we will be somewhat lenient on the five-minute rule, but just a bit, to ensure that each of you can fully introduce your proposals.

So, we will begin with you, Mr. Nunes.

STATEMENT OF HON. DEVIN NUNES, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

*Mr. Nunes. Well, thank you, Chairman Boustany and Ranking Member Neal, for inviting me to testify today before the Tax Policy Subcommittee. It is nice to be down here with the common folks, instead of up there.

It is my honor to present H.R. 4377, the American Business Competitiveness Act, known as the ABC Act, a business tax reform plan that I have been developing for several years. I look forward to your questions and our continued dialogue on comprehensive tax reform.

Many Republicans and Democrats agree the United States needs to adopt a broad-based consumption tax. We are paying the price through fewer jobs, less economic growth, and less tax revenue for being one of the only developed countries in the world without one.

Most of the world's consumption taxes are sales taxes or value-added taxes, but the ABC Act is different. It would encourage business investment by allowing 100 percent expensing in the current year. This means that companies of any size, no matter how they are organized, would pay no tax on any of their spending for personnel, equipment, property, or any other expenditure related to the operation of their business in the United States.

Today the income tax penalizes new investment, but the ABC Act would eliminate that penalty, rapidly spurring economic growth.

First and foremost, the ABC Act applies to all business entities, regardless of their structure, including corporations, S corporations, partnerships, sole proprietorships, LLCs, and any other business entity. The bill would lower the maximum tax rate on net business income to 25 percent. Anything a company purchases, including property, services, compensation, and inventory would be fully expensed. With full expensing, all the business tax credits and deductions littered throughout the tax code would be systematically eliminated.

The bill also replaces our complicated, duplicative, and uncompetitive international rules with a simple territorial system. In an increasingly interconnected world, we need to boost our global competitiveness. The ABC Act would achieve that goal by undoing our worldwide tax so that American businesses are only taxed on income effectively connected with business inside the United States. All the complicated deferral rules would be wiped away, leaving us with a simple and fair territorial code. The only fee companies would pay for repatriating foreign-held earnings up to date in the United States would be a one-time toll charge of five percent assessed in the first year of enactment -- on undistributed foreign earnings minus dividends paid out in that year.

When combined with immediate expensing and new, lower tax rates, these provisions would make America the largest tax haven in the world. Companies would be scrambling back to reinvest money in the United States. This would boost American jobs, increase GDP, and spark widespread investment in all sectors of the economy.

The ABC Act will not only kickstart economic growth, but it will also allow for the allocation of investment and decision-making based on best business practices, not the tax code. Inefficient business models based on our current tax code would be rendered irrelevant.

The current tax code is over 70,000 pages long, and is plagued with senseless regulations and special interest loopholes. This unfairly benefits big businesses, which are often armed with high-priced accountants and tax attorneys who find ways to exploit the complicated provisions. Every day Americans who dream of starting their own business quickly realize that they lack the resources to fight these complex rules and regulations.

My plan would drastically simplify the tax code by eliminating all the pet credits and deductions for businesses, which would no longer be necessary with full expensing.

In my home state of California, where tax and business regulations are exceedingly convoluted, the ABC Act would vastly improve the business climate and encourage entrepreneurship. In fact, the ABC Act would provide every American the opportunity to start up a business without being penalized with steep taxes and burdensome regulations. Though this bill makes no changes to the individual code, other than bringing down the rate on interest income, this efficient, fair, and simple plan would completely revamp business taxes in order to give all citizens a shot at the American dream of owning their own business.

It is increasingly clear that simply lowering the corporate tax rate or adjusting specific provisions of the code will not yield dramatic economic growth or drastically increase the number of start-ups. Instead, businesses of all sizes will continue to be burdened by a bewildering, punitive tax code, while jobs and investment will continue to transfer overseas.

That is why I have been working on eliminating the income tax and moving to a consumption tax. The ABC Act does exactly that. The bill has 29 cosponsors representing a diverse cross-section of Members.

And I look forward to your questions. I yield back.

*Chairman Boustany. Thank you.

Dr. Burgess, you may proceed.

STATEMENT OF HON. MICHAEL C. BURGESS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

*Mr. Burgess. Thank you, Chairman. Thank you for holding this hearing. And I just want to say how grateful I am to the chairman of the full committee, Kevin Brady.

You know, as the landscape stretches out ahead of us for the remainder of this term and whatever happens in next term, I do feel that the accumulated weight of desire for some type of fundamental tax reform will finally achieve that goal.

Now, as Mr. Woodall knows, this is the point in the discussion where I usually play a few lines from a Sheryl Crow song, "Can't Cry Anymore." She says, "Money comes in, but the fact is I don't make enough to pay my taxes." And I want to help Sheryl Crow. I want to help simplify her life, because I understand how --

*Chairman Boustany. Mr. Burgess, that is the suspicion we have, that you want to help Sheryl Crow.

[Laughter.]

*Mr. Burgess. Well, the truth is, I want to help every American. And it is -- we have made life so difficult for the average citizen with our tax code. And this Subcommittee knows it much better than I. I mean I am just a simple country doctor. What do I know about tax policy? Next to nothing. And I will readily admit that.

But let me just tell you my own personal journey with the Flat Tax Act. It actually goes back to calendar year 1993. Bill Clinton and I that year earned exactly -- exactly -- the same amount of money. But when Bill Clinton's taxes were published in the newspaper and I calculated his effective tax rate, it was 19 percent. When I calculated my effective tax rate -- remember the tax increases that were retroactive for the rich and the dead in 1993 -- I fell into that category. Not dead, but certainly well off. And my tax rate was 32 percent.

