

**Hearing on How Tax Reform Will Grow Our
Economy and Create Jobs**

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Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

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

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WAYS AND MEANS

CHAIRMAN KEVIN BRADY

Chairman Brady and Subcommittee Chairman Roskam Announce Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

House Committee on Ways and Means Chairman Kevin Brady (R-TX) and Tax Policy Subcommittee Chairman Peter J. Roskam (R-IL) announced today that the Full Committee will hold a hearing on how tax reform will grow our economy and create jobs across America. **The hearing will take place on Thursday, May 18, 2017 in 1100 Longworth House Office Building, beginning at 10:00 AM.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Thursday, June 1, 2017**. For questions, or if you encounter technical problems, please call (202) 225-3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be

printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available at <http://www.waysandmeans.house.gov/>

HOW TAX REFORM WILL GROW OUR ECONOMY AND CREATE JOBS

Thursday, May 18, 2017

House of Representatives,

Committee on Ways and Means,

Washington, D.C.

The committee met, pursuant to call, at 10:07 a.m., in Room 1100, Longworth House Office Building, Hon. Kevin Brady [chairman of the committee] presiding.

Chairman Brady. The committee will come to order.

Good morning. And thank you all for joining us. And today our committee is focused on a top priority for the American people, pro-growth tax reform that will create jobs, increase paychecks, and strengthen our Nation's economy. America now has one of the most costly, unfair, and uncompetitive tax systems in the world. The need for pro-growth tax reform is urgent.

Today's high tax rates on American businesses drive good-paying jobs overseas. It makes it much more difficult for our job creators and our workers to succeed here at home. America's burdensome international tax system destroys U.S. competitiveness and discourages investment in our local communities. Scores of loopholes give favored treatment to Washington's special interests while millions of hardworking Americans haven't seen a real pay raise in years.

Here is the good news: President Trump is leading the charge for bold tax reform that will unleash the growth of jobs and paychecks nationwide, and he is calling on The House and the Senate to put forward our best ideas. Our committee is ready to answer that call.

Over the past several years, we have held roughly 40 full committee and subcommittee hearings on all aspects of tax reform. All of our members, no matter what side of the dais you sit on, know that tax reform is an economic imperative.

Now is the time to go bold. Now is the time to deliver real results for the American people. We welcome all serious solutions that will help achieve that goal.

While there is no perfect way to tax, there are proven solutions to grow our economy and improve the lives of all Americans, especially the middle class. So let's take a look at the numbers. Currently, we have the highest corporate tax rate in the developed world at 35 percent. For small businesses, it is worse. The rates can be as high as 44.6 percent. To unleash job creation, increase middle class paychecks, we know these rates have to come down. Washington must take less from American job creators so they can invest more in their businesses, their workers, and their futures.

In addition to lowering rates, we also know that bold policies, such as full and immediate expensing, are incredibly pro-growth for jobs, for paychecks, and for our economy as a whole. According to estimates from the nonpartisan Tax Foundation, this provision alone, allowing businesses of all sizes to immediately write off their business investment in buildings, equipment, software, and technology, will grow America's economy by more than 5 percent over the next decade, create 1 million full-time jobs, and raise wages and paychecks significantly.

Finally, the numbers show us that businesses of all sizes are eager for tax reform. They are ready for the opportunity to innovate, to grow, and to hire new workers. Recently, the Business Roundtable surveyed a group of more than 120 CEOs about tax reform: 82 percent of them said tax reform will prompt companies to increase business investment, and three out of four said they will increase hiring. These CEO responses make clear that tax reform will create jobs, create paychecks, and grow our economy.

But make no mistake: There are also consequences if we fail to act. Ninety percent of the CEOs said that delaying tax reform will harm the U.S. by causing slower growth, slower hiring, and slower capital investment. And more than that, delay would force all Americans to continue to live with a Tax Code that works against them, not for them.

Take from Roger and Natalie Goertz, constituents of mine who own and operate a Mr. Rooter plumbing franchise in Montgomery County, Texas. Roger, who is a friend, and his wife, who are so deeply involved in the community, said: As a small business owner, I am scared to death each year in how I am going to have to pay into the government. That uncertainty is devastating, he says. It is kind of like trying to operate your business with one

hand tied behind your back; sometimes you feel like both hands are tied behind your back. All small businesses know that feeling.

In today's hearing, we will hear from more business leaders, real live business leaders about exactly what is needed to get jobs, paychecks, and the economy moving again.

Our witnesses are top-level executives from American companies of all size, from 80 workers to 80,000 middle class workers. Their expertise will help us understand how different proposals will impact America's job creators, workers, and our families. Since releasing our House Blueprint for Tax Reform last June, we have received thousands of comments from businesses and thought leaders, feedback we take very seriously. We look forward to the expert guidance our witnesses will provide today. We thank you all for being here to lend us your insight.

Again, there is no perfect way to tax. But there are proven ways to grow our economy. With today's hearing, we will take a critical step toward putting these ideas into action for the American people.

With that, I will now recognize Ranking Member Neal for his opening statement.

Mr. Neal.

Mr. Neal. Thank you, Mr. Chairman, for holding this important hearing and highlighting the need for tax reform. We all agree the Tax Code is broken. It is far too complicated and certainly in need of repair. Our current tax system isn't working for families and businesses alike, and we all agree that any revisions to the Code should promote economic growth and create jobs for working families.

However, we should reject ideology and work together to reform our tax system for the 21st century. According to a recent Pew study -- based on fact, not opinion -- the share of adults living in middle-income households in the United States fell from 62 to 59 percent from 1991 to 2010. Aggregate household income has also shifted from the middle- to the upper-income households. Pew's research found that 49 percent of U.S. aggregate income went to the upper-income households in 2014, up from 29 percent in 1970. And for middle-income households, the share of income was 43 percent in 2014, down from 62 percent in 1970.

Wealth is now concentrated at the top, and I assume there is broad agreement on that issue. We can disagree on how that happened but not to miss the point greater concentrated wealth at the top is a reality as we proceed to this discussion.

Income stagnation is a real challenge and one that needs to be addressed in tax reform. This is in part why working families sent a strong signal to Congress last November.

They haven't received a pay raise in years. Their bills are piling up, and they are concerned about uncertain financial security. Put simply, too many feel forgotten and left out by their government. Tax reform should be about moving the dial to help middle class families prosper. That means focusing on job creation and helping families with day-to-day costs, like housing costs, grocery bills, and childcare. It also means helping working families to buy their first home, to send their children to college, and help care for their elderly parents. And, of course, it also means helping families save for retirement, and that means protecting the tax incentives in the Code for retirement savings.

Our focus should be on making sure that when our American families sit down around the dinner table, they can look across at their spouse, or their partner, and their children and know that things are going to be all right. That is not the case in too many homes across the country today, and that needs to be addressed. That is why Democrats are committed to ensuring that middle class tax reform is the true winner in any tax reform proposal. The American people don't believe that massive tax cuts for millionaires and billionaires grow the economy. The American family knows that tax reform that provides middle class tax relief and asks corporations and the wealthiest Americans to pay their share is what will grow our economy.

We will oppose any tax plan that simply helps the rich get richer and does nothing for those who really need our help. And all of us should oppose any tax reform that results in a greater burden on the middle class. The Trump tax plan currently fails to meet this standard, and I hope the administration will move back to the test that was set out by Secretary Mnuchin for tax reform, which he stated, quote, "There will be no absolute tax cut for the upper class."

Furthermore, the tax reform, if it is to be successful, must be done in a responsible manner. To that end, words like dynamic scoring and supply-side economics are thrown around a lot these days. But make no mistake, tax cuts do not pay for themselves and anything to the contrary is a nonstarter.

However, as we consider tax policy and economy-wide effects, I would argue the importance of considering the macroeconomic effects of other policy changes, including an acknowledgment that robust investment in our Nation's infrastructure would have significant growth effects throughout our economy.

I also think that we should think about using the revenue from a deemed repatriation tax to pay for infrastructure and for other productive investment purposes.

In conclusion, we have a unique opportunity to sit down and work together on tax reform. After all, we all agree that the current system is inefficient and underproductive. I stand ready to work in good faith on tax reform with our Republican allies and friends in Congress and also the administration, and only if we do and make the effort to assist the middle class.

Thank you, Mr. Chairman, for calling this hearing. We look forward to calling our witnesses as they join us today. And we look forward to a continued and productive conversation.

Chairman Brady. Thank you, Mr. Neal.

Today's witness panel includes five experts: John Stephens is the senior executive vice president and CEO of AT&T, Inc.; Zach Mottl is the chief alignment officer at Atlas Tool Works, Inc.; David Farr is chairman and CEO of Emerson Electric; Douglas Peterson is president and CEO of S&P Global; and Steven Rattner is chairman of Willett Advisors LLC.

The committee has received your written statements, and they will all be made part of the formal hearing record. We reserve 5 minutes to deliver your oral remarks.

Mr. Stephens, we will begin with you. And, again, welcome. Thank you for being here.

STATEMENT OF JOHN J. STEPHENS, SENIOR EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, AT&T INC.

Mr. Stephens. Thank you, Chairman Brady and Ranking Member Neal. And thank you, members of the committee. I appreciate the opportunity to be in front of you today.

I am John Stephens. I am the chief financial officer of AT&T, and I sincerely appreciate this opportunity to discuss the importance of enacting comprehensive corporate tax reform with you today.

AT&T is a company with a 140-year heritage of research and innovation that includes eight Nobel Prizes and more than 15,000 patents and pending patents worldwide. We employ more than 200,000 people here in the United States. And over the past 5 years, we have invested more in the U.S. economy, than any other public company, right at \$135 billion.

One of the biggest issues facing this country is how to unleash economic growth which has underperformed for the last decade. We can and should do better. The key driver of U.S. economic growth is private sector investment. When investment increases, so does economic activity, hiring and wages. And when more people are working and making more money, they have more money to spend.

However, private sector investment in the U.S., measured as a percentage of GDP, is at its lowest level in generations. It is not surprising that the U.S. economy has been marred in sluggish growth for nearly a decade. If we are serious about robust growth, then we must get serious about jump-starting private sector investment. And the best way to do that is to fix our broken, last-century corporate Tax Code.

Achieving competitive corporate tax rates is likely the most effective catalyst available for public policymakers to increase capital investment, create jobs, and increase wages.

Lowering the corporate tax rate will also make the United States more competitive globally. We can respond to foreign countries that have implemented modern tax policies to aggressively compete for our jobs and our investment.

We have a once-in-a-generation opportunity to comprehensively update the Code for the 21st century and put the U.S. back on top.

First, we need to reduce the top corporate tax rate. This is the quickest, most straightforward way to jump start investment in our country. We will bring our tax system in line with other developed countries. By reducing the rate, simple economics will drive companies to invest more in America rather than elsewhere.

Second, policymakers should allow for the full expensing of capital investments. This is an effective way to quickly stimulate the economy. The tax foundation estimates that this policy change would create the equivalent of one million full-time jobs. One hundred percent immediate expensing removes the negative effects of taxation on investment. And we know it works. Bonus depreciation, a provision with bipartisan support from this committee, allowed accelerated depreciation that positively affected our investment decisions in those years. Plain and simple, we at AT&T invested more under bonus depreciation than we would have otherwise done.

The ability to fully expense investment would do even more to incentivize AT&T and companies throughout the United States to accelerate investment. And more investment directly means more jobs.

We recognize that any comprehensive corporate tax reform will involve tradeoffs. That is clear. But the key word is "comprehensive." Any plan being considered should be judged in totality, not just by a single provision.

For example, one area I know the committee has looked at is eliminating interest expense deductibility. Viewed in isolation, that provision would be extremely problematic for me. But I understand that it may be necessary as part of a broader solution. If the committee plans to eliminate interest deductibility, I would encourage you to utilize reasonable transition rules that do not penalize past choices companies like ours have made under a vastly different tax system. This would not only give companies appropriate time to adjust their capital structures to the new system but also allow them to immediately increase their investment in response to a lower overall tax rate.

STATEMENT OF JOHN STEPHENS

Senior Executive Vice President and Chief Financial Officer

AT&T Inc.

Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

United States House of Representatives, Committee on Ways and Means

May 18, 2017

Thank you, Chairman Brady and Ranking Member Neal, Members of the Committee.

I am John Stephens, Chief Financial Officer of AT&T, and I appreciate the opportunity to discuss the importance of enacting corporate tax reform with you today.

AT&T is a company with a 140-year heritage of innovation that includes 8 Nobel Prizes and more than 15,000 patents and pending patents worldwide. We employ more than 200,000 people in the United States, and over the past five years, we've invested more in the U.S. than any other public company — nearly \$135 billion.

One of the biggest issues facing the country is how to unleash economic growth, which has underperformed for the last decade. We can and should do better.

The key driver of US-economic growth is private-sector investment. When investment increases, so does economic activity and hiring. And when more people are working, they have more money to spend. However, private-sector investment in the U.S., measured as a percentage

of the nation's Gross Domestic Product, is at its lowest in generations.¹ It is not surprising then that the U.S. economy has been mired in sluggish growth for nearly a decade.

If we're serious about robust growth, then we must get serious about jump-starting private sector investment. And the best way to do that is to fix our broken, last-century corporate tax code. Achieving competitive corporate tax rates is likely the most effective catalyst available to our public policy makers to increase capital investment and create jobs.

The current tax code

Our current tax code is outdated. It has been over 30 years since major tax reform was enacted. As a result, our 20th century tax code fails to reflect the realities of today's 21st century global and internet-focused economy. We no longer live in a world where the U.S. can set a corporate tax rate without considering what our international competition looks like. Countries are vigorously competing against each other to attract investment and jobs, but the U.S. has done little to retain its competitive advantage. When tax reform was passed in 1986, we were competitive with other OECD countries, but over the last 30 years, tax rates in other countries have moved from about 35% to about 20%. This puts the U.S. at a real disadvantage. We thereby have saddled our economy with the highest corporate tax rate in the developed world, which is exacerbated by our system that taxes companies in the U.S. on their worldwide income.²

¹ Restoring Investment in America's Economy, Robert D. Atkinson, Information Technology and Innovation Foundation, June 2016.

² Tax Foundation, "The U.S. Has the Highest Corporate Income Tax Rate in the OECD," January 27, 2014.

Lowering the corporate tax rate will make the United States more competitive globally. We can respond to foreign countries that have implemented modern tax policies to aggressively compete for jobs and investment. Tax reform will also propel domestic investment and job creation by businesses of all sizes. Reform would increase productivity and GDP, which was just 1.6 percent in 2016³ and 0.7 percent in the first quarter of 2017.⁴

Our current tax system also harms workers; they bear up to 75% of the corporate tax burden through lower wages.⁵ And a study commissioned by the Business Roundtable estimates that over a 10-year period a 10-percentage point reduction in the corporate tax rate would have reduced the number of U.S. companies and subsidiaries sold to foreign acquirers in OECD countries by 1,300.⁶ That represents hundreds of thousands of jobs moved offshore.

With meaningful tax reform, we can expect to see more companies stay in the U.S. rather than relocate to countries with lower tax rates. A lower corporate tax rate would give companies less incentive to execute these inversions. It would also reduce the risk of foreign companies taking control of American companies.

³ Bureau of Economic Analysis, U.S. Department of Commerce, “National Income and Product Accounts, Gross Domestic Product: Fourth Quarter and Annual 2016 (Third Estimate), Corporate Profits: Fourth Quarter and Annual 2016,” March 30, 2017.

⁴ Bureau of Economic Analysis, U.S. Department of Commerce, “National Income and Product Accounts, Gross Domestic Product: First Quarter 2017 (Advance Estimate),” April 28, 2017.