Why that discrepancy? Why treat one American citizen who happens to have a very well-paying job -- the President of the United States -- why treat that person preferentially, as opposed to someone who is delivering your health care late at night in their local hospital?

So, I started down this journey. And then, in 1995, my predecessor, Representative Dick Armey, Majority leader Dick Armey, published a book called "The Flat Tax." I read it on a -- actually, I was on my way to a medical convention. I bought it at the airport. I read it and it was like a revelation. Why don't we do this? Why don't we simplify? Why don't we give people back, if not money, the gift of time, the amount of time it takes to keep that shoebox full of receipts and prepare your taxes every year?

I actually spoke to Representative Armey about it early in 1996. He assured me that President Dole would sign the bill into law early in 1997. But, as we all know, history took a different turn that year. So here we are today, many years later, still talking about some of these things.

But again, I believe the accumulated weight of desire to affect the tax code in a positive way has reached the point where something is, in fact, going to happen.

Now, look. This idea is not new with me. Congressman Armey obviously had a bill to create a flat tax. The Hall-Rabushka proposals from years before. The concept is simple. You fill out a form, your amount of income less some personal deductions and some family deductions. I have got the form up there. It is really pretty simple. It is a one-page form. Fill it out on a post card and mail it in. The obvious takeaway from that is you don't have to spent all of those hours and dollars with your accountant every year.

My own personal situation, I have got two half-days blocked off while we are out of session the next couple of weeks to accomplish this for myself. It is complicated. Even when everyone under the sun knows what the United States congressman earns, I have still got to go through this exercise every year, lest I do something wrong and be called to account for it.

But you could fill out a simple postcard. You could fill out a simple return, and then everyone of the same income level would pay the same amount. It would have no bearing on the cleverness or astuteness of your accountant. It is just a fact of life.

And this was well illustrated by Ben Carson during one of the prayer breakfasts a few years ago. He related it to biblical tithing. My rate is a little higher than the biblical tithing rate, but he said, "If 10 percent is good enough for God, it ought to be good enough for the IRS." You know, again, my rate is a little higher.

The other thing that is different in the bill that I have introduced, H.R. 1040, different from what Congressman Armey had introduced previously, is that it is voluntary. If you like your tax, you can keep your tax. Can we just go ahead and say that, and make it as plain as day, that if you like your life under the code, you don't have to change a thing you can stay there.

But if you have reached the point where your frustration level is high enough, and the difficulty with keeping up with all of the pieces of paper is high enough, you could opt in to a flat tax. You can only make the election one time, there would be a 19 percent rate for 3 years, following to 17 percent for every year subsequent to that.

My belief is that you would not run two systems simultaneously for long because giving people back the gift of time and simplicity in their lives, and allowing them -- let them make the choice. Rather than us make the choice that you are going to go into a flat tax, you are going to go into a consumption tax, rather than us make the choice, let people decide for themselves when the time in their life is right for them to elect into a flat tax.

I stand by to answer your questions. I thank you for the opportunity.

*Chairman Boustany. Thank you, Dr. Burgess.

Mr. Woodall, you may proceed.

STATEMENT OF HON. ROBERT WOODALL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

*Mr. Woodall. Thank you, Mr. Chairman. I appreciate you and the ranking member holding this hearing. I -- reading the Wall Street Journal today, big data firms strike tax inversion deal. Why? Because our friends in the UK offer a 25 percent rate and we have a 35 percent rate. I agree with what Mr. Nunes has said about trying to lower that corporate rate, eliminating the deductions and exemptions. I agree with what the good doctor from Texas said about having all American families pay the same rate, ending the disparity.

But rather than dealing with it from an income perspective, I deal with it from a consumption perspective. And, like the good doctor from Texas, this is not a new idea. H.R. 25, the Fair Tax, while it is the most widely cosponsored fundamental tax reform proposal in the House, while its roots are in bipartisanship -- we first had one Republican and one Democrat, we then had two Republicans and two Democrats, then four Republicans and four Democrats, then two of those Democrats retired and one of those Democrats became Republican, and our bipartisanship was lost. But we started down that road.

And this goes back, not just through Congressman John Linder, not just through Congressman Schaffer from Colorado, not just from Senator Dick Luger, who pushed the sales tax back -- it goes all the way back to Governor Jerry Brown, who I believe ran for president on this same kind of platform, this idea that we should be encouraging savings, we should be encouraging productivity, we should be dealing with consumption.

I do share the ranking member's frustration that we are talking about it again, rather than doing something about it. Though, Mr. Chairman, it has been 15 years, by my count, since this Committee last held a Members panel to talk about the big fundamental proposals. And I am grateful to you for putting this on the calendar. It hasn't happened in years past.

I have got the front page from a Joint Committee on Taxation tax modeling project from 1997. This was when Bill Archer was running the committee. And absolutely every group they brought in from the left to the right, modeling a consumption tax relative to our current system, said we could grow the American economy faster with a consumption tax. I could support any consumption tax we are talking about here. I think mine is best. I just need us to start moving. Mine is the furthest down the road. I want us on this road getting started.

Fair Tax does a couple of things no other proposal does. Takes the corporate tax rate to zero. This fiction that businesses pay taxes has to be stopped. Businesses don't pay taxes. They collect them from their employees in lower wages, they collect them from their consumers in higher prices, or they collect them from their holders of capital in lower rates of return. Businesses do not pay taxes, they collect taxes from other entities and pass them along. I think we should be honest about that.

My proposal deals with the payroll tax. Eighty percent of American families pay more in payroll taxes than they pay in income taxes, and yet we seem obsessed with the income tax code. If you really want to help working families move up that ladder, you have got to deal with the payroll tax code. The Fair Tax does that.

And the Fair Tax recognizes that compliance is not just an expense, not just a disincentive, but a solvable problem. You may not know, but the economic census that the Census Bureau conducts tells us that 908 businesses in this country sell 60 percent of all the product. The bottom -- or the top 10 percent, 8.8 percent of businesses in this country, sell 87 percent of all of the product.

What I am proposing is moving the tax code away from 200 million individual American citizens and families, having them pay the tax when they purchase goods at the retail level, but have the tax collection and payment, the auditing process, focused on those folks who are doing the selling. Take businesses out of the role of paying taxes, but leave them in the role of collecting taxes. Take citizens out of the role of having to report taxes, leave them in the role of paying taxes.

It frustrates me that I look at former Soviet Bloc countries and they are all moving to low-rate, simple, consumption-based taxes. If it is good enough for the Soviet Union former republics to grow their economies, it has to be good enough to grow ours.

I know if you sit on this Committee it is easy to see how picking winners and losers through the tax code can help Americans to succeed more. I don't want to do that. And I understand the kind of authority that takes away from this Committee and it takes away from this institution.

But what I propose is a tax code with no exemptions, no exceptions, no deductions, just a simple rebate for folks up to poverty-level spending to insulate the poor from being punished, and a free-for-all above that level. If you drive that Mercedes, you pay for it. If you drive that used Ford Fiesta, we believe you deserve a break.

And with that, Mr. Chairman, thank you so much for having me here today.

*Chairman Boustany. Well, thank you. All of you have given really excellent testimony and -- about these ideas. And so we will now move to some questions.

I -- we all hear about the complexity in the tax code, the unfairness of it, when we go back to our districts. And our current income tax system certainly has very complex cost recovery rules that allow business investments to be recovered over time. In some cases over a period of many years. And the three bills today all have rules for business investments that are very different from the current code.

I would like each of you to describe -- how does your bill change the impact of tax on investment decisions by business? Just briefly kind of cover that for the record.

*Mr. Nunes. Well, I think, clearly, a lot of -- all three of these bills do something similar, because it moves to a consumption-based system. If you look at what -- the way that we attacked this in the ABC Act is we take all business activity and you essentially are taxed on your net cash-flow. So you take your income, minus your expenses in that calendar year, so at the end of the year whatever is left over you will pay tax on.

And what this does is it encourages investment. So, unlike today, when you have got -- everybody has a special credit, or some deduction, or something that they want, where they are gaming out, like a lot of my constituents do and like I used to have to do before I was elected to Congress, you have to -- by the end of the year you have to say, "Okay, what can I buy that the tax code allows me to buy?" And I am not sure that that is really -- it wasn't an efficient use of my time, it wasn't an efficient use of capital, and it sure didn't help create jobs.

And so, I think that that is how my bill achieves this, and I think the other bills are very similar, but just slightly tweaked differently.

*Chairman Boustany. Dr. Burgess?

*Mr. Burgess. I spent most of my time talking about the individual income tax. There would also be a similar flat tax option for businesses, as well.

Essentially, the bill, as written, would eliminate the capital gains tax. As far as the tax imposed on business activities, the deductions that would be allowed would be the cost of business inputs for the business activity, wages, and retirement contributions. So I -- my assumption is that, since retirement contributions are removed from -- are an allowable deduction, that those would not be adversely affected by the implementation or the election to a flat tax.

*Chairman Boustany. And Mr. Woodall?

*Mr. Woodall. Mr. Chairman, by eliminating business taxes all together, you no longer have tax code involved in those decisions.

I confess I am confused why, as Americans, we are trying to get ourselves in the middle of the pack, in terms of corporate tax rates. We are leaders in America. I want to be the leader of the pack in that space, wherever that turns out to be. Again, if we want to tax employees, tax employees. If you want to tax consumers, tax consumers. If you want to tax return to capital, tax return to capital.

But, more importantly, the fair tax -- again, the only proposal in Congress to eliminate the payroll tax, and that is going to impact the decision to invest in people. And if there is one thing we need this tax code to encourage, it is buy all the robotics you want to, but I need you to invest in people and workers, and the Fair Tax does that.

*Chairman Boustany. Thank you. And I guess a follow-up question is, you know, many businesses use debt now to fund investments and growth. We have heard a lot of testimony from experts about the problems associated with debt financing and the risk associated with all that.

But maybe comment, each of you, about what the impact would be on business with regard to debt financing, and how business is actually funded and how investments are carried out. Mr. Woodall, you want to start?

*Mr. Woodall. Because there would be no deductions, because there would be no tax at all, there would be no benefit to debt financing, and -- under a fair tax there would be no deduction for those interest payments. So whether you wanted to finance through debt or whether you wanted to finance through equity, the fair tax would treat you the same.

*Chairman Boustany. Dr. Burgess?