⁵ The Business Roundtable, “Tax Reform: Advancing America in the Global Economy,” October 2015, page 6.

⁶ EY, “Buying and Selling: Cross-border mergers and acquisitions and the US corporate income tax,” prepared for the Business Roundtable, March 2015, page 18.

Elements of tax reform

We have a once in a generation opportunity to comprehensively update the code for the 21st century and put the U.S. back on top.

First, we need to reduce the top corporate rate. This is the quickest, most straight forward way to jumpstart investment in our country. It will bring our tax system in line with other developed countries. By reducing the rate, simple economics will drive companies to invest in America rather than overseas.

Second, policy makers should allow for full expensing of capital investments. This is an effective way to quickly stimulate the economy.⁷ The Tax Foundation estimates this policy change would create the equivalent of 1 million full-time jobs.⁸

Rather than providing industry-specific tax credits or grants that can be cumbersome to administer and allow policy-makers to pick winners and losers, 100% immediate expensing removes the negative effects of taxation on investment. And we know it works. Bonus depreciation, a provision with bipartisan support from this Committee, allowed accelerated depreciation that positively affected our investment decisions in those years. Plain and simple, we invested more under bonus depreciation than we otherwise would have. The ability to fully expense investment would do even more to incentivize AT&T — and companies throughout the United States —to accelerate investment. And more investment results in more jobs.

⁷ Tax Foundation, “Why Full Expensing Encourages More Investment Than a Corporate Rate Cut,” May 3, 2017.

⁸ Tax Foundation, “Options for Reforming America’s Tax Code,” 2016, page 77.

We recognize that any comprehensive corporate tax reform will involve trade-offs. But the key word is “comprehensive.” Any plan being considered should be judged in totality, not just by a single provision. For example, one area I know the Committee has looked at is eliminating interest deductibility. Viewed in isolation that provision would be extremely problematic, but I understand that it may be necessary as part of a broader solution. If the Committee plans to eliminate interest deductibility, I would encourage you to utilize reasonable transition rules that do not penalize past choices companies made under a vastly different tax system. This would not only give companies appropriate time to adjust their capital structures to the new system, but also allow them to immediately increase their investment in response to the lower overall tax rate.

I’d encourage all companies and interested parties to join the conversation so that you, our legislators, hear all sides to this important debate. With open dialogue, we can find a comprehensive solution that works.

The results of corporate tax reform

We are confident that these reforms will encourage businesses to step up their capital investment plans. In fact, the Business Roundtable, an association of CEOs of leading U.S. companies, recently released the results of a survey of its CEO members on the topic of corporate tax reform. The results make it abundantly clear that businesses are ready to step up their investment and hiring in the U.S. if Congress enacts comprehensive tax reform. That will have a demonstrable positive impact on the overall pace of economic growth.

According to the survey, a significant majority — 71% — of Business Roundtable CEOs believe that tax reform is the single most effective action Congress can take to accelerate economic

growth over the next year.⁹ The CEOs overwhelmingly agree that successful tax reform will lead to more jobs. Seventy-six percent of the respondents said they would increase hiring if the United States tax system is reformed.¹⁰ And 82% said they would increase capital spending, making investments that lead to even more hiring and broader economic growth.¹¹ This is an important ripple effect that will magnify the positive impact of tax reform.

The CEOs also see significant negative consequences of inaction. Roughly 90% of respondents said that delaying tax reform for an extended period will lead to lower rates of hiring, growth and investment.¹² Another 57% said that they would delay capital spending, the investment that drives jobs and growth, if tax reform is delayed.¹³ And 56% said they would delay hiring.¹⁴

I can tell you what tax reform would mean for AT&T. A lower corporate tax rate would give us an incentive to step up our investment in technology and next-generation networks. We could rethink the pace of our fiber and wireless build outs, including our buildouts of next generation broadband networks that will fuel the exploding “Internet of Things.” Over the past five years, no other public company has invested more in this country than AT&T, and with comprehensive tax reform, the levels of investment can go even higher.

And tax reform will generate economic growth. Companies throughout the U.S. would likely see an increase in revenues. As those companies become more open to new investment, we

⁹ Business Roundtable, “New CEO Survey: Tax Reform Will Lead to More Jobs and U.S. Investment,” May 4, 2017.

¹⁰ Id.

¹¹ Id.

¹² Id.

¹³ Id.

¹⁴ Id.

would expect to see an increase in their spend with their vendors, including AT&T. This is the most exciting aspect of tax reform; it will give us the opportunity to grow our top line.

And with investment and increased revenues come jobs. We already employ more than 200,000 people in the United States. And we're the nation's largest private employer of full-time union employees. A significant uptick in investment accompanied by more business from other U.S. companies would require that we employ people in new jobs. And, not only that, our vendors and contractors would also need to increase their hiring. Again, that's the important effect of investment — it spurs additional investment throughout the economy.

That is why the biggest beneficiary of tax reform — and the growth it will stimulate — is the American worker. An expanding economy increases demand for labor and pushes wages higher. Economists project that even a modest modernization of the tax code would raise American wages by 3.8 percent or more over 10 years.¹⁵ And it would grow GDP by 2.2 percent over 10 years.¹⁶

¹⁵ The Business Roundtable, "Tax Reform: Advancing America in the Global Economy," October 2015, page 9.

¹⁶ Id.

We will have failed American businesses and American workers if we let this opportunity slip by. I look forward to continuing this important dialogue and continuing to move us toward meaningful tax reform. I welcome your questions.

Thank you again Mr. Chairman for this opportunity.

Chairman Brady. Mr. Stephens, thank you for your testimony. Five minutes always goes faster than it appears on paper. So we will return during the questioning period for you.

Again, thank you for being here.

Mr. Mottl, you are next up. Thank you, again, for being a witness.

STATEMENT OF ZACHARY MOTTL, CHIEF ALIGNMENT OFFICER, ATLAS TOOL WORKS, INC.

Mr. Mottl. Mr. Chairman and members of the committee, my name is Zach Mottl. I am the chief alignment officer for Atlas Tool Works, a fourth-generation, family-owned, small manufacturer in Lyons, Illinois. I am here today representing not only my own company but also the 750 manufacturers who are members of the Technology and Manufacturing Association, TMA, in Illinois. These manufacturers, many in Congressman Roskam's district, are proud to provide good-paying jobs and careers to about 30,000 people in the Chicago area. Most are like mine, small- to medium-sized supply chain companies that have survived NAFTA, weathered the China tide, and managed through the Great Recession.

Through innovation, modernization, and cost control, we now produce more product than we did 20 years ago. Plus, we are poised to take advantage of the well-earned opportunity for reshoring. We are successfully competing against the best the world has to offer, and we are proud to help manufacture the wealth of America.

However, in order to continue our success and grow while creating more good-paying jobs for Americans, we need your help. I am here today to testify in support of your work to comprehensively reform the U.S. Tax Code. I believe this is the best and fastest way to grow the U.S. economy and create more jobs in America.

I would like to highlight two things: the opportunity for trade competitiveness through tax reform and the unique pain felt by small manufacturers due to excessive complexity and unfair treatment under the current Code. Today, the most difficult barrier to growth American manufacturers face is our self-inflicted Tax Code. Much of it, written decades ago, fails to account for today's internationally competitive environment.

I understand that many are going to argue for simply reducing the current rates. And this might be helpful in the short run, but I believe our economy and our citizens need and deserve permanent comprehensive reform that also improves America's trade competitiveness. That is why the manufacturers I represent are so pleased that this committee has placed border adjustability at the center of its tax reform efforts. Nearly every one of our trading partners currently use border adjustable consumption taxes, BATs, in the form of value added taxes, VATs, or good and services taxes, GSTs. These average 17 percent globally, and they act as tariff and subsidy replacements.

Most European Union nations have VAT rates between 17 and 22 percent, and every American exporter into the EU has to pay those rates to sell their product there.

Now when Mexico agreed to NAFTA, they abolished most of their tariffs. But, instead, they raised the Mexican VAT to 15 percent. So they basically built a new tax wall for American products.

India, it is now in the process of adopting a goods and services tax.

Furthermore, any country that wants to mimic a currency devaluation can increase their VAT and use the proceeds to reduce other domestic taxes.

In reality, I believe tax policy and trade policy, they go hand in hand. And I believe that tax policy has far greater effect on trade than any trade agreement ever could. Good tax policy, one that encourages domestic production and exports is, in effect, good trade policy. Moreover, it is unilateral. We don't need to negotiate with anyone. We don't need to ask permission from any international trade body, and we don't need to risk sparking a trade war.

Remember, every one of our trading partners has already some type of a BAT system. So we simply need to change our tax laws and immediately American producers regain their edge, and the working men and women can get a tax break. In short, I want to get back to a world where American producers compete and win on price, quality, and service.

The second point I want to highlight today is the importance of simplifying the Tax Code and reducing the overall rate.

My company, it is like many small manufacturing businesses in America. We are often family owned. We usually own our own real estate, and we do not

have a significant staff of tax experts. We work hard to be competitive, create jobs, and pay our fair share.

Consider that small businesses have provided some of the fastest employment and output growth in the United States, but we receive some of the worst tax treatment under the Code. Usually, smaller manufacturers are paying the highest rates because we do not have the resources to develop a globally comprehensive tax avoidance plan. That is why I believe we must reduce the overall rate, offer a reduction in payroll taxes, and fund these reductions through BATs.

It is also important to simplify the Tax Code and avoid disadvantaging small businesses, subchapter S and LLCs. These types report the taxes on the owners' personal tax reform. The calculations, they are excessively complicated.

My own family business, which together employ about 80 people, have three different tax structures: one C corp, two S corps, and one LLC to hold the real estate.

TMA member companies like mine and tens of thousands of others throughout the United States, we are not looking for a handout or an unfair advantage. What we are hoping for is a level playing field from our Tax Code and the opportunity to earn our prosperity by, again, competing on price, quality, and service.

All we are asking for from Congress is a permanent Tax Code that drastically improves our competitiveness through a move toward a more simplified and reduced tax system that places the emphasis on a border adjustable component. This reform will provide a level playing field so that we can dramatically increase good-paying American jobs and grow the American economy at a rate we have not seen in decades.

Thank you for the opportunity to provide this input. I look forward to your questions.

05/18/2017

**US House of Representatives; Committee on Ways and Means
Hearing on How Tax Reform Will Grow Our Economy and Create Jobs Across
America**

Written Testimony of: **Zachary Mottl**

Mr. Chairman and members of the committee, my name is Zach Mottl. I am the Chief Alignment officer for Atlas Tool Works, a fourth-generation family-owned small manufacturer located in Lyons, Illinois.

I am here today representing not only my own company, but also the more than 750 manufacturers who are members of the Technology and Manufacturing Association (TMA) in Illinois.

These manufacturers, many in Congressman Roskam's district, are proud to provide good paying jobs and careers to about 30,000 individuals in the greater Chicago Metropolitan area. The members of TMA are small-to-medium sized supply chain manufacturers that have survived NAFTA, weathered the China tide, and managed through the great recession. Through innovation, modernization, and cost control, these manufacturers and others like them throughout our country, now produce more product than we did 20 years ago. Plus, we're poised to take advantage of the well-earned opportunity for re-shoring. American manufacturers are successfully competing against the best that Europe, Asia, and the world has to offer. We are proud to help manufacture the wealth of America.

However, in order to continue our success and grow our manufacturing industry while creating more good paying jobs for Americans, we need your help. I am here today to testify in support of your work to comprehensively reform the U.S. Tax Code. I believe this is the best and fastest way to grow the US economy and create more jobs in America.

I want to highlight two things: the opportunity for trade competitiveness through tax reform and the unique pain felt by small manufacturers due to excessive complexity and unfair treatment under the current tax code.

Today, the most difficult barrier to growth American manufacturers face is our self-inflicted tax code. Much of it was written decades ago, and it fails to account for today's internationally competitive environment. I realize this will be hard and contentious work. Manufacturers understand that there will be those who argue for simply reducing current tax rates. While a reduction in tax rates may be helpful in the short run, I believe our economy and our citizens need and deserve permanent, comprehensive tax reform that also improves America's trade competitiveness. That is why the manufacturers I represent are so pleased that this committee has placed border adjustability at the center of its tax reform efforts so we can neutralize the border tax problems imposed on us by other countries and reclaim our competitive edge in international trade.

Currently nearly every one of our international trading partners use "Border Adjustable" consumption tax systems (BATs), in the form of value added taxes (VATs) or goods and services taxes (GSTs), averaging 17% globally which act as tariff and subsidy replacements.

A VAT is a consumption tax that is applied to companies at every stage of the production process, instead of just at the final sale like an American state sales tax. The big advantage of a VAT is that it is imposed on all imports and generally rebated on exports. Other domestic taxes, like income taxes, must

be reduced to gain the trade advantage offered by any BAT regardless of the form, either a VAT or GST, but the income generated by BATs allow the taxing regime to shift towards more border adjustability while reducing other taxes.

Most European Union nations have VAT rates between 17% and 22%. Every American exporter into an EU nation must pay those VAT rates to sell their product there. When Mexico agreed to the NAFTA and abolished most tariffs charged on U.S. goods, it raised the Mexican VAT rate to 15%, thus erecting a new tax “wall” so to speak against American goods. Under the leadership of prime minister Narendra Modi, India is now in the process of adopting a nationwide GST tax.

Furthermore, a country can mimic a currency devaluation by increasing its VAT and using the proceeds to reduce other domestic taxes. Domestic producers and consumers receive no net tax increase. Exports are cheaper due to the VAT rebate combined with the domestic tax cuts. Imports are more expensive because the VAT is applied with no offsetting domestic tax reduction for foreign suppliers.

Looking at the mechanics of these BATs combined with the understanding that over 150 of our trading partners use them, it's clear that the US is out of alignment with the rest of the world when it comes to globally competitive taxation schemes. What I mean is that most other countries have lowered tariffs, often times through trade agreements, but then replaced those tariffs by combining a border adjustable consumption tax increase with a cut in non-border adjustable, usually income, taxes while maintaining similar overall tax revenue. The shift from non-border adjustable to border adjustable taxes is their strategic secret, one that the U.S. government has not, in the past, figured out. The effect has been a major impediment to retaining and growing more manufacturing jobs in the USA and has resulted in the disenfranchisement of main street America on trade.

In reality, tax policy and trade policy go hand in hand and I believe that tax policy has far greater effect on trade than any trade agreement ever could. Good tax policy, one that encourages domestic production and exports, is in effect good trade policy. Moreover, it is unilateral, meaning we don't need to negotiate with anyone, ask permission from any international bodies, or risk sparking a trade war. Remember, nearly every one of our trading partners already has some type of a BAT system. We simply change our tax laws and immediately American producers regain their advantage in the global economy.

More specifically, creating a U.S. goods and services tax at perhaps 12%-15% while using the proceeds to fund the elimination of the payroll tax burden and reducing overall tax rates would be revenue neutral domestically but would cause a tremendous boost to our trade competitiveness. US labor costs would be reduced, workers would get an immediate raise, and the price of goods and services would be largely unaffected. In short, I want to get back to a world where American producers compete, and win, on price, quality and service, rather than tax regimes.

Besides the importance of border adjustability to tax reform, the second point I want to highlight is the importance of simplifying the tax code and reducing the overall tax rate.

My company is very similar to the other 750 TMA member companies in that we are all small businesses, we are all manufacturers, and we are often family owned. Usually we own our own real estate, and we do not have a significant staff of tax accountants or tax attorneys to help us. We work hard to be competitive, to create jobs, to do the right thing, and pay our fair share. However, what exactly is our fair share is not clear.