*Mr. Burgess. Under the business tax section, the carryover of -- credit equivalent of excess deductions, if in any year your deductions would exceed the amount of money posted in the -- as a profit, that can carry over to subsequent years. So there would not be a penalty for not having -- you would not lose the ability to have credit for those carryover expenses.

*Chairman Boustany. Mr. Nunes?

*Mr. Nunes. So the way that it works is that, you know, in order to have a real consumption tax to function properly, you can't allow for interest expense. I think that is the primary -- I think that gets to the heart of what your question is.

And that is just -- you know, so what does it do in the big picture? We really don't know, because nothing like this has ever been tried. My -- I think when you start to game this out, and you look at what -- business models that people have, those business models will all have to change, because people will be spending their time -- similar to my example earlier -- focusing on what they need to invest in, not how they have to structure their company and how much debt load they have to incur.

So, it would open up all sorts of new investment opportunities for the companies that are -- a lot of the companies, the big equity companies in Boston, they would end up changing. I think it would benefit a lot of new investment-type equity firms that would have to develop. The banks would develop new products because capital would be more readily available under a plan like this.

*Chairman Boustany. And one final, last question. Two of the proposals have been around for a while in some form. Mr. Nunes, yours is a new proposal. We have had a lot of discussion within the committee about should we proceed along the lines of 1986 reform approach, you know, using the income tax as the base, or do we move to something differently.

And I think, Mr. Woodall, you mentioned earlier the need to be competitive, to leapfrog ahead of our competitors. Do you think the timing -- talk to me a little bit about the timing of these new proposals with regard to tax reform. Is the timing right? Should we really move forward in this direction, or should we, you know, perhaps consider the 1986 reform model as the way to go?

*Mr. Woodall. Mr. Chairman, what I liked about the 1986 reform model was the collaborative way in which it took place. I don't know of any other way to do the big things that we have to do in this country.

But inversions are one of those things that bring us together. Why is it that folks want to leave? This is the best place in the world to do business. Why are we running folks off? I think it is the right time for that.

And more than that, from a consumption tax perspective, we have a billion new middle-class consumers coming online in India, a billion new middle-class consumers coming online in China. If there is ever going to be a time to talk about bringing manufacturing back to America, getting back to our exporting roots, that time is now.

*Chairman Boustany. Thanks. Dr. Burgess?

*Mr. Burgess. You know, I wasn't here in 1986, but I was running a medical practice in 1986. It was a hard year in Texas. Energy prices collapsed, we had the collapse of savings and loans. Real estate prices went downhill, and that was exacerbated by the fact that things that used to be called tax shelters, bad business ideas that people would invest in to -- so that they could shelter dollars from income taxes at a much higher rate, those tax shelters went away, literally, overnight with the imposition of the 1986 tax code.

Good thing or bad thing I am not here to decide. But what I do remember is there was a significant amount of disruption in the lives of people. That is why the concept that I am putting forward is a voluntary election that someone will decide that, hey, I want to change my tax code, rather than us decided up here in Washington. The time might not be propitious for someone back home to make a major change. They may have done significant investments.

Scott Burns, who writes a financial column for the Dallas Morning News in my paper back home, always references the home mortgage deduction. The home mortgage deduction in San Antonio, Texas, when you really put pencil to paper in the average sales price of a home in San

Antonio, you are really just pushing around a few dollars on a page. But if you bought a starter castle in Santa Barbara, and we suddenly alter the deductibility of your home mortgage, that is a big deal.

So what I like about the ability for the constituent to decide is they decide when the time is right for them. As I said, if you like your tax you can keep your tax. If you want your life out of the code, that is your decision. Now, of course, you can't go in and out as whatever would be favorable for you.

But look, I remember the 2012 election. A lot of heartburn over the fact that Mitt Romney only paid an effective tax rate of 13 or 14 percent. We are going to put him in 19 percent for three years, and then 17 percent thereafter. He is going to be paying more tax. Fundamentally, that is a fairer thing.

*Chairman Boustany. Thanks. Mr. Nunes?

*Mr. Nunes. So I really believe part of what led me to where this -- where I am at today with this legislation was when you try to do across-the-board reform it is very, very difficult, because everybody has their favorite credit. You have -- the entire economy has been built upon the code.

And so, by taking the business activity and separating that out, anyone who is involved, or most people who are involved in business activity in the United States of America have accountants, lawyers, somebody -- you know, even in my family small business we had -- you know, had to have an accountant to do our -- pay our taxes and file our tax returns.

So, I think it is achievable because it doesn't disrupt the wage side of the equation. To be honest with you, in a perfect world, I would prefer to have something more full-scale, like what Dr. Burgess is talking about or what Mr. Woodall is talking about. But part of what went into this calculation is what is actually achievable under the circumstances that we face today.

And, look, anything we do is going to take Republicans and Democrats. I think that is what I said in my testimony is Republicans and Democrats both agree on a few things: one, that we need to switch to a consumption-based system; and, two, that we need to fix -- move to some type of territorial system. Those have to be done. Those are two things that we agree on. Why don't we do them, but let's do them in a way -- one step at a time?

*Chairman Boustany. Thank you. I now yield to the ranking member, Mr. Neal.

*Mr. Neal. Thank you, Mr. Chairman. I appreciate the historic references, obviously, because I knew those individuals, I came here two years after that historic act. And those individuals, including Bradley and Gephardt, Rostenkowski, Packwood, Reagan, and O'Neill, they all saw that as one of their finest moments, because they were overcome -- they were able to overcome the short-term objections.

And not to miss the point that there were winners and losers that were created by what they did in 1986, but this is a much different atmosphere in which we all served -- I mean we serve now. I mean that was a calm, rational, fact-based discussion of virtually every item.

And a reminder, there was more opposition on the Republican side to what Dave Camp did than there was on the Democratic side. I think that is a fair statement. I advise colleagues on this Committee specifically to be very careful how they handle some of the Camp proposals because, in fact, they were long overdue and they were very, very genuine.

But Devin, to your point -- and correct me if I am wrong -- you mentioned a five percent repatriation rate. And how did you arrive at that number?

*Mr. Nunes. Largely because it was -- I kind of looked at all the different pieces of legislation that were out there that were dealing with the funds that are sitting overseas now, and that was kind of right in the middle. So I thought it was kind of a compromise of what Republicans, Democrats all over the spectrum wanted to do.

And so, remember, when you -- it is only necessary one time. If you switch to a system like the ABC Act, then you move to a territorial system, and then people can bring back money how they wish. But I just put, for the repatriating the dollars that are sitting overseas now, one-time fee of five percent. That is how I arrived at it.

*Mr. Neal. Just again with institutional memory here, when we did this, when Chairman Thomas was the author of the major piece of legislation on that, we brought it back at -- it was brought back over our objections at five-and-a-quarter. And the premise of the return was job creation.

In this town, broadly, think tanks would all come to the same conclusion: there was no job creation. The money was passed on to shareholders. Now, if that had been the premise that was offered, then we could have had an honest debate about that. But the argument instead was this is going to spur a lot of new investment. And that really didn't happen. I think that is a fair statement.

So there is some suspicion as to the rate, and the Administration has proposed a 19 percent minimum tax, which I assume is negotiable. So we should perhaps begin to have a conversation along those lines, because we all agree that you can't have trillions of dollars sitting offshore for non-productive purposes when it could be better invested back here.

And to Mr. Woodall, to your comment about the proposal that you have offered, the Bush treasury examined that proposal, and they came to the conclusion that it wouldn't work. That is W's Administration. His Treasury Department examined it from A to Z and they came to the conclusion that you run the risk of creating a whole new entitlement program in America.

*Mr. Woodall. I certainly would not point to the Bush administration as the place to go for good fundamental tax reform. He had a chance to reform the code and he chose Social Security over tax reform.

They also said that our proposal did the most for low-income American families to lift them from that one rung on the ladder up to the next. I think that is important. And thinking about the good old days, I would remind the ranking member that in those Rostenkowski days of calmness and reasonableness, the Catastrophic Care Act had his car being rocked left and right. Those days were raucous days, too. I still think we have an environment in which we can do this together.

*Mr. Neal. Right, but it -- I remember the description of what happened on that day. And remember, I was one of the ones that voted to repeal that act. So there was -- again, we weren't locked into the silos of partisanship. And I can tell you it certainly increased my name recognition with Chairman Rostenkowski that I voted to repeal that.

[Laughter.]

*Mr. Neal. I thank the gentleman.

*Chairman Boustany. I thank the gentleman.

Mr. Tiberi?

*Mr. Tiberi. Thank you, Mr. Chairman. Thanks for holding this hearing.

You know, Mr. Neal, before I leave here, it is probably going to be called the Camp Levin-Obama tax draft.

[Laughter.]

*Mr. Tiberi. I just -- I don't seem to remember Democrats rushing to be supportive of it, in fairness.

*Mr. Neal. Would the gentleman yield?

*Mr. Tiberi. I would love to yield to you, Mr. Neal.

[Laughter.]

*Mr. Neal. Mr. Larson is a witness to what I suggested in our caucus about how to respond to the Camp tax proposal. There were things in there that a Democrat would not have done. That was really -- there were a lot of bipartisan things that Dave Camp did.

*Mr. Tiberi. Sure.

*Mr. Neal. And I remember the fury when that proposal was released.

And just another example to the newer Members, 52 Members of your caucus signed a letter to him.

*Mr. Tiberi. Sure.

*Mr. Neal. That never would have happened in those days that Mr. Woodall described. There really would have been a let's digest it and talk about this calmly, quietly, and have a discussion.

*Mr. Tiberi. So, Mr. Nunes, as you know, I am a cosponsor of your legislation, I appreciate your hard work. And, you know, whether it is your proposal or Mr. Burgess's proposal or Mr. Woodall's proposal -- and, by the way, you might want to take this on the road. When I originally ran for Congress, Mr. Armey did a road show that was quite entertaining. You guys are just about there.

So, as a former small -- the smallest of business owners, I was a one-person business, as a Realtor, I am always concerned about, in terms of reform, what a reform proposal will do, how it will impact someone like I was, as a Realtor.

And so, Mr. Nunes, I will ask you first. As someone who paid his business income through his personal return, how would the ABC Act -- first question -- impact the small business owners?

And a concern that I have heard -- and if you could, clear up for me with respect to the ABC Act -- how last-in, first-out accounting is impacted, how LIFO inventory under LIFO would be treated under the ABC Act.

*Mr. Nunes. Well, with LIFO we do away with it, because it is no longer necessary. A lot of the reason that we have LIFO now -- and it is part of the example that I was giving earlier -- the end of the year, businesses have to start to dodge and weave their way over what inventory they are going to carry. It is a complete, you know, waste of people's time, and it is an inefficient use of one's resources.