Consider, for example, that smaller businesses have provided some of the fastest employment and output growth for the United States, yet receive some of the worst tax treatment under the current code. As a result, smaller American businesses pay some of the highest income taxes in the world. According to BLS and Census data, 98 percent of America's manufacturing firms are small. More than one in three Americans who work in the manufacturing sector are employed by a business which employs fewer than 500. In addition, most large manufacturing companies in the United States rely on small and medium-sized manufacturers as essential suppliers. However, the current U.S. nominal corporate tax rates are the highest in the developed world, higher than any other OECD member state. The OECD non-U.S. average rate is 25 percent, and is forecast to fall to 24.2 percent this year based on already enacted reductions, compared to the U.S. 35 percent nominal rate.

I support the Committee's focus upon destination based business taxes. A destination based profit tax, through sales factor apportionment, should be considered in addition to a destination based cash flow tax. Sales factor apportionment, already in use by the states, would largely eliminate base erosion through profit shifting to tax havens because income is attributed to the tax jurisdiction where the final sale occurred. This would broaden the tax base by as much as 30% thereby enabling lower rates for all businesses. The rates could be applied across all business types.

In addition, oftentimes, tax issues affect manufacturers of different sizes in different ways, usually smaller manufacturers, like the TMA member companies, are the only companies paying a higher tax rate because we do not have the staff or the resources to develop a comprehensive global tax avoidance plan like our larger peers who actually pay far less in taxes that we do. That is why I believe we must reduce the overall rate, offer a reduction in payroll taxes, and fund these reductions through BATs to avoid an unsustainable loss of government revenue.

Additionally, it is important to simplify the required computations in order to avoid disadvantaging Subchapter S and LLC businesses, many of which are small businesses. Subchapter S and LLC businesses, both large and small, report taxes on the owner's or member's personal income taxes and the calculations are excessively complicated. My own family businesses, which together employ about 80 people, have 3 different tax structures. One is a C corp, two are S corps, and one is an LLC.

All of this is ridiculously complicated, given our small size. However, at the time each entity was set up, it made sense to do it this way and there was a valid reason. Now, as we have grown and laws have changed, this messy structure has become a burden. My family would like to transfer ownership to the next generation and, with the help of my sisters, become a woman owned business. However, because of the tax implications we are stuck and cannot do this prudent planning. We can't even move our fiscal year end so that all the companies share the same year end without triggering a massive tax liability. I'm sure if I was a much larger business with a staff specialized in this, we could perhaps figure out a way. Instead, we must deal with our situation and hope and pray that comprehensive tax reform, simplifying this whole mess, will occur sooner rather than later.

TMA member companies, and tens of thousands of others like them throughout the United States are not looking for a hand out, or an unfair advantage. What we are hoping for is a level playing field from our U.S. Tax Code, and the opportunity to earn our prosperity by winning on price, quality and service. U.S. manufacturers are proud of our workforce, we are proud to lead the world in productivity, innovation and quality, and we will continue to innovate and control costs. All we are asking from Congress is a permanent tax code that drastically improves our competitiveness through a move toward

a more simplified and reduced tax system that places emphasis on a border adjustable tax component. This reform will provide a level playing field so that we can dramatically increase good paying American jobs and grow the American economy at a rate we have not seen in decades. Thank you for the opportunity to provide this input. I look forward to your questions.

Chairman Brady. Thank you, Mr. Mottl.

Mr. Farr, you are recognized. And welcome.

STATEMENT OF DAVID N. FARR, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, EMERSON ELECTRIC CO.

Mr. Farr. Thank you very much.

Good morning, Chairman Brady, Ranking Member Neal, and distinguished members of the Committee. Thank you for the opportunity to appear before you on this critical U.S. economic growth issue.

My name is David Farr. I am chairman and CEO of Emerson in St. Louis, Missouri. I serve as the current chairman of the National Association of Manufacturers, NAM, Board of Directors.

Emerson is a \$15 billion manufacturing company providing innovative products, solutions in industrial, commercial, and residential markets. And we have over 80,000 people and operations in more than 150 countries. The NAM, the Nation's largest industrial trade association, is committed to a policy agenda that helps manufacturers grow and create jobs. We appreciate the current efforts to advance pro-growth and permanent tax reform.

Manufacturers of the United States struggle to compete and win under a tax system with high tax rates and outdated international tax rules and a significant tax compliance burden. We have the best chance in over 30 years to advance significant tax reform and must take full advantage of this opportunity. It will enhance U.S. economic growth.

Since the last major reform in 1986, manufacturers in the U.S. have innovated, but the Tax Code has not. With a combined statutory corporate tax rate that could top 39 percent, manufacturing in the United States faces the highest corporate tax rate among OECD nations. And this is a competitive problem. And top rates for manufacturers organized as passthrough entities can be even higher, and this hurts their investment opportunities.

Over the past 3 years, Emerson paid \$1.8 billion annually in taxes worldwide. More than half of that was paid in the United States. At an average effective tax rate of approximately 32 percent and a marginal tax rate of over 37 percent, Emerson pays real cash taxes here in the United States.

A key NAM objective shared by Emerson is a top Federal tax rate of only 15 percent. We must also lower tax rates for passthrough entities including many smaller companies in the U.S. manufacturing supply chain. Lower rates will make manufacturing more competitive, encourage greater investment in the United States, and promote job creation, and stronger economic growth.

Outdated and cumbersome tax rules for taxing international income represent another major problem. Emerson's business is global. More than 52 percent of our sales in 2016 were outside the United States. As a U.S. company headquartered in St. Louis, Missouri, Emerson typically pays more in taxes on worldwide earnings than our foreign competitors. This is another competitive issue. Most developed countries have territorial systems, and their global companies pay little to no tax when they bring their foreign earnings back home. The United States, on the other hand, has a worldwide system, meaning global U.S. companies, where they do business they pay taxes, as well as in the United States when we bring the earnings back home. This added tax burden is a significant disadvantage when U.S. companies are competing for global business.

To improve U.S. competitiveness, any tax reform plan should include a territorial system similar to those in other countries where our competitors are headquartered. This will increase U.S. jobs, exports, and strengthen U.S.-based suppliers and allow for the flow of capital back to the United States for investment right here in America.

A tax reform plan must encourage long-term capital investment by allowing accelerated depreciation of newly invested assets, one of the most important being the full expensing the first year. Expensing lowers the after-tax cost to capital, can drive increased investment and economic growth along with job growth.

As the head of a global manufacturing company headquartered in St. Louis, Missouri, I strongly support a robust R&D incentive. Continuous research and development is critical to ensuring that the United States remains a leader in global innovation and maintains Americans' competitive advantage in technology.

U.S. manufacturing want the United States to be the best place to compete and manufacture in the world. We want to attract direct foreign investment. A permanent tax reform that reduces the corporate tax rate to 15 percent, provides lower tax rates for passthrough entities, moves to a territorial system, maintains a strong R&D incentive, and includes faster capital cost recovery, will ensure

we achieve this goal and improve our country's competitiveness and ability to grow.

We operate in a fiercely competitive global economy, and we need a fiercely competitive tax system. And we need it now.

Emerson and NAM are committed to working with you to advance this much-needed tax reform as soon as possible.

Mr. Chairman and the committee members, thank you very much for having me here today, and I look forward to the Q&A. Thank you.

**TESTIMONY OF DAVID FARR, CHAIRMAN AND CEO, EMERSON
BEFORE THE U.S. HOUSE COMMITTEE ON WAYS AND MEANS**

Hearing on

“How Tax Reform Will Grow Our Economy and Create Jobs Across America”

MAY 18, 2017

Good morning Chairman Brady, Ranking Member Neal and distinguished members of the committee. Thank you for the opportunity to appear before you and for holding this hearing today on the important subject of tax reform.

My name is David Farr, and I am chairman and CEO of Emerson in St. Louis, Missouri. I also serve as the current chairman of the Board of Directors of the National Association of Manufacturers (NAM). I have been involved in manufacturing my whole life – 36 years with Emerson and over 30 years with my Dad’s career with Corning Glass Works.

Emerson is a \$14.5 billion global manufacturing and technology company founded in the United States 126 years ago. Emerson has over 80,000 employees and operations in more than 150 countries. Emerson provides innovative products and solutions for customers in industrial, commercial and residential markets. Emerson’s Automation Solutions business helps process, hybrid and discrete manufacturers maximize production and protect personnel and the environment while optimizing their energy and operating costs. Emerson’s Commercial and Residential Solutions business helps ensure human comfort and health, protect food quality and safety, advance energy efficiency and create sustainable infrastructure.

Over the past 20 years, Emerson has employed a global approach to ensure that products sold in a country also are manufactured in that region as much as possible for speed and cost. I am proud to say that over 80 percent of products we sell in the United States are

manufactured in the United States – a strategy we mirror across the globe and a crucial element of being a successful U.S. multinational company with deep U.S. roots and commitment.

The National Association of Manufacturers (NAM) is the nation's largest industrial trade association and a voice for more than 12 million men and women who make things in America. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Both the NAM and I very much appreciate your current efforts to advance pro-growth, pro-competitiveness and pro-manufacturing tax reform – it is truly needed to accelerate U.S. economic growth.

Manufacturers like Emerson have been leading the charge for comprehensive tax reform for more than a decade. While we've seen some positive changes, manufacturers and other businesses in the United States still struggle to compete against our international competitors under an outdated tax system that includes very high tax rates for both corporate and pass-through businesses, arcane rules for taxing international income and a significant compliance burden. Tax reform is a critical issue for my company – and all manufacturers – and I believe we have the best chance in more than 30 years to advance permanent pro-growth reform. It is imperative that we take full advantage of this opportunity to improve our global competitiveness and grow the economy and increase U.S. manufacturing jobs.

An NAM study, *A Missed Opportunity: The Economic Cost of Delaying Pro-Growth Tax Reform*, released in 2015, looks at the potential impact of a tax reform plan that includes lower tax rates for businesses, a robust capital cost-recovery system, a strong research and development (R&D) incentive and a territorial tax system. The study concludes that this multipronged reform package would fuel the economy substantially and result in increased jobs and investment. Over a 10-year period, this plan would contribute more than \$12 trillion in GDP,

add more than 6.5 million jobs to the U.S. economy and increase investment by more than \$3.3 trillion – and I believe this strongly as a CEO of a U.S. based manufacturing company.

Emerson and other NAM members are optimistic that Washington will deliver on tax reform this year. The NAM Manufacturers' Outlook Survey for the first quarter of 2017 showed that manufacturers' optimism rose to a new all-time high in the survey's 20-year history. The rising confidence stems in part from the belief that Washington policymakers will act on pro-growth tax reform as well as much-needed regulatory relief and a significant infrastructure package. Indeed, business leaders are cautiously optimistic that pro-growth policies from Washington will allow the country to emerge from the most sluggish expansion seen in the years since the Great Recession.

Lower Tax Rates for Businesses

The last major overhaul of the U.S. tax code was in 1986. Since then, manufacturers in the United States have innovated, expanded and evolved but the U.S. tax code has not kept pace. In fact, manufacturers in the United States now face higher tax rates on business income than their competitors in all relevant competitor nations. With a combined (federal and state) top statutory corporate tax rate that could exceed 39 percent, manufacturers in the United States face the highest corporate statutory tax rate among the 35 industrialized nations of the Organisation for Economic Co-operation and Development (OECD), far higher than the average OECD statutory tax rate of 23.75 percent.

Meanwhile, top statutory tax rates for some manufacturers organized as pass-throughs are even higher – in some cases, more than 40 percent.

Emerson is a large U.S. taxpayer. Over the past three years, we paid an average \$1.8 billion annually in taxes worldwide. Of that, more than half (approximately \$1 billion) was paid in

the United States at an average effective tax rate of approximately 32 percent and with a marginal rate on each additional dollar of income we may earn of over 37 percent. These high marginal and effective tax rates, and the impact they have on our global competitiveness and ability to grow, invest and create jobs in the United States, are one of the major reasons that Emerson is so engaged in the tax reform debate – we need it to compete and win every day.

A key NAM objective in tax reform, which is shared by Emerson, is to create a national tax climate that enhances the global competitiveness of our nation's manufacturers and encourages investment and job creation in the United States. An important step to achieving this goal is to adopt a top federal statutory corporate tax rate of 15 percent, which would make our nation's manufacturers much more competitive in the global marketplace, encourage greater investment in the United States and promote U.S. job creation and overall economic growth.

Similarly, we also must lower the tax rate for the two-thirds of manufacturers that currently pay taxes at individual tax rates as pass-through entities. Indeed, pass-through companies are the most common business form in the United States and include many companies in the manufacturing supply chain as well as customers of manufacturers like Emerson.

For more than 60 years, many manufacturers and other business owners have chosen to organize as S corporations or other pass-through entities to benefit from comprehensive liability protection and a single level of federal taxation. Since pass-through business income currently is taxed at individual tax rates, many pass-through manufacturers today pay marginal tax rates upward of 44 percent, when you take into account federal, state and local taxes. A lower tax rate for pass-throughs will allow these business owners to stay competitive, reinvest at

greater levels in their business and retain and create jobs and support large corporations like Emerson.

Modernizing International Tax Rules

Outdated rules for taxing international income represent another major problem with the current tax code. Emerson's business is global. More than 52 percent of our sales in 2016 were outside the United States, and most of our major competitors are domiciled abroad. Since Emerson is headquartered in St. Louis, the company pays more in taxes on worldwide earnings than our foreign competitors. This makes it harder for Emerson to compete in the global marketplace and also means we are prone to being outbid by our foreign competitors for acquisition targets due to their much lower tax rate and bills.

Despite the benefits of global competitiveness to the U.S. economy, our nation's tax laws clearly make it more difficult for global U.S. companies to thrive and compete in the worldwide marketplace. Most developed countries have territorial tax systems that enable their resident multinational companies to pay little or no additional "home country" tax when they bring back foreign earnings as a dividend to the parent corporation allowing them more funds to invest locally. In contrast, the United States has a worldwide system that taxes income regardless of where it is earned. Thus, global U.S. companies like Emerson generally are subject to taxes in the foreign countries where they are doing business and in the United States when they bring foreign earnings back home.

This added tax burden on global U.S. companies represents a significant disadvantage when U.S. companies are competing for business in a global marketplace. When U.S. companies cannot compete effectively abroad, where 95 percent of the world's consumers are

located, the U.S. economy suffers from the loss of both foreign market share and the significant U.S. based jobs that support foreign operations.

Thus, any tax reform plan should include a modern territorial international tax system. Territorial systems are now the international norm. Almost all our large trading partners have territorial systems that tax income earned within their borders but do not tax foreign profits that are repatriated back into their own economies. Adopting a tax system that is comparable to tax systems in other industrial countries is critical to the ability of manufacturers in the United States to compete in the global marketplace. A territorial tax system will impact jobs at U.S. operations, increase exports from manufacturers in the United States, improve the efficiency of supply chains and make U.S. based manufacturing more competitive and better positioned to win.

In addition, a territorial system would allow for the free flow of capital back to the United States from foreign operations for reinvestment in the domestic economy. The current top federal marginal corporate tax rate of 35 percent, even though it is partially offset by foreign tax credits at lower tax rates imposed outside the United States, often results in a high U.S. tax charge on earnings repatriated from foreign subsidiaries. This additional charge causes what is often referred to as the “lockout effect” preventing foreign earnings from being brought back to the United States and encouraging investments abroad rather than in the United States.

Spurring Investment

Meanwhile, although business investment has been slowly picking up in recent months, investment levels in the United States are not where they should be. It is critical that any tax reform plan encourages the capital investment needed to ensure durable economic growth and job creation increasing U.S. productivity and competitiveness.

One of the most effective ways to spur business investment and make manufacturing in the United States more competitive is through a strong capital cost-recovery system. Recent data released by the Bureau of Economic Analysis reinforces the role that a healthy manufacturing sector plays in strengthening the nation's economy. Manufacturing in the United States is in the midst of a recovery, but for the nation to benefit fully from this resurgence, manufacturers need tax policies that promote increasing investment and allow them to compete in today's global economy.

For example, a robust capital cost-recovery system would have a very positive impact on capital spending and productivity. Indeed, the positive economic impact of expensing capital equipment is well recognized throughout economic literature. The cost of capital to a firm includes three components: the price of capital equipment, the cost of financing the equipment and the tax treatment of the investment. Expensing lowers the after-tax cost of capital and increases the number of profitable projects a firm can undertake, helping to spur investment, productivity and growth.

Manufacturers of all sizes take into account the tax impact of cost-recovery mechanisms on projected cash flows in making investment decisions. For manufacturers large and small, cash flows are managed carefully to support key growth objectives, and cash flow is critical when access to credit is difficult, especially for small and medium-sized manufacturers. Comprehensive business tax reform that includes pro-investment provisions will help drive the increased growth our economy needs.

Encouraging Innovation

As the head of a large global manufacturing and technology company, I know firsthand how important it is that any tax code overhaul maintains a robust R&D incentive to

allow the United States to remain a leader in global innovation. Manufacturers account for more than three-quarters of all private-sector R&D in the United States. The United States has been a leader in promoting R&D for more than 30 years but has slipped behind in recent years as more and more countries have provided more robust R&D incentives – we must regain our global innovation leadership.

A top NAM priority, one that Emerson strongly supports, is to ensure manufacturers in the United States are the world's leading innovators. The tax treatment of R&D, including the current deduction for R&D expenses and a strengthened R&D credit, is critical to achieving this goal. A strong R&D incentive is the only way to keep the United States competitive in the global race for R&D investment dollars. The United States must maintain and expand our innovation leadership.

Conclusion

Emerson and indeed all manufacturers want the United States to be the best place in the world to manufacture and attract foreign direct investment. There is no doubt that the U.S. tax code is a significant negative drag on economic growth and competitiveness. Comprehensive, permanent business tax reform that reduces the corporate tax rate to 15 percent, provides lower rates for pass-through entities, moves to a modern territorial international tax system, maintains a strong R&D incentive, and includes a robust capital cost-recovery system will go a long way to attract this investment and economic growth and our country's competitiveness.

Manufacturers appreciate the magnitude of effort required to reform America's tax code and we are committed to working with you and your staff to advance much-needed reform as soon as possible. Making comprehensive business tax reform a near-term top priority will promote investment in America, enhance the global competitiveness of U.S. manufacturers and

other businesses in the United States and ensure durable economic growth well into the future.

Thank you for inviting me to testify before you today as I am passionate about U.S. manufacturing and making sure the United States wins on the global playing field. I am happy to answer your questions.

Chairman Brady. Thank you, Mr. Farr.

Mr. Peterson, welcome. And you are recognized.

**STATEMENT OF DOUGLAS L. PETERSON, PRESIDENT AND CEO,
S&P GLOBAL INC.**

Mr. Peterson. Thank you.

Good morning. Chairman Brady and Ranking Member Neal, thank you for inviting me to speak. I am grateful for the opportunity to share my perspective on how tax reform can help U.S. companies of all sizes that are competing in the global marketplace.

I am Doug Peterson, president and chief executive officer of S&P Global. Our commitment to transparency, integrity, and superior analytics has been at the forefront of U.S. economic growth since our founding over 150 years ago as a small business. Beginning with the expansion of the Nation's railroad system to the rise of the world's most liquid and resilient capital markets to the growth of digital information technology, S&P Global's essential intelligence has remained independent and guided important decisions throughout U.S. history.

Today, I want to thank the committee for all the work you have been doing to reform the Tax Code.

I offer you my continued support as you move through the legislative process.

My message to you today is twofold.

First, we need to reform the U.S. tax system, including lowering the corporate tax rate, to level the playing field and putting in place a more competitive international system.

Second, we need a permanent, comprehensive fix that will promote investment, innovation and growth in the U.S. economy to support American companies and American workers.

S&P Global competes on an international level. While we have grown significantly since our inception, we have kept most of our intellectual property in the U.S., which means we pay a large majority of our taxes in the U.S. Since the U.S. currently has the highest statutory corporate tax rate among the countries in the OECD, at 35 percent, we have a much higher effective tax rate

than our international competitors. For example, Canada has dropped its corporate rate from 36 percent to 26 percent, and the United Kingdom will have a rate of 17 percent by 2020. In fact, throughout S&P Global's history, we have consistently paid an effective tax rate of over 30 percent. While many of our competitors pay in the low teens, this high rate hurts our ability to compete against companies located in countries where corporate tax rates lower their overall costs.

With a less competitive international system, U.S. companies face an uphill battle. Currently, when foreign companies establish in a country with a territorial tax system to sell goods into the U.S., they pay little, if any, corporate tax here. In addition, foreign companies may pay little to no corporate tax when they return profits home. In contrast, U.S. businesses that sell goods and services to foreign customers are taxed fully in the U.S. And more than \$2.5 trillion in profits from U.S. companies is offshore today, something that doesn't happen under other tax systems.

The basis of our Tax Code was designed after World War II when our economy was geared toward manufacturing and agriculture. The last rewrite, in 1986, occurred before the internet and the information economy, which introduced new innovative business models. The emergence of technology, advanced manufacturing, modern agriculture, the growth of intellectual property, and the globalization of markets, are all new features of our economy. The Tax Code, though, has not evolved with the economy. The result is a highly unfair system that undermines competitiveness. The tax inequities that advantage foreign competitors over their American counterparts can be traced to this antiquated code. It is time for a change. For decades, the United States has been the birthplace of innovation and new business formation. We should use this opportunity for comprehensive, permanent tax reform to ensure it continues to be the engine of growth for small businesses, startups, and other American job creators. Today, we are losing ground, and we should be leading.

I hope Congress will seize this moment and enact substantial changes that will foster investment, growth, and jobs in the U.S.

Thank you for the opportunity to provide this testimony, and I look forward to having a discussion with you today. Thank you very much.

U.S. House of Representatives

Ways and Means Committee Hearing

“How Tax Reform Will Grow Our Economy and Create Jobs”

Testimony of

Douglas L. Peterson

President and Chief Executive Officer

S&P Global

May 18, 2017

Chairman Brady and Ranking Member Neal, thank you for inviting me to speak today. And thank you to the entire Committee for your efforts to modernize the U.S. tax code.

I'm grateful for the opportunity to share my perspective on how tax reform is essential for U.S. companies to better compete in the global marketplace.

S&P Global is the Worldwide Provider of Essential Intelligence

S&P Global is a leading provider of ratings, benchmarks, analytics and data to the capital and commodities markets worldwide.

S&P Global's insights and commitment to transparency, integrity, and superior analytics have been at the forefront of U.S. economic growth since the company's founding over 150 years ago. Beginning with the expansion of our nation's railroad system, to the rise of the world's most liquid and resilient capital markets, to the growth of digital information and technology, S&P Global's essential intelligence has remained independent and has guided important decisions throughout U.S. history.

Two of our flagship products, the S&P 500® and the Dow Jones Industrial Average®, are widely accepted as the leading measures of U.S. equity market performance. Our research, products, and insights offer American investors, their families, coworkers, and friends the critical information needed to make informed financial decisions.

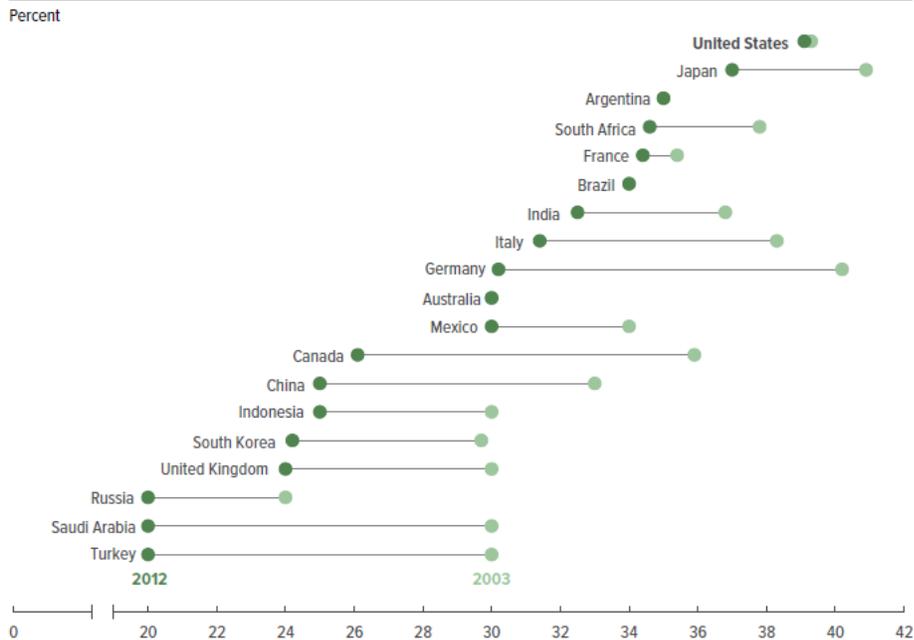
In addition to employing thousands of Americans across our great country, we work extensively with businesses of all sizes to help them invest and grow, as well as state and local governments, to help facilitate investment in schools, roads, bridges, and other public works. There is bipartisan agreement about the challenges facing our country's aging infrastructure, and we hope to continue to bring our data, in-depth analytics, and unique ideas to the table to work with Congress to address those issues.

U.S. Tax System is Uncompetitive Globally

Currently, the U.S. has the highest statutory corporate tax rate among the 35 countries in the OECD. Importantly, other countries are attempting to lure our businesses—and their tax revenues—abroad. A recent Congressional Budget Office (CBO) analysis demonstrates not only the high statutory corporate rate in the U.S., but also the changes that have been made to tax rates in other G20 countries while the U.S. has stayed static. This study, which encompasses the 2003-2012 timeframe, shows how almost every country around the world has been incentivizing corporate investment through lower taxes. For example, during this timeframe, Canada dropped from 36 to 26% and China from 33 to 25%. The United Kingdom will have a 17% corporate tax rate by 2020.

Figure 1

Top Statutory Corporate Income Tax Rates in G20 Countries, 2003 and 2012



Source: Congressional Budget Office, using data from KPMG International and the Organisation for Economic Co-operation and Development.

Rates in Argentina, Australia, and Brazil were the same in 2003 and 2012.

G20 = Group of 20.

Source: CBO International Comparisons of Corporate Income Tax Rates, March 2017

According to our research, the other countries where our competitors domicile their business and intellectual property have significantly lower corporate tax rates compared to the U.S., as seen in the chart below.

Figure 2

	United States	Ireland	U.K.	Singapore
Corporate Tax Rate	35%	12.5%	19% (17% in 2020)	17%
Local income taxes	Yes	No	No	No
VAT/GST	Sales/Use Taxes	23%	20%	7%

S&P Global’s Tax Rate is Twice That of its International Competitors

S&P Global is a U.S.-headquartered company, but, like so many others, we compete at the international level. While we have grown significantly since our beginnings, we have maintained ownership of most of our intellectual property in the U.S. We therefore have a much higher effective tax rate than our international competitors do. In fact, throughout our history, we have consistently paid an effective rate of over 30%, while many of our competitors pay in the low teens. As an example, we paid an effective tax rate of 30.1% in 2016 and \$683 million in taxes. Because our greatest asset is our people, not machines or real estate, we are unable to avail ourselves of deductions and write-offs in a tax code that was written for a different time and a very different economy.

Figure 3

S&P Global Reported Effective Tax Rate

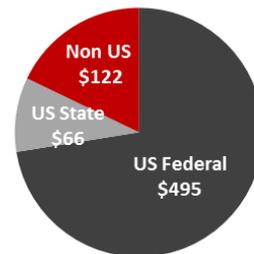
2016	2015
30.1%	30.1%

Figure 4

Cash Income Taxes Paid

2016

\$683 Million Paid



Includes taxes paid on sale of J.D. Power

In 2016, even though 60% of our revenues were domestic, our U.S. tax base was 70% of our income because of our U.S.-based intellectual property. Over the last five years, S&P Global has paid \$1.8 billion in taxes in the U.S.

Figure 5
Domestic vs. Foreign Source Revenues

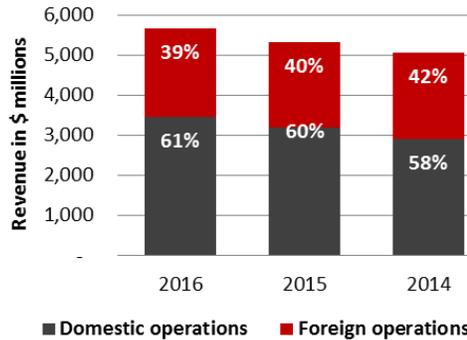
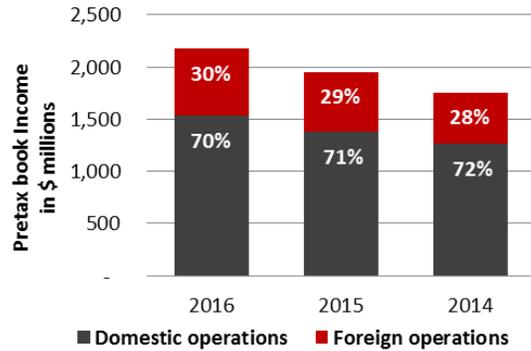


Figure 6
Domestic vs. Foreign Mix of Income



At this unique moment in time, our country has the opportunity to put aside political differences and enact tax reform that not only brings the tax code into the 21st Century, but also ensures that America remains the best place in the world to do business.

It Is Time to Level the Playing Field

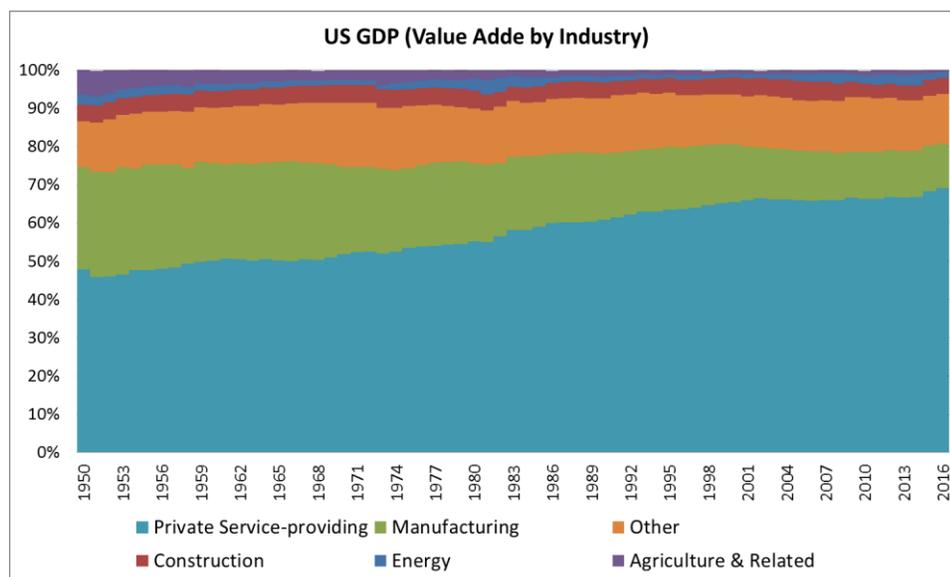
The U.S. federal tax code was last updated over 30 years ago, in 1986. Its structure, however, is rooted in the post-World War II era. We have a markedly different economy today. For example, who could have foreseen the ubiquitous nature of technology in the way we conduct business today? Intellectual property is more important than ever to our global economy. And the pace of technological change is only accelerating.