So, the way it works now is -- under the ABC Act -- is business buys what they need to buy, and they put it in their inventory. And so, you know, effectively, you can -- you as long as you are growing and investing, you can actually drive your effective tax rate pretty low. But if you don't want to grow, you don't want to invest, then you are going to pay the 25 percent rate.

As it affects a small businessman, I mean, from my perspective, I wrote it with that in mind. Because as someone who was dealing with the horrible tax code -- especially in agriculture -- that I worked in, it was very confusing, very complex, remains complex today. We have had to deal with some of those issues in last year's tax bill.

So, I think this is just very simple, because -- as in your case, you would just take all your business income that you have, you minus off your expenses, what you use on your wage side. You would pay -- you would be under the old system, effectively.

Now, look, it goes back to what I said earlier. I don't believe on the wage side we need to keep the system the way it is. I think it needs to be simplified. But, you know, that has got to be figured out, how you get to that point. I think the Camp draft actually had a lot of good proposals in terms of what you could do on the wage side.

*Mr. Tiberi. Mr. Burgess, Mr. Woodall, any comments?

*Mr. Burgess. One of the things that struck me when I was in a small business like you, I was given advice that, in order to keep the dire wolf from the door, that I ought to keep three months of operating capital in a readily-accessible liquid CD at the time. The problem with doing that is you go to the end of a calendar year, and the next year, if you bring that money out, it is brought out at your individual tax rate.

So I, in fact, did that and got significantly criticized by my partners because then the money was paid out to partners in the corporation. They, in turn, paid at the highest rate. So we were taxed twice on that same money, but it seemed like a prudent business decision. And I guess part of my idea with the business side of this is we don't punish people for making prudent business decisions. I think it is a good idea to store up some surplus in good times to guard against the bad times.

*Mr. Woodall. And, Mr. Tiberi, in our proposal the small business owner would still have to deal with the tax man by collecting taxes from whatever it was they were selling. But they wouldn't have to interpret the tax code, because it would just be those collections that would happen on each purchase that went out the door, everything being taxed once but only once.

*Chairman Boustany. Mr. Larson?

*Mr. Larson. Thank you, Mr. Chairman. This has been an enlightening day. We had a great hearing earlier this morning on fixing Social Security, or a portion thereof. And I especially appreciate it when Members get an opportunity to come before a committee. And it doesn't happen often enough. And the Congress, at the end of the day, should be about the vitality of ideas, and how we interact with those ideas, and how we interact with one another and hopefully achieve those bipartisan or non-partisan ends that we all would like to see. And I think everyone acknowledges in order to move the nation, or to move a bill forward, that is exactly what we need.

A lot of these -- you know, a lot of the proposals here have been around for some time. That doesn't mean that they still don't have salience. And also, I think not to discuss these things -- and, frankly, other forms of taxation -- where there is broad agreement that we need reform, where there is broad agreement that we have to be more competitive, especially in manufacturing states like the State of Connecticut, there does seem to be an awful lot of reasonable ground.

One of the questions that I have that came up in your testimony -- and feel free to any one of you or all three of you to answer -- is in dealing with the various consumption and fair tax proposals, how do you treat the payroll tax vis a vis FICA, or the Social Security program that we talked about this morning?

*Mr. Burgess. Under H.R. 1040 it would not change.

*Mr. Larson. Okay.

*Mr. Nunes. Same for my proposal.

*Mr. Woodall. We would abolish the FICA tax as it exists, and build it in to the purchase price of every item that you buy. Included in our rate is a statutory payment to the Social Security and Medicare trust funds, up to the amount of payroll.

*Mr. Larson. How would that work, exactly?

*Mr. Woodall. We anticipate this Committee solving our Social Security issues for generations to come. But in the interim we would say employers would still need to report their payroll so that we could properly credit that amount of FICA tax. But it would come from the sales, not from --

*Mr. Larson. One of the things that I hope the committee -- and we addressed this earlier today -- that I hope that we focus on is looking at the Social Security issue as one -- as you all know, Social Security, by law, has to sustain solvency for 75 years. Now we are not remotely close to that. And I think sustainability and solvency are the key words here to restore trust in the American people so that any underlying tax proposal -- that if you have the trust of the American people going forward, you have the ability to sale -- to sell your program.

Further, I really believe -- and again, tailing on the -- or building upon the discussion we had earlier today, I really think that if we treat Social Security like a premium, which it is -- it is called the Federal Insurance Contribution Act -- and the contribution is yours, a.k.a. the citizen and the business who pays, that we bipartisanly can come to a very simplistic resolution.

The thing I admire about your proposals is the simplicity. There is doubts about the efficiency, but we ought to be open to hear those. And, of course, we are very concerned about regressivity on our side of the aisle, and what that would mean to people, and whether or not you get there by dynamic scoring, and what that truly means.

But certainly, all of these proposals, and certainly proposals that come from Members, are something that we ought to be discussing in this Committee. I commend Chairman Brady for doing that, Chairman Boustany for bringing it up. The more we engage like that -- and I think the beauty of what Dave Camp did is he said, "Look, let's get out of the spotlight. Let's make it Members-to-Members." You are the best representatives of your constituents. You are out there talking with them all the time. It would be nice if we had more of these conversations.

I appreciate all the experts that we bring before the committee, but you are the expert in your district, and we ought to hear more from you. Thank you for being here today.

*Chairman Boustany. I thank the gentleman.

Mr. Renacci?

*Mr. Renacci. Thank you, Mr. Chairman. I really appreciate your doing this. I hope we can do additional panels like this. It is good to hear different proposals. I really appreciate all of you and your ideas.

I am going to ask you some questions based on a CPA that has been in business, and not only practices as a CPA, but also is in business. And I think every one of your programs has some good points. I am going to touch on the negative side. And hopefully you can give me some answers on that, and just tell me what your thoughts are.

First off, Mr. Nunes, I will start with you. I go back to my -- how I started out in business. I had very little. I was able to go to a bank, borrow some money, get started in a nursing home business. There was a competitor down the road who had a lot more money, so he was able to acquire the asset, he was able to buy the building. I couldn't. I had to just buy the operation and lease it.

So, he, on the other hand, under your proposal, would have a -- if you are picking winners and losers, he would be a winner. He would have a deduction that I wouldn't have. He would be able to expense that facility, and I would be sitting over having to pay a 25 percent tax on my earnings, based on your proposal.

So the concern I have in that case is the picking of winners and losers: the guy who can afford to capitalize his business and the guy who can't. The small guy like myself, now, I was successful enough over 25 years to be able to build the business and acquire those assets down the road. But that is because we were in the system we are in today. So that is one question: How do you -- help me on that one.

And the other question is -- which is so concerning for me -- is without that interest deduction I would definitely not be able to compete with them, because that is the only deduction I had, where he would be able to capitalize or write off his building.

*Mr. Nunes. So, thank you, Mr. Renacci. We have had discussions about this in the past. And I think you are very thoughtful and clearly have experience at dealing with this.

I think one of the challenges that a lot of people have when they first look at this tax bill, the ABC bill specifically, is they look at it through the lenses of an income tax. And that is one of the challenges that I have when I am dealing with the business people is because they are looking at it like income tax. Going to be income tax, just like income tax has always been, not realizing that this does away with the income tax for all business activity in the United States, and it becomes a consumption tax.

So, I would argue that whatever that business model was -- because I am not, you know, familiar with how you started out -- that would not be the business model if this system was put into place.

So, for example, you know, how would you do it? Well, I think there would be some -- as I talked about earlier, about different equity opportunities that would come up, there would be so many more equity opportunities, because you would have so many more Americans that perhaps don't have a lot of capital, but what little capital they do have they would take risks with people like yourself. Today, those people don't invest. They really have no other options but to maybe invest in the stock market. They have no opportunity to get -- invest into small business.

And so, I think those types of investors would be open especially to a small business person like yourself. And so, when you come to the end of the year, what you would do, if you are continuing to grow as a small businessman, the end of the year you have got -- whatever money you have left over, you might want to go out that December and you might want to go out and make investments so that you don't get taxed at that 25 percent rate that year.

*Mr. Renacci. The only other response I would have is that -- I think I told you this on the floor -- I am not too sure I would want to have 10 or 12 partners. I kind of like the idea, as you are growing a business, just to have the bank as a partner. Then you just have to answer to one. I wouldn't want 10 or 12 people trying to tell me how to operate, which is the negative side of having equity investors.

But I do appreciate. I am supportive of a consumption. I just don't know how two business models exactly the same -- one has more capital, can buy the building, one who can't, one of them is going to be a winner, one of them is going to be a loser.

Mr. Woodall, I do 100 percent believe with you -- believe what you said. Businesses do not pay taxes. And once we get to that point, if everybody can agree to that -- because they pass it on -- we can reduce the rate.

Explain to me under your plan, which is the down side of the fair tax, that somebody who has lived their whole life, saved up money, paid taxes at 36 percent, 38 percent, whatever, now is sitting with a savings account, they are elderly, and all their spending, they are going to have a double taxation. They have already paid tax once, they are going to pay tax again. Explain how that is good for that individual.

*Mr. Woodall. It is a rotten deal, generationally. Just the bottom line. We can either decide that because we are stuck in a bad deal today our kids are going to have to be stuck in that bad deal, too, or we can decide we are going to get the bad deal but our kids are going to do better.

But many seniors living at the low end of the income spectrum -- our prebate allows folks up to the poverty level to live tax free. We insulate Social Security payments against any one-time inflationary jump that may happen because of the imposition of a double-digit sales tax in the economy. Any sort of inflationary jump would be captured in outgoing Social Security payments.

And finally, my hope is we would put the economy on fire. And folks, instead of getting a quarter percent on their CD or a two percent on their bond, are going to get back into the six, seven, eight percent yields that they deserve.

*Mr. Renacci. Mr. Burgess, I know I am pretty much out of time, but the one question I would have for you is you said that you can opt into your system. So if I am not paying taxes today, I am going to stay in the current system. But if I am paying 38 percent I am going to opt into your system. That is going to bring the treasury -- the dollars coming into the treasury significantly down, because you are going to -- everybody is going to pick the lower side, and you are going to have a rate of at least 19 percent or less, because the people who are already paying less than 19 percent aren't going to opt in. So how would you fix that disparity?

*Mr. Burgess. Well, and with all due deference to your profession, the answer lies in the simplicity. Look, I have got to visit my accountant every year and make sure I have spent down the equity of my corporation to where I am not going to be taxed. If you elect -- and this would be a voluntary election, no one is going to force you into it, but if you elect into the flat tax, then that is going to be the rate from that day forward.