Figure 7
Evolution of U.S. Economic Activity

US GDP (Value Added by Industry)			
	1950	1986	2016
Private Service-providing	47.9%	60.0%	69.2%
Manufacturing	26.8%	18.1%	11.7%
Other	12.0%	14.3%	12.9%
Agriculture & Related	6.6%	1.6%	0.9%
Construction	4.3%	4.3%	4.2%
Energy	2.6%	1.5%	1.4%

Note: Figures may not add to 100% due to rounding

Figure 8



Source: Bureau of Economic Activity

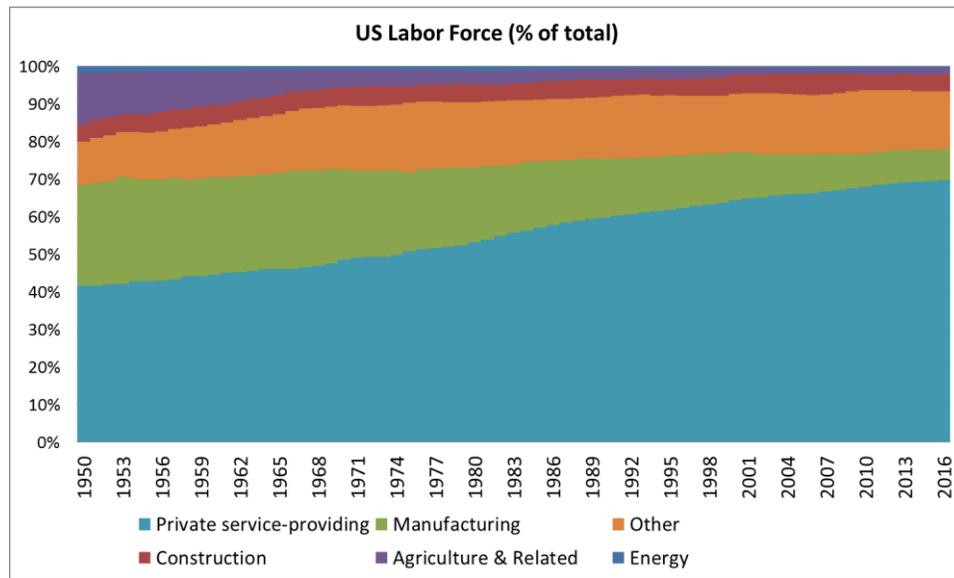
Figure 9
Evolution of U.S. Employment

US Labor Force (% of total)

	1950	1986	2016
Private Service-providing	41.6%	57.8%	69.7%
Manufacturing	26.7%	17.1%	8.4%
Other	11.6%	16.4%	15.1%
Agriculture & Related	13.6%	3.0%	1.6%
Construction	4.5%	4.8%	4.5%
Energy	1.7%	0.8%	0.4%

Note: Figures may not add to 100% due to rounding

Figure 10



Source: Bureau of Labor Statistics, St. Louis FRED, and Census Bureau

We must make adjustments that reflect the growth and development of our dynamic economy in order to keep up with the quickly evolving competitive global market. Three primary elements are critical to help ensure that U.S. companies can better compete in the global marketplace. These include:

Lower Rates

A lower corporate income tax rate must be part of any tax reform plan. Our country's high statutory rate hinders the ability of U.S. companies to successfully compete on the global stage. A lower tax rate would not only help curb the exit of U.S. companies from our great country but would also create a powerful incentive for others to move here.

Competitive International Tax System

A tax reform effort must also result in a level playing field for American companies. Currently, foreign companies established in a country with a territorial tax system that sell goods in the U.S. pay little-to-no corporate tax when the profits return to the home country. In contrast, U.S. businesses that sell goods and services to foreign customers are taxed when their profits are returned to be reinvested in the U.S. This discourages reinvestment of profits generated abroad into the United States, a dynamic that simply doesn't exist for the international competitors of U.S. companies.

This unfair playing field is tilted further against U.S. companies by border-adjusted taxes such as Value Added Taxes (VAT) that have been enacted in more than 130 countries around the world. Foreign companies can sell goods and services from a VAT country into the U.S. without paying VAT in the source country and without any border-adjusted tax upon import to the U.S. In contrast, goods and services produced in the U.S. and sold into a VAT country bear a tax upon importation at rates that can reach 20%.

This does not benefit American businesses, the communities in which they operate, their employees, or their families.

Modernized Tax Code for America's Evolved Economy

Since the tax code was last reformed, the American economy has changed dramatically in terms of the products it makes, the markets it sells into, and the skills it requires. The emergence of technology, the growth of intellectual property, and the globalization of markets are all new features of our economy.

The tax code, though, has not evolved with the economy. The result is a highly unfair system that undermines competitiveness. The tax inequities that now exist between companies, and the inequities that advantage foreign competitors over their American counterparts can be traced to an antiquated code.

It's time for a fresh start to American tax policy—one that levels the playing field for all American firms—and ensures that no firm ("old" economy or "new" economy, manufacturing or service) is disadvantaged when competing.

Restoring Growth and Competitiveness to the U.S. Economy

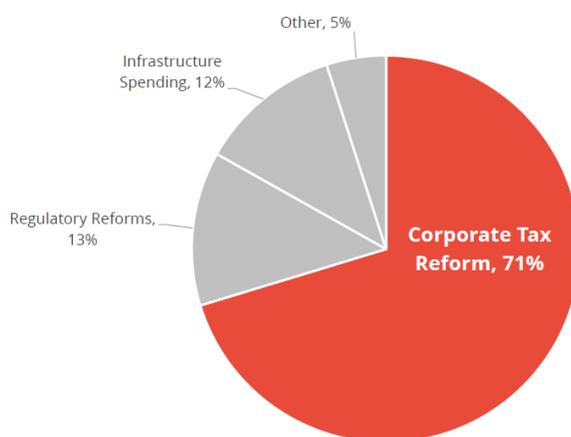
In a recent survey by the Business Roundtable, 71% of CEOs who responded identified tax reform as the best way to accelerate U.S. economic growth. This overwhelming response demonstrates the potential and the importance of reforming our tax code.

Figure 11

CEOs: Tax Reform is the Best Way to Accelerate Growth



Question – The best way to accelerate U.S. economic growth in the next 12 months would be by:



Source: BRT CEO Tax Reform Survey 2017

The U.S. remains a “tax outlier.” Our tax system is antiquated, unfair, and hinders our ability to compete on a global scale. It is time for a change. The current system is stifling our economic growth. We are losing ground at a time when we should be leading. It is incumbent on us to seize this moment and enact substantial changes that will eliminate concerns for businesses about growing, investing and innovating in the U.S.

I hope this Congress will seize this moment.

Thank you for the opportunity to provide this statement at such an important time. I welcome any questions you might have.

Chairman Brady. Thank you, Mr. Peterson.

Mr. Rattner, you are recognized. Again, welcome.

STATEMENT OF STEVEN RATTNER, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, WILLETT ADVISORS LLC

Mr. Rattner. Thank you, Mr. Chairman and Ranking Member Neal for having me here today. I speak as someone who has spent 35 years in the private sector as an investment manager meeting with companies, analyzing companies, investing with companies, as well as having spent time in the Treasury in the early part of the Obama administration. And I would certainly concur with what every single previous speaker has said about the need for comprehensive tax reform after 30 years of neglect.

However, in my opinion, any major tax legislation should meet several important tests. First, it should be deficit neutral given projections for rising fiscal gaps. Second, it should be fair and certainly not diminish the progressivity of our system. Third, it should be growth- and investment-enhancing. Fourth, it should improve our international competitive position.

On that basis, the proposal by the administration falls short in several important respects.

While the President's focus on tax reform is laudatory, his 1-page plan includes far more detail on how the administration would cut taxes than how it would pay for those reductions. Based on the information provided, nonpartisan researchers have estimated that its net cost could be \$5 trillion to \$6 trillion over the next decade. Without adequate offsets, these tax cuts would drive up interest rates, the deficit, and the Federal debt. And I would note that the deficit is already rising again.

These projected deficits would be substantially exacerbated by the Trump plan. Again, before incorporating the administration's plan, the Committee for a Responsible Federal Budget forecasts that the ratio of debt to gross domestic product, already at a historic high of just under 80 percent, would rise sharply and could reach 89 percent by 2027, above every previous high, except for a short period after World War II. The Trump plan would drive this ratio to an astounding 111 percent by 2027 even as we continue to deal with the effects of an aging population.

To counter these concerns, the Trump administration appears to be resurrecting discredited supply-side theory that high deficits resulting from tax cuts don't matter because faster economic growth will quickly close the gap. That is not what happened following the Reagan tax cut of 1981. And by the end of Reagan's tenure, roughly two-thirds of his tax reductions had been reversed. Nor is it our experience following the tax cuts pushed through by President George W. Bush in 2001 and 2003.

To pay for the Trump plan, we would need average growth of 4.5 percent per year. That has not happened on a sustained basis in modern history and is highly implausible in the future given our current aging and productivity trends. For its part, the nonpartisan Congressional Budget Office projects approximately 2 percent growth for the next decade. Treasury Secretary Steven Mnuchin believes that annual growth of 3 percent is attainable from the Trump plan. I know of no independent economist who thinks that is possible. And even if it were, the result would be about \$2 trillion of additional revenues, far short of what is needed.

Second, on fairness: Given the economic strains on middle and working class Americans with which we are all familiar, it is critical that any tax reform plan be focused on helping these Americans. However, the details of the Trump plan unassailably contradict Secretary Mnuchin's assertions that there would be no net tax cut for the rich. The plan includes lowering the top rate on earned income, eliminating a 3.8-percent levy on investment income, and doing away with the estate tax and the alternative minimum tax. Yes, some deductions are to be eliminated, most notably for State and local taxes. But when the Trump administration provides enough information for experts to score the proposal, I have no doubt that the rich will be the big winners.

Gary Cohn, the Director of the National Economic Council, has argued the increase in the standard deduction qualifies Mr. Trump's plan as a middle class tax cut. The problem is that a family of two or more pays less tax under current law than it would under Mr. Trump's plan because of the availability of both the standard deduction and personal exemptions, which Mr. Trump said in the campaign he would end.

Third, regarding growth and investment: While the large tax cuts could be viewed as enhancing short-term growth, the size of Mr. Trump's tax cuts, a lack of progressivity, will quickly overwhelm the positive benefits. Most importantly, rising interest rates will soon squeeze out private investment. The

Tax Policy Center has estimated that his plan would reduce GDP by half a percent after a decade and 4 percent after two.

Fourthly, it should enhance our international competitive position. I would agree that the need for corporate tax reform is without question. While the stated rate for U.S. companies is 39 percent, many pay far less because of the use of avoidance techniques. As a result, the average corporate tax rate is 10 to 15 percent -- 10 to 15 points lower less than the statutory rate. That is unfair to many stakeholders. What should be done is a thorough elimination of abusive practices, such as transfer pricing, in return for lowering of the standard rate to 25 percent, which is in line with the OECDs unweighted average.

I would like, during the questions, to talk more about issues like the trapped cash that were referred to in the earlier comments. But, for the moment, I would close by simply agreeing, again, that a comprehensive tax bill is long overdue. But it needs to be deficit neutral, and it needs to be fairer to the average American as well as reforming our corporate tax system.

Thank you very much.

Steven Rattner
Chairman and Chief Executive Officer, Willett Advisors LLC
Testimony Before House Ways and Means Committee
May 18, 2017

No one can doubt the need for comprehensive tax reform. It has now been more than 30 years our revenue code was last thoroughly overhauled. Since that time, many loopholes and methods of achieving avoidance have crept into the system. And the policies and practices of our global competitors have also evolved, in many cases to our detriment.

However, any major tax legislation should meet several important tests:

- 1) It should be deficit neutral, given projections for rising fiscal gaps
- 2) It should be fair and certainly not diminish the progressivity of our system
- 3) It should be growth and investment enhancing
- 4) It should improve our international competitive position

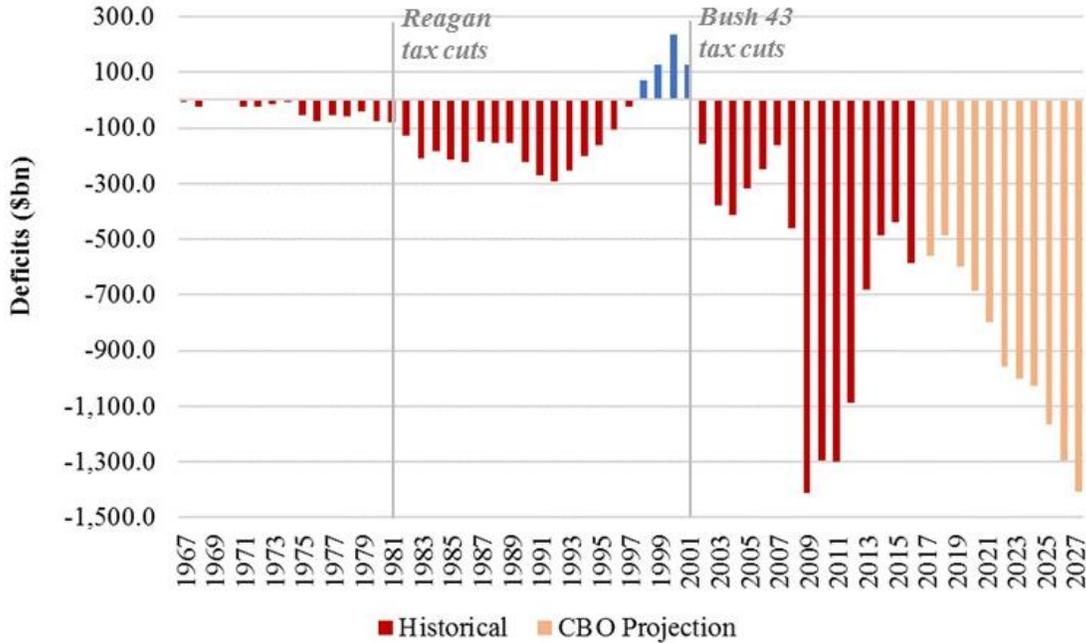
On that basis, the proposal by President Trump falls short in several important respects.

1) It should be deficit neutral, given projections for rising fiscal gaps

While the President's focus on tax reform is laudatory, his one-page plan includes far more detail on how the administration would cut taxes than on how it would pay for those reductions. Based on the information provided, non-partisan researchers have estimated that its net cost could be \$5 trillion to \$6 trillion over the next decade. Without adequate offsets, these tax cuts would drive up interest rates, the deficit and the federal debt.

Even before incorporating the administration's tax proposals, the federal deficit – after having declined dramatically since the financial crisis – is again on the march upward, as a result of entitlement spending and interest costs rising faster than revenues.

Deficits Are Rising

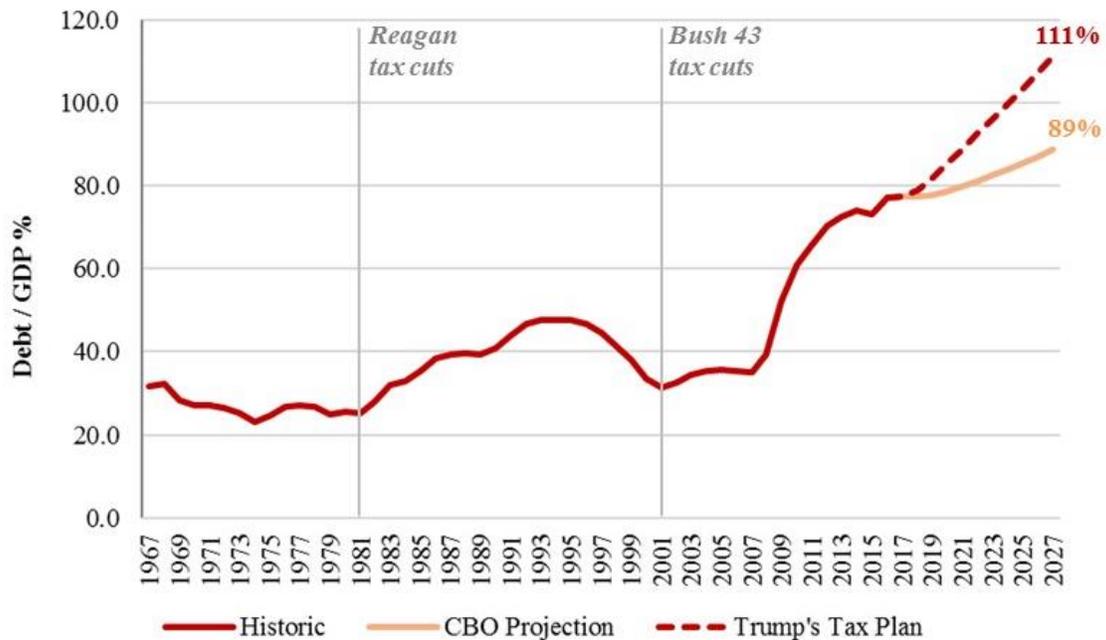


Source: Congressional Budget Office

These projected deficits would be substantially exacerbated by the Trump plan. Again before incorporating the administration's plan, the Committee for a Responsible Federal Budget forecasts that the ratio of debt to Gross Domestic Product – already at an historic high of just under 80% would rise sharply and could reach 89% by 2027, above every previous high except for a short period after World War II.

The Trump plan would drive this ratio to an astounding 111% by 2027, even as we continue to deal with the effects of an aging population.

Debt is Exploding



Source: Congressional Budget Office, Committee for a Responsible Federal Budget

To counter these concerns, the Trump administration and its supporters appear to be resurrecting the discredited supply side theory that high deficits resulting from tax cuts don't matter because faster economic growth will quickly close the gap.

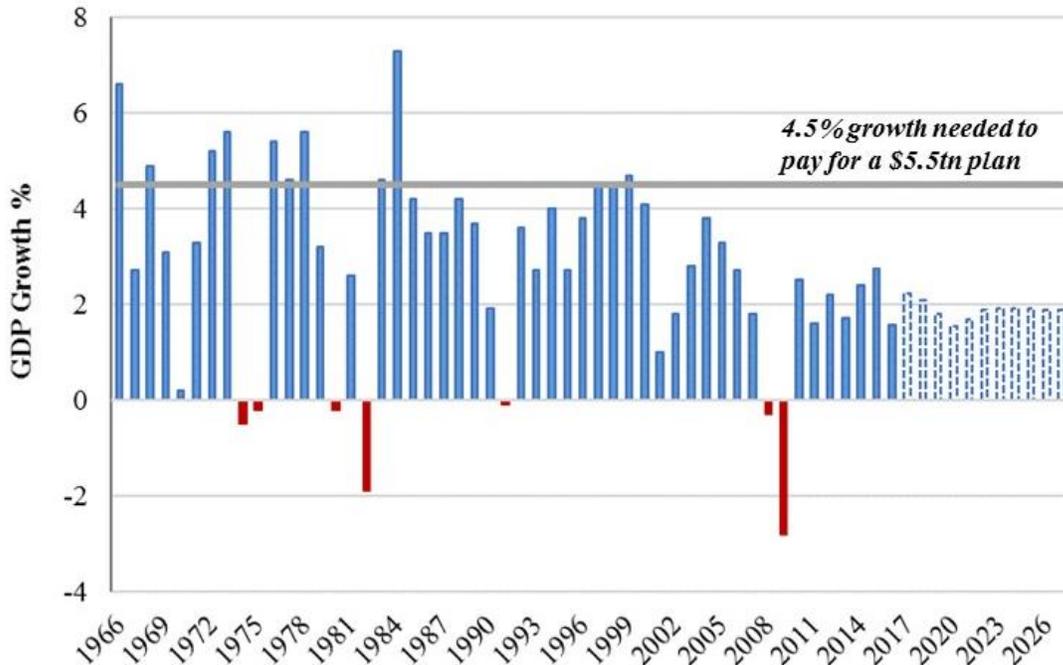
That's not what happened following the Reagan tax cut of 1981 (and by the end of Reagan's tenure, roughly two-thirds of his tax reductions had been reversed). Nor is it our experience following the tax cuts pushed through by President George W. Bush in 2001 and 2003.

To pay for the Trump plan, we would need average growth of 4.5% per year. That hasn't happened on a sustained basis in modern history and is highly implausible in the future given our current aging and productivity trends.

For its part, the non-partisan Congressional Budget Office projects approximately 2% growth for the next decade.

Treasury Secretary Steven Mnuchin believes that annual growth of 3% is attainable from the Trump plan. I know of no independent economist who thinks that is possible. And even if it were, the result would be about \$2 trillion of additional revenues, far short of what is needed.

Trump's Tax Plan Cannot Pay for Itself



Source: Congressional Budget Office, Committee for a Responsible Federal Budget

2) It should be fair and certainly not diminish the progressivity of our system

Given the economic strains on middle and working class Americans with which we are all familiar, it is critical that any tax reform plan be focused on helping these Americans.

However, the details of the Trump plan unassailably contradict Secretary Mnuchin's assertions that there would be no net tax cut for the rich. This includes lowering the top rate on earned income, eliminating a 3.8% levy on investment income, and doing away with the estate tax and the alternative minimum tax.

Yes, some deductions are to be eliminated, most notably for state and local taxes, but when the Trump administration provides enough information for experts to "score" the proposal, I have no doubt that the rich will be the big winners.

Gary Cohn, director of the National Economic Council, has argued that the increase in the standard deduction qualifies Mr. Trump's plan as a "middle-class tax cut."

The problem is that a family of two or more pays less tax under current law than it would under Mr. Trump's plan because of the availability of both a standard deduction and personal exemptions, which Mr. Trump said in the campaign he would end.

3) It should be growth and investment enhancing

While large tax cuts could be viewed as enhancing short-term growth, the size of Mr. Trump's tax cuts and lack of progressivity will quickly overwhelm the positive benefits.

Most importantly, rising interest rates will soon squeeze out private investment. Last year, for example, the Tax Policy Center estimated Mr. Trump's \$6 trillion campaign tax plan would reduce the GDP by 0.5% after a decade and 4% after two.

The lack of progressivity in President Trump's proposal will also affect growth. In 2015, a study on income inequality by the International Monetary Fund found that increasing the income share of the top 20% results in lower growth because of the propensity of the wealthy to save rather than spend. Furthermore, a study by Brookings Institute last year found there is no guarantee tax cuts will increase long-term economic growth.

4) It should enhance our international competitive position

The need for corporate tax reform is without question.

While the stated corporate rate for U.S. companies is 39% (including state and local taxes), many pay far less because of the use of avoidance techniques. As a result, the average corporate tax rate is 10 to 15 points lower than the statutory rate.

That is unfair to many stakeholders. What should be done is a thorough elimination of abusive practices (such as transfer pricing) in return for a lowering of the stated rate to 25%, which is in line with the OECD's unweighted average.

The President's proposal, on the other hand, again goes way too far and gives up too much revenue for too little. His proposal to cut the corporate tax rate from 35% to 15% alone would cost us \$2.2 trillion over the next 10 years.

The administration has proposed extending the corporate rate to the so-called "pass throughs," corporate entities that are taxed as individuals. While I am sympathetic to the goal of having all true business activities pay the same rate, I am not aware of any effective method of avoiding the creation of yet another loophole, the ability of high-income individuals to convert what should be wage income taxed at full ordinary rates into business income that would be taxed at a lower rate.

Three last points on business and investment income taxation:

To ensure deficit neutrality, I would not lower levies on interest, dividends and capital gains as the administration has proposed but would raise them as it is these individuals who will indirectly benefit most from a reduction in corporate tax rates.

In 1986, President Reagan equalized the top marginal and capital gains rates. This prevented the wealthy from getting special treatment and did not cause investment to fall.

The Trump administration also wants to move to a territorial tax system, in line with most other developed countries. There are certainly benefits associated with such a step but it could also inadvertently create more incentives for companies to move offshore. It is a complicated issue that deserves further study.

Finally, much attention has been focused on the \$2.6 trillion of profits earned by American corporations but “trapped” overseas. While we should not be overly optimistic about the economic benefits of repatriation, I would be supportive of allowing repatriation at a modest tax rate if those revenues were used to address our critical infrastructure needs.

Conclusion

As I said at the outset, a comprehensive tax bill is long overdue. However, in my opinion it should be deficit neutral using conventional scoring methodologies. It should focus on reforming and simplifying our excessively complicated system while enhancing our international competitiveness.

Chairman Brady. Thank you, Mr. Rattner.

And we will begin questions.

So, fixing our broken Tax Code only occurs once in a generation. It is important we do this right.

The goals the House Republicans developed for this once-in-a-generation opportunity is, first, rather than a Tax Code designed merely to wring money from you, we already have that one, we want a Tax Code built for growth, literally designed to grow jobs, grow paychecks, and grow the U.S. economy, and, as we are doing that, leapfrog America from nearly dead last among our global competitors into that top three and keep us there. That means designing a Tax Code where our local businesses can compete and win anywhere in the world, especially here at home. And so we are going all in on growing middle class jobs and growing middle class paychecks.

So let's begin with a bipartisan issue. For years, here in this room and back at home, we have heard from our businesses, large and small, about the importance of investing back into their workers and into their future. That is what led us, Republicans, Democrats, together, to support issues like what we call bonus depreciation and section 179, the small business expensing. It is all about rewarding businesses for investing in buildings, equipment, software, and technology.

But we want to go bolder. And, as you know, the House blueprint calls for a shift from an onerous business income tax to a U.S.-based simpler cashflow tax system. And at the heart of that, we would provide for a full and immediate write off of all that new business investment. And that investment, by the way, not only is the key to middle class and Main Street job growth, it is key to making our workers more productive. That is what drives wages. That is what drives America to the lead pack and having the strongest economy on this planet.

So I want to start with our witnesses.

So can you explain how having access to full and immediate write off of your business investment will lead you to invest more in growth and jobs both for you and for customers, for example, and businesses who are making those investments themselves?

Mr. Stephens, we will begin with you.

Mr. Stephens. Thank you, Mr. Chairman.

Very directly, just as it has with bonus depreciation over the last few years for our company, we would invest more with immediate expensing. We would take the dollars saved on that tax return and invest those in more capital. When we do that, we invest in research, we invest in technology, we invest in productivity. For us, that means building out more broadband. For us, that means building out more fiber optics. Those provide jobs: not only the engineers who design and the researchers who develop those new 5G-type systems, but our proud employees who actually construct those and who build those and who maintain those. And so they are going to have better jobs. They are going to have higher wages. And, therefore, the entire ecosystem is going to be better off.

I will also tell you it will have a direct impact on our property tax liabilities. So the State and local and county governments will get more revenues because we do pay property taxes --

Chairman Brady. Yes, sir.

Mr. Stephens. -- sales taxes on all that investment. So it is a virtual cycle of economic growth that comes out of additional business fixed investments.

Chairman Brady. Does it also make your customers -- many are small businesses and other businesses -- you know, buying this technology, really upgrading your equipment, your computers, all your technology can be expensive. So being able to write that off immediately, does that help small businesses be able to invest more in the types of technologies you are offering?

Mr. Stephens. Certainly. You know, many of our vendors, many of the people in our supply chain are small businesses. Many of them are diverse businesses. So they would be immediately helped. It would help them generate the business. And, you know, from a perspective of being what I think most would consider a large business, small businesses are some of our best, most wonderful customers. We want small business in this country to succeed. It is good for the demand on our services.

Chairman Brady. Absolutely.

Mr. Stephens. So this is a complimentary situation, not one that is in different views. We want small business to have that opportunity to succeed in this environment.

Chairman Brady. Thank you.

And so that leads to the family-owned business, who both invests in your plant, but customers were buying your products as well.

Mr. Mottl, from your standpoint, the ability to write off those new investments going forward both for you and your customers, what is that impact?

Mr. Mottl. Well, that is really important for us, Mr. Chairman. Since 2015, my company has invested \$3.5 million in new equipment and new plant. Right now, we are doubling the size of our plant, putting on an addition right now. All of those types of things, immediately expensing them, that would really help us. You know, for our sales, our sales are just under \$10 million. So, from a perspective of a percentage-wise, we are really investing in the future; we believe in it. And I think that an accelerated depreciation would certainly help us continue to do that.

Chairman Brady. Thank you, Mr. Mottl.

Mr. Farr, manufacturing, if you want to stay competitive, you got to reinvest all the time in your business.

Mr. Farr. Right.

Chairman Brady. It is expensive. And your customers are reinvesting; they are buying those products. So how, for the first time in history, all businesses of all sizes immediately being able to write off from their taxes that business expense, what impact does that have?

Mr. Farr. It has a significant impact on our returns, obviously drives a higher level return from the standpoint of cashflow, gives our cash back to us, which gives us more money to invest down the road. We have invested over the last 5 years over \$3 billion in capital.

Capital drives growth. Capital drives productivity; it drives jobs. But having a return on that, obviously at a higher level, and the cash coming back into the corporation gives us more money to invest in capital, people, and growth, and that will drive faster economic growth overall.

Chairman Brady. Thank you, Mr. Farr. And that sort of illustrates the power of a simpler cashflow system that really focuses on that.

Mr. Peterson, your insight, sort of looking, you know, at a broader range of the economy, but the technologies and services that you sell as well, what is the impact of being able to immediately write those down and capture that cash, make those new investments?

Mr. Peterson. What is most important for us is that it would allow us to keep those jobs in the U.S. Today, there is a competitive environment because other countries around the world have such low tax rates. In fact, there are countries calling on us. We receive relationship management calls from other countries, from Singapore, from Ireland, where they come visit us to ask us to move those jobs to those countries. They are high-paying jobs that require economists, quants, mathematicians, people designing new intellectual property. They want that intellectual property overseas. These types of tax changes will allow us to continue to develop our products and services in the U.S. We will invest in the U.S.

In the last 2-1/2 years, we have invested in large operations in Charlottesville, in Texas, in Colorado, and in New York. And this would ensure that we would continue to do those investments in the United States.

Chairman Brady. Thank you, Mr. Peterson.

Mr. Rattner, thank you for bringing your criteria forward on pro-growth tax reform. Bringing those solutions and principles is extremely helpful. So your viewpoint, you work and see many clients, whether they are in manufacturing or technology, small or large businesses, investment growth, you know, growth that comes from that investment and incentives.

So your view on unlimited, immediate, all size business investment, and those productive investments, what impact do you see from this provision?