On your question about the difference in treatment for someone who has bought the building and someone who I presume then is renting the building, that is treated equally under the section on inputs, business inputs in the flat tax, whether it is the cost of a building purchased, or the cost of rental. It is treated identically for the person who is invested in the building. That would be phased in over time, over the -- the credit allowance over time.

*Mr. Renacci. Thank you, gentlemen. I appreciate your input. I yield back.

*Chairman Boustany. I thank the gentleman.

Mr. Holding?

*Mr. Holding. Thank you.

Mr. Nunes, I believe in response to Mr. Tiberi's question you addressed the impact of your proposal, which I am a very proud cosponsor of, the impact of your proposal on pass-throughs. You know, pass-through businesses employ about 50 percent of the private-sector workforce and earn more than 64 percent of all business income. And I believe your answer to him covers my concerns there.

But you know, there is another type of business -- I mean they may be pass-throughs or C corps, and these are innovative pre-revenue start-up companies, you know, small businesses throughout the country, particularly in my part of North Carolina and pharmaceutical area and technology sectors, and my little area of North Carolina. And a lot of these companies faced losses for years. The -- before finally making a profit.

In fact, some of these aren't such small companies. I was reading an article that Twitter has been around for 10 years, and I don't think it has ever made a profit. So how would these companies be taxed in fair -- under your proposal?

*Mr. Nunes. Well, the -- sometimes, to develop new technology, it takes investment like that. And I actually feel that -- and this gets to Mr. Renacci's question also -- that the current tax code is inhibiting innovation. Lack of capital is inhibiting innovation. And so, this proposal is perfect for those types of businesses that have to make huge investments year after year after year to develop technology in order to achieve the technology in order to then get to profitability.

And so, what we really want -- I mean through all these consumption taxes we talk about businesses not paying taxes. Essentially, that is what the consumption tax allows, as long as you are consuming. And that is what we are trying to get to, and that is what this proposal does.

*Mr. Holding. And your proposal, Mr. Nunes, as well as Dr. Burgess's and Mr. Woodall's, you know, truly would upend the system. And new business models would have to arise, you know, from these tax proposals, which gets me to the thought of transition.

You know, we have companies that, you know, have hundreds of millions, of not billions of dollars of tax credits stored up, you know, deferrals, so forth. And that is baked into their business models for years to come. So I will just go down the line, ask each one of you your thoughts on transition, kind of big-picture thoughts on transitioning, you know, to this new form of taxation. So I will start with you --

*Mr. Nunes. Well, thank you, Mr. Holding. And we spent a lot of time with this proposal, thinking about just that. We have -- because we are only dealing with business activity, and everybody that pretty much is in business, as I said earlier, has accountants and lawyers or advisors, you will be able to -- there will -- the transition -- the needed transition will be known, for sure, by this Committee and these Members if you move a proposal like this, because everybody that would need transition would be in here.

We have identified a lot of that. I am not sure how much is actually needed or not needed. You know, when you truly put the option to accompany -- okay, you are saying you need some transition, but if your option is no transition but you get this new code, would you take no transition? And I think often times the answer is yes.

But for example, we do allow for loss carry-forward to be sort of businesses who have incurred losses or businesses who have made big investments to still be able to write those expenses off.

*Mr. Holding. Dr. Burgess?

*Mr. Burgess. And under the -- this section deals with the carryover of credit equivalent or excess deductions. And Mr. Renacci pointed out if a company is not paying taxes now, under a voluntary election to a flat tax, could continue under the model that they are in, where they are not paying any taxes. And that might be a satisfactory arrangement.

But if they elected to go into a flat tax system and their deductions were in excess of their earnings, obviously there would be no tax liability at the end of the year. And that is based on an accrual method over time, that those deductions can accumulate and carry over from year to year, so the cost of capital for starting a business would be expensed over time.

*Mr. Holding. Mr. Woodall?

*Mr. Woodall. Mr. Holding, when folks play by the rules, they ought to get -- their expectations ought to be met. The 1986 transition crushed folks, crushed commercial real estate, crushed folks in passive loss circumstances. Even as recently as the President's health care bill -- I met with a couple who was in the tanning business, and that 10 percent gross receipts tax on tanning salons -- they had been working their entire life playing by the rules, and now their asset was virtually worthless, because they weren't making that kind of margin. There is no satisfactory explanation for the folks who are going to lose because they have been playing by a convoluted set of rules for the last decade.

But as Milton Friedman said when he testified before George Bush's tax panel, it may just be time to wipe the slate clean. We have one transition rule in the fair tax, and that is on inventory. If you bought inventory and the taxes were all baked in throughout the system, you shouldn't have to double tax that as you are trying to move that inventory out of the system.

But I hope we will not let the unmet expectations of folks who have been playing by the rules prevent us from wiping the slate clean. And perhaps, if we do wipe the slate clean, we will never have to have the conversation about folks who counted on Congress maintaining the tax code in a constant state, only to be let down.

*Mr. Holding. Thank you. Thank you, Mr. Chairman.

*Chairman Boustany. I thank the gentleman. We want to thank you guys for bringing these really important proposals forward. It is really a valuable addition to our -- what we are looking at as we really are all committed to fundamental tax reform.

So, also be aware that over the next two weeks there may be some additional questions we will submit to you in writing, and we ask you to follow up and answer those.

And, with that, the subcommittee stands adjourned.

[Whereupon, at 4:41 p.m., the subcommittee was adjourned.]

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