Mr. Rattner. Thank you, Mr. Chairman.

First, I would certainly concur with others that the rate of investment in this country is below what it should be.

Secondly, I would certainly concur with the notion that if you gave someone, for example, immediate write off of all of their capital expenditures, that they would invest more. That is fairly obvious. If you give somebody money to do something, they are likely going to do more of it.

But I think that the focus on this provision is excessively narrow in terms of what is affecting investment in this country. When I spend time talking to CEOs in companies, sure, if you lower their taxes they might invest more. But they also are faced with the fact that demand in this country is quite weak because personal incomes have been quite weak because wages haven't gone up. And so they are investing more money in other parts of the world where they see faster growth and more demand, and so I think the question of investment in this country has to be viewed more holistically in the context of, how do we get growth here? And this may be one piece of the final solution, but it is not the Holy Grail. It is not going to singlehandedly solve the investment challenges in this country.

Chairman Brady. Thank you, Mr. Rattner. I agree. We have to take tax reform in a comprehensive way and put together a number of pro-growth provisions, but the investment part of this is key to middle class growth. And the estimates of the House blueprint are that it will raise the average after-tax wages of a family of four by \$5,000, again, helping create the demand that helps grow our economy as well.

So thank you all for those responses.

Mr. Neal, you are recognized.

Mr. Neal. Thank you, Mr. Chairman.

Mr. Rattner, let me begin by taking a moment to thank you for your leadership and to recognize the success of the automobile restructuring that took place during the midst of the recession.

I remember having extensive conversations with individuals like Mr. Levin at the time. And our greatest fear was that, if that industry entirely collapsed, the R&D would have been moved offshore permanently and trying to get it back would have been near impossible. So I think we begin by thanking you for what you were able to do to help turn around that industry and also to thank you for your government service.

And as I noted in my opening statement, Mr. Rattner, my priority for tax reform is the middle class. The middle class has contracted in the United States over the past two decades, while those at the top have done better than ever before. That is not a statement that comes from a Democratic manifesto; it is from the Pew Foundation and many think tanks across the country.

Working families did send a strong signal last November. They are frustrated by stagnant wages. They are tired of a Tax Code that favors the big- over the medium-sized incomes across the country, and the greater concentration of wealth, again, at the top. They are anxious about a very uncertain financial future. And the true winners of tax reform must be middle class Americans and their families.

In your testimony, Mr. Rattner, you agreed with the position that was offered that it is critical that any tax reform plan be focused on helping middle and working families.

Would you please provide us with some suggestions that you might have? And I hope that you will also have a chance to touch upon the need for greater retirement savings incentives in our Code for the very families that I have just described. So addressing income stagnation and retirement savings and rising income inequality is a big problem in America. Based on your experience, Mr. Rattner, we would like to hear from you.

Mr. Rattner. Thank you, Congressman Neal.

I think any tax reform package needs to be a balance. It needs to address a variety of needs. We have talked a lot in the first part of this about investment, but you have now talked about the situation with the average American.

I don't believe, in response to Chairman Brady's comment, that, while there certainly would be indirect effects on average Americans of investment tax benefits, I don't believe that that is the most direct way to help them. I think it is, frankly, a kind of a form of trickle-down.

I think when you look at the tax proposal that has been made by the administration, you will see that it is very unbalanced. It has not yet been scored, but President Trump's campaign proposal was scored, and 83 percent of his tax plan would have gone to the top 20 percent of Americans, who would have gotten an average of a \$25,000 tax cut. The middle class average American would have gotten a \$1,000 tax cut. That is not my view of what a fair and balanced tax plan would look like.

So I think part of the equation is to give middle class Americans more of a tax cut so that they can go out and spend and they can help get our growth rate up to a higher level.

With respect to the question of retirement savings, that is a whole another subject, but we have a huge problem of retirement savings in this country. 401(k)'s and IRAs have created some benefits, but they have also led to a vast amount of undersaving by Americans, who are facing a really tough time in retirement, and I think we need to think about a fairly comprehensive restructuring of that whole program.

Mr. Neal. Thank you.

Chairman Brady. Thank you, Mr. Neal.

Mr. Nunes, you are recognized.

Mr. Nunes. Thank you, Mr. Chairman.

I think it is safe to say that all of you have expressed some level of support for moving to a cashflow system. And one of the opportunities that we have during hearings like this -- and this being one of the first hearings that we are going to have of multiple hearings, I think, over the course of the next few months -- is having folks like yourselves be able to speak before the American people here in Congress, but begin to talk about, you know, switching from an accrual system to this cashflow system with full expensing and all of the benefits that that will do for the American people in terms of not only growth in the economy but also wage growth.

And why don't we just start with you, Mr. Stephens. Having a big company, one of the largest companies in the United States, the opportunity to go from a complicated accrual accounting system, where I am sure you have an army of lawyers and tax accountants, switching to a cashflow system like this, I think this is going to give your folks that work with you some real opportunities to get away from trying to navigate the complicated Tax Code and begin to look at where best to invest money for your company.

I don't know if you could expand on that and explain some of the opportunities this will give you.

Mr. Stephens. Certainly simplification of the process and the simplification that might be required to provide some balance to comprehensive tax reform would be very helpful. You are right: We file over 250,000 tax filings a year here in the United States. And yes, we do have a large collection of professionals who work hard to make sure we live up to all those laws.

Quite frankly, from our perspective, the provisions of a lower rate and incentive to invest in capital would be the most effective way for us to increase our investment and, through that, hire more people, generate more jobs through our supply chain, and generate more research with technology development and, quite frankly, improve the wages of our employees and, quite frankly, of their peers who work for other companies. And as that goes through the system, it would generate demand for our services, and that is the real answer for economic growth.

As peer companies that are represented today from all sizes invest, they would put demand on our services. They would put demand for labor and for wages. And you would see growth of a significant level, we believe, for all. And then for us, it would generate on the top line.

So, yes, there would be simplification, but we are a large company. We have resources. That simplification aspect is really much more beneficial, I think, to the small- and medium-size businesses. And they are very important to our company because, you know, they make up some of our best customers.

Mr. Nunes. I think that is a great transition, because sitting next to you is a small-business man from Illinois.

Mr. Mottl, welcome. I have a district that has a lot of small businesses. And I think having you here today sitting next to one of the largest companies in the United States really shows how we can get big businesses in America and small businesses in America to agree that moving to a cashflow system like this would be very beneficial.

And so could you walk us through just kind of the opportunities that moving to this system would give a small business like yours, Mr. Mottl?

Mr. Mottl. Absolutely. Thank you. You pointed to the relationship here. I would like to point out AT&T and the telecom industry was one of the biggest customers of my company for almost a hundred years. You know, we built a lot of the components of the phone network. So the supply chain relationship that we are talking about is so important. If my big customers are healthy and they are buying parts and pieces and product from me, I am happy. You know, that is tax reform for me, making my big customers competitive and able to do business in the U.S.

I think, in relation to the tax that we are talking about, the cashflow tax, you know, I have seen some models that maybe have a little concern for small

businesses, but I would just ask you to consider maybe thinking about a border adjustable profit tax as you move through that. It is very similar to what you are talking about, but maybe would focus more on profits and cashflow. But either one of the models is a great improvement. And, again, anything that simplifies, reduces, and gets my customers happy and doing business with me, it is a great tax reform for me.

Thank you.

Mr. Nunes. Thank you, Mr. Mottl.

I have got a few seconds left, Mr. Farr.

Mr. Farr. I agree. Having healthy small business is very important. They are key suppliers of ours. If I can redirect money from tax compliance and doing tax forms to engineering and new products and innovation, that will obviously grow the economy because that is productive assets which go into growing the economy and making new products and helping America be competitive. So that really allows us to redeploy where our assets go into productive parts of the economy. I am not saying tax lawyers aren't productive, but I would rather make a new product.

Chairman Brady. We know that, Mr. Farr.

Mr. Nunes. Thank you very much.

I yield back, Mr. Chairman.

Chairman Brady. We would never say that.

Mr. Levin, you are recognized.

Mr. Levin. Thank you.

And welcome to all of you lawyers and nonlawyers.

You know, I think there is general agreement we need to look at the corporate tax structure, and the Obama administration did so. And I think the question is, how, and in what environment?

I just want to read from a new report, just a couple months old, from the University of Chicago Booth entity, and I quote: "I find that the stimulative

effects of income tax cuts are largely driven by tax cuts for the bottom 90 percent and that the empirical link between employment growth and tax changes for the top 10 percent is weak to negligible over a business cycle frequency."

And then I will continue reading: "If policymakers aim to increase economic activity in the short to medium run, this paper strongly suggests that tax cuts for top income earners will be less effective than tax cuts for lower income earners."

"Overall, the results not only suggest some skepticism for 'trickle down' economics, but they also provide evidence that supply-side tax policies should do more to consider the relative efficacy of tax cuts targeted lower in the income distribution."

So I just want to mention that when we talk about comprehensiveness, just let's keep in mind whom we are trying to benefit. Jobs. There is much talk on the Republican side about the middle class. The Trump proposal is the opposite of that.

Also, I just want to make a comment. Mr. Stephens, one of your statements: Our current tax system also harms workers; they bear up to 75 percent of the corporate tax burden through lower wages.

I just suggest there be some caution because corporate tax profits have increased dramatically while wages have stagnated. And I think there is much doubt, if I might say so, about that reference.

Let me just say a word about bonus depreciation. We tackled that a couple years ago. And CRS made clear that the efficacy of bonus depreciation depended on its being temporary. And that is why it was enacted in the first place, as a boost during a recession. And so when you essentially adopt it in a nonrecession period, the CRS casts immense doubt on its efficacy over the longer run.

And I mention this because I think we need, on a bipartisan basis, to take a hard look at these issues and not kind of just put them out there as if they are some kind of a magic wand because CRS essentially says it is not. And, indeed, Dave Camp left bonus depreciation out of his proposal all together.

I want to ask each of you quickly: None of you except Mr. Rattner have talked about the impact on the deficit and how we pay for a corporate tax reform. Are

you concerned about this, or are you among those who say, "Let it flow; if the deficit increases, it will essentially bring about economic growth"?

Just quickly, there is just a minute. Are you worried, each of you, about paying for corporate and other tax reform?

Mr. Stephens. Representative Levin, I can start. Certainly, we are as a member of the group of companies that operate here in the United States and part of our -- and this is our home. Absolutely. That's why in our comments we talked about trade-offs.

Mr. Levin. Okay.

Mr. Stephens. In comprehensive reform, there will be tradeoffs. We understand that. And that is just something that we are going to have to work through so that we come up with a complete and workable package.

Mr. Levin. Mr. Mottl, are you concerned?

Mr. Mottl. Yes, Representative, but I want you to have your cake and eat it too. I have given you the opportunity to, with the goods and services tax, to pay for the corporate tax cut and give working Americans an immediate boost to their paycheck. So I hope that answers your question.

Mr. Levin. All right.

Mr. Farr. Congressman Levin, I would say, yes, I am concerned about the deficit as an individual taxpayer and a CEO, and I look for tradeoffs back and forth to make sure we do this right for the economy on a balanced basis. So I think it is very important.

Mr. Levin. Mr. Peterson?

Chairman Brady. Thank you. All time is expired, Mr. Levin.

Mr. Levin. Okay.

Chairman Brady. So I would point out the House Republican blueprint, as designed, balances in the budget counting on economic growth is properly measured.

Mr. Tiberi, you are recognized.

Mr. Tiberi. Thank you, Mr. Chairman.

I want to echo your comments, Chairman, earlier about full expensing and how important it is, and that is why I have been an advocate of 179, making 179 expensing permanent, bonus depreciation. I am not going to take the bait and ask someone to respond about bonus depreciation because I think that was covered as well.

Business investment, as all of you know, declined last year for the first time since the recovery began. Not a good sign. So before I ask my question, I want to thank you all for sharing your experiences, but one of the things in Mr. Stephens' and Mr. Farr's testimony that struck me as so important is the underlying debate in letting the perfect be the enemy of the good is the cost of delay.

You know, we can pick apart any piece of this, but the cost of delay is so important. And how do we put a cost to that delay? And as the rest of the world has reformed and lowered rates and taken our jobs, we continue to let the perfect be the enemy of the good.

I would like each of you to comment, if you could, in terms of jobs, in terms of economic growth, in terms of investment, what is the cost of delaying? We have been talking about tax reform here on this panel for years now, and yet we continue like the perfect be the enemy of the good.

Mr. Stephens, what is the cost of delaying this again?

Mr. Stephens. Lost wages for our working class today. It is underemployment. It is participation rates in the workforce that are at historically low levels.

Mr. Tiberi. And middle class workers are probably the bulk of your employees.

Mr. Stephens. By far, the bulk. We are the largest, we believe we are the largest union employer in the country. We have over 120,000 representative workers. We are proud of them. They do great work for us. They would be the largest beneficiaries of the additional capital investment, because they are the ones who do much of that work.

Mr. Tiberi. So your headline is the cost of delay impacts the middle class worker.

Mr. Stephens. Absolutely.

Mr. Tiberi. Thank you, Mr. Stephens.

Mr. Mottl.

Mr. Mottl. Absolutely. Delay cannot happen. You know, we saw what happened with the markets yesterday because they are concerned people, we are not going to get things done here. So, you know, I have invested all that money in my business, and I am expecting to get a return on it and be able to pay back the investors, my family, and the bank. So I need my customers to be healthy. I need tax reform right now. My employees need it as well. They want to start saving and getting ready for the future.

Mr. Tiberi. Mr. Farr, thank you for your investment in Ohio, by the way.

Mr. Farr. Thank you very much. We are moving ahead- because I am assuming this body will get true tax reform done- in Ohio, with a \$100 million investment there right now. But the cost of delay means lack of innovation, less new products, less jobs, and it is that simple. We just look at how much growth is going to be, and we pare it back based on delay. And every time it is delayed, we push that investment out. And so it does have a real impact on people, how we hire, investment, new products.

But I firmly believe that we will get tax reform, and that is why we are moving forward in Ohio, Wisconsin, and down in Texas and Missouri right now, because I think that this body understands the importance of getting real tax reform in the first time in over 30 years. So we are betting on you that you are going to get it done.

Mr. Tiberi. Mr. Peterson?

Mr. Peterson. The cost of delay is also the cost of investment. If the delay is to not get a lower rate and not to get a territorial system, we are going to see more companies looking for some sort of inversion, not bringing their cash flow back from offshore.

Just recently, one of the companies in our industry did a \$3.3 billion offshore investment with their offshore cash. We have no chance of getting any of that cash back to the United States.

Mr. Tiberi. Great point.

Mr. Rattner, don't ruin the picnic now.

Mr. Rattner. I am sorry, I didn't hear.

Mr. Tiberi. Don't ruin our picnic.

Mr. Rattner. I am not going to ruin your picnic on this one.

Chairman Brady. Thank you.

Mr. Rattner. We can all agree on that on your question. I don't think there is any -- there is a lot of disagreement probably on exactly what we should do, but I don't think any reasonable person could disagree that sitting where we are sitting now, having done nothing really for 30 years in terms of comprehensive tax reform has cost us millions of jobs, billions of dollars and so on. And every day when I pick up the paper and read about another company either moving itself or moving its jobs overseas, it really upsets me, because I think we could be doing something about that right now.

Mr. Tiberi. Thank you, sir.

Mr. Chairman, I yield back.

Chairman Brady. With that agreement, we ought probably stop the hearing at this point, just so you know. Thank you very much.

Mr. Lewis, you are recognized.

Mr. Lewis. Thank you very much, Mr. Chairman.

Mr. Rattner, I want to join Ranking Member Neal with thanking you for your service, for your service to our country.

Mr. Rattner, I am very concerned about fairness and values in comprehensive tax reform. Some have said this is a once-in-a-generation opportunity. I think we must take our time and we must do it right. We must get it right.

As we consider tax reform, do you think it is important to consider the impact on working families and future generations when we consider reforming the tax policy?

Mr. Rattner. Yes, I do. I think it is important. As I said, I think it is just as important as getting comprehensive tax reform, removing the loopholes and avoidance techniques, both for individuals and for companies, as well as getting the corporate tax system fixed. I think it needs to be fair, and I think it needs to have a positive impact for the average American.

I think to have a \$5-1/2 trillion tax bill that involves a \$1,000 tax cut for an average American making \$50,000 a year doesn't seem fair to me. I think there needs to be fairness.

As I said earlier, I think the comments on business investment, which I understand why they are being made, affect the supply side principally of more investment, more factories. That is all good. But we also need to do things on the demand side of putting people in a position to earn higher wages so that they can go out and spend more and get the economy growing faster.

So while I do share the view that we need comprehensive tax reform, I am very troubled by the proposals that are on the table, both from the administration and the House blueprint that the chairman has referred to a few times in terms of a balance of, not just fairness, but also of stimulating every part of our economy, not just the investment side of our economy.

Mr. Lewis. Do you have any recommendation what we should be doing?

Look at the panel. Just look. All White men. Where are the women? Where are the minorities? Where are the low people?

Would you like to respond?

Mr. Stephens. Representative Lewis, from AT&T we take great pride in the diversity of our employee base, our customer base. We have been recognized by many, many industries for our accomplishments. We have a longstanding supplier diversity program. We spent close to \$15 million --

Mr. Lewis. Sir, I appreciate that, but I don't see any African American, Latinos, Asian Americans, or Native Americans. I don't see any women here speaking up or speaking out of what they need, what they want.

Our country is a very diverse country. Our forefathers and our foremothers all came to this great country in different ships, but we are all in the same boat now, and we should look out for each other and care for each other.

I yield back.

Chairman Brady. Thank you, Mr. Lewis. I think we agree on that point and recognize that our Democratic colleagues on the committee have an opportunity to bring witnesses to this table as well. I think it is important for us.

Chairman Brady. Yes. And made that choice. And I think it is important, if I may.

Mr. Lewis. Mr. Chairman, would you yield?

Chairman Brady. Not at this time.

Mr. Neal. Mr. Chairman, would you yield?

Chairman Brady. Yes, I will.

Mr. Neal. Mr. Chairman, the breakdown of the witnesses, which is a pretty good discussion, I think we would all agree it is helpful, but the breakdown of the witnesses four-to-one is not representative or reflective of the proportions of representation on the committee from the two political parties.

Chairman Brady. So it is traditional to take this type of approach. My only point is this: I think it is important as we talk about middle class workers, as we invite our witnesses here, we recognize they represent a diverse group of Americans that Mr. Lewis has championed beautifully for over the years.

Mr. Neal. Mr. Chairman, does the gentleman yield?

Chairman Brady. Not at this time.

So, Mr. Reichert, you are recognized.

Mr. Reichert. Thank you, Mr. Chairman. Thank you for your testimony today. Bottom line is we are trying to create a tax code. You have all touched on it, all the members of the panel, that would allow job growth, create jobs, increase paychecks, grow our economy, and help hard-working Americans.

We all agree the Tax Code is broken. It is too complicated. So I want to touch on a question that Mr. Tiberi highlighted, and I will also tie it back to Mr. Lewis' point, if I could.

So, Mr. Peterson, you talked about the impact of our outdated Code on your business, and I just would like you to elaborate just a little bit more on what an updated code would mean for you, and more I think importantly, what it would mean for your employees, for the hard-working Americans that Mr. Lewis has referred to and others prior to my questioning, how is it going to impact your employees? And it has been mentioned a little bit, but if you can dive into that question for me.

Mr. Peterson. Thank you, Congressman. As I described before, and let me give a little bit more detail, we have been a company that has been around for 150 years. We have developed our products and services which create intellectual property. We don't produce tangible goods. We produce goods and services. Our intellectual property is registered and owned in the United States, principally in New York.

When we export our services, we pay full taxes on those goods and services in the United States and in the New York State. Our competitors have their intellectual property and intellectual capital registered offshore, and they pay very low taxes. When they sell those products and services into the U.S., they do not pay those same taxes on their products and services.

Second point, new companies that are being developed today, in the last 15 or 20 years, they begin their development of their company from scratch with a tax policy. And they register their intellectual property offshore. Immediately, they set up the employees offshore. They put a service center in Dublin or in Luxembourg or in Singapore. They own their intellectual property offshore, and then they sell it back to the United States, and they don't pay taxes on it because the royalties go back to an offshore business. We compete against companies --

Mr. Reichert. Okay. For Americans today that are watching, how is this going to help them with taxes?

Mr. Peterson. What it means for Americans today is if we reform this tax, the territorial taxes to a low rate, we will invest more in the United States.

Mr. Reichert. What does that mean for the American worker, investing more here in the United States?

Mr. Peterson. What that means is that we will create more jobs.

Mr. Reichert. Creating more jobs. Are they going to be higher paid jobs?

Mr. Peterson. There are all kinds of jobs. We have jobs all the way from lower-end jobs. We need people at all different levels --

Mr. Reichert. These are not jobs just for White Americans, White older male Americans?

Mr. Peterson. These are jobs for people from all over the country and all backgrounds.

Mr. Reichert. Diverse Americans. Every American citizen, every American who is working in this country will benefit from this tax code. Is that correct?

Mr. Peterson. Every American --

Mr. Reichert. All of you are nodding your heads.

Mr. Peterson. Every American --

Mr. Reichert. It will be good for all hard-working Americans, correct?

Mr. Peterson. This is good for all hard-working Americans. Every time we start a new operation, we have to build facilities, we have to get it organized in that regional section. We hire all types of workers, and it is a great benefit for the entire spectrum of U.S. workers.

Mr. Reichert. Great. All of you agree?

Mr. Farr, I would like to follow up on your comments about the importance of tax reform as it relates to U.S. competitiveness and economic growth. In your view, and I know we have had, you know, lower corporate rates, permanent, territorial, simplified, a little expensive, comprehensive. What is your, in your opinion, the best thing that we can do, the most important thing we can do when it comes to tax reform?

Mr. Farr. From my perspective, the lower tax rate is the most important thing. And I know there is going to be a lot of tradeoffs plus and minus relative to that lower tax rate, but I think it is very, very important to have the lowest tax rate. That will help all employees.

In the last 10 years, we have increased our wages year by year by year, but my employee base has lost a lot from higher taxes, higher cost of benefits, and so that is eaten away. So a lower tax rate will help them.

Mr. Reichert. In 20 seconds, the importance of permanence.

Mr. Farr. Permanence is critical because I make decisions over 3 years, 5 years, and 10 years. I don't make a decision by a quarter. It is a 10-year horizon.

Mr. Reichert. You need certainty to help American workers keep their jobs, right?

Mr. Farr. That makes a big difference. That is why I am betting to making those investments in Ohio right now, because I am certain you are going to do it.

Mr. Reichert. Great. I yield back.

Chairman Brady. Thank you.

Mr. Doggett, you are recognized.

Mr. Doggett. Thank you, Mr. Chairman, and thank you to our witnesses.

This is a very troubling time in American history. Our national security has been jeopardized. Our democracy is threatened, while so many have remained silent about it. Hopefully, the appointment of a special counsel is a first step to seeking justice and to assuring Americans that our system of checks and balances is not entirely broken.

The subject of today's hearing is directly related to the willingness of so many to ignore a growing tower of Trump travesties. Some see Trump as the only ticket to more tax breaks, and they are willing to pay almost any price to get them. Today is also noteworthy as the first time ever, after almost an entire year, that anyone has come forward in a public hearing anywhere to justify this self-styled Better Way tax plan.

Now, I certainly favor public policies, including tax policies, that are designed to encourage entrepreneurship and grow jobs here in America. And we know what some of those public policies are: that if we invest in our workforce where there are growing workforce shortages, in education, and job training for jobs that are going unfilled, we can become more competitive. Those are the very programs that President Trump proposes to slash.

We know that if we have a competitive infrastructure instead of trucks backed up on our highways and trains on outdated systems like our competitors in Europe and Asia, we can be more competitive and grow our economy. But some of those are programs that President Trump proposes to cut and the rest of the ones that he has never gotten around to making a proposal on.

And, of course, the best way to grow our economy at the least cost is comprehensive immigration reform, according to economists and business groups across the spectrum. But that doesn't fit the ideological structure of this administration.

As for tax policies, well, apparently our Tax Code is outdated. It is full of loopholes. It doesn't work very well, but the witnesses that are before us today are from companies that seem to have done pretty well under that system. And they tell us today that if they pay less or no taxes every time they invest a dollar at home, they will begin investing more at home. Well, I question the logic of that. I think they offer many valuable insights, a number of which I agree with.

I think that we need a tax policy that encourages jobs at home. And when the Chairman of our committee tells us there are proven ways to grow our economy, I think what these hearings have to be about is to show us the proof that this particular Better Way tax plan will actually grow jobs. And that proof has to come from some people who come before this committee who are not telling us basically that they think giving themselves a tax break is a good thing, because I think everybody will agree to that kind of conclusion.

As far as what has been testified to here today, we do need a tax rate for corporations that is lower than it is today. Of course, if we lower the tax rate into the 20 percentile, that will be much more than many corporations are actually paying today. We need comprehensive tax reform that involves tradeoffs. The Tax Code is replete with tax loopholes, but we don't have really a list of tax loopholes that would be close today, only vague talk of tradeoffs. And certainly, we don't just need tax cuts, we need comprehensive reform.

This is not the first tax cut that this committee has considered. We have already approved in the House an almost trillion-dollar tax cut that will provide most of its benefits to the super rich and a few corporate interests like the pharmaceutical industry.

Before his confirmation, Treasury Secretary Mnuchin promised that there would be no absolute tax cut for the upper class, but the one page, I guess it is shorter than a grocery list, that has been presented more recently by Mr. Mnuchin is chock-full of candy for those at the top and very vague promises for the middle class. One analysis of it suggests that the top 400 taxpayers will get \$15 million each.

We need to be working on a comprehensive tax reform that provides benefits to the middle class and that does not raise the national debt. The committee has said that is their position. That has not been Mr. Trump's position. And coming together on that will be critical as we move forward.

I yield back.

Chairman Brady. All time has expired. Thank you.

Mr. Roskam, you are recognized.

Mr. Roskam. Thank you, Mr. Chairman. My friend from Texas just argued essentially that we needed a lower tax rate, and then implicitly criticizes the people that are coming advocating for a lower tax rate, but I digress.

There is an old phrase that says this, that when the bulls fight, the grass loses. So who loses as we dither under the current Tax Code? The wealthy are not suffering today. Wealthy are doing well. It is the folks who are at the lower end of the economic spectrum who suffer if we wring our hands and lose a once-in-a-generation opportunity by pursuing a perfect tax code, which is a complete illusion. Perfect tax code is the unicorn of 2017. What we want is a good tax code. What we want is a tax code that Mr. Lewis can celebrate when he says, "Let's get it right." Okay. Let's get it right.

So one of the things that we need to discuss and really litigate, publicly understand what it means to get it right, two of you, Mr. Mottl and Mr. Farr, mentioned in your testimony, and I am interested in exploring this, what is the value of permanence? What is the value of permanence?

So we often talk in terms of, you know, renting things versus buying things. We put a premium on owning something. And it would seem to me that there is a real premium on permanence. All of you have been, you know, been exposed in terms of market places and so forth.

So, Mr. Stephens, let's start with you. A permanent tax policy versus a temporary tax policy, and put this in the context of all the anxiety that we feel and the debate around this place where we have these tax extenders and temporary policy that, you know, that fade off in 24, 36, 48, pick it, number of months. What is the value to you? And then further on down the line, because you told Mr. Reichert what happens down completely throughout the whole chain, how important is permanence? You got a minute on it?

Mr. Stephens. Permanence is extremely important. The ability to look at, not as Mr. Farr said, a quarter or a year, but looking at 3- and 5- and 10-year plans, particularly in the investments that a company like ours make that are in infrastructure investments that provide benefits literally over decades. And so having that ability of permanence, knowing what the rules are, tell us what the rules are and we will abide by them, but knowing that and having that allows us to make consistent, significant, material capital investments that allow for the demand for jobs, demand on our suppliers, and, quite frankly, with the demand on those jobs, as you put more demand for more labor, wages go up. It is simple supply and demand.

It is a consistent, it is a cycle that continues to repeat itself as they come back and buy more mobile services, as they buy more --

Mr. Roskam. Thank you.

Mr. Stephens. So it is very important to have consistency and permanence with regard to the rules.

Mr. Roskam. Mr. Mottl?

Mr. Mottl. Yes. Well, you know, I can't speak enough about permanence. You know, businesses vote with their feet, right? You have to answer to your constituents. Most of them have a job. But a business doesn't vote. It just leaves and takes its jobs. And, you know, you talked about the success of businesses. I have been fighting for my life, my business, for the past decade as my customers keep leaving this country. I get one industry figured out and we are doing great with them, and then they leave, and now I have got to find another and another. And it has been a tough battle for the last decade or longer.

So I think a permanent tax code is so important to get my customers back in this country buying product from businesses like mine.

Mr. Roskam. Mr. Farr, what would it mean for you and Emerson Electric if this Congress were to give a tax code that you could rely on beyond a decade, so --

Mr. Farr. It means a lot to us because we make investments. The new facility we are putting in Ohio, we are replacing a facility that was built in the 1960s. So we are making a facility investment of \$100 million that is going to last for 20 and 30 years.

I have the world to invest in, and I have the choice to look at who offers the best incentives, who gives the most consistent tax rates. And from that perspective I look at this world.

If you do a short-term, one-time accelerated depreciation impact, you will have a surge 1 year of capital and then it dies. That is not a long-term strategy relative to investing, and that is why, from my perspective, I need to think about 2, 3, 4 years. I am thinking about capital investments, right now, 3 years out and where I am going put that money. Where am I going to build that next facility for \$100 million, \$200 million? That is why I need a permanent tax rate, and I need it for at least 10 years, for my thought process.

Mr. Roskam. Mr. Peterson, just quickly.

Mr. Peterson. Permanence creates certainty. Certainty reduces risk.

Mr. Roskam. Mr. Rattner, even quicker.

Mr. Rattner. I agree.

Mr. Roskam. Amen to that. I yield back.

Chairman Brady. And you got in under the wire. Well done.

Mr. Thompson, you are recognized.

Mr. Thompson. Thank you, Mr. Chairman. Thanks to all the witnesses for being here. I am glad that we are looking at doing comprehensive tax reform. I think it is extremely important.

And this morning, I was just making some notes to myself, the things that I think are real important, and number one is comprehensive reform, and that is

what this bill needs to be, not simply a tax cut bill. If we do a tax cut bill and we ignore the reform, we lose, and the American people lose.

I think it needs to be paid for. And I think all the witnesses recognize the importance of that, but I think we need to pay for it in real terms, not just with there needs to be tradeoffs. We need to specifically pay for this. We can't add to our national debt. And I think it is important that it is bipartisan. Big things that happen in Congress aren't good unless they are bipartisan. And we have all experienced what happens when we try and do it some other way.

And we need to make sure, as a lot of my colleagues have already mentioned, that we really hone in on, focus in on the middle class. That is extremely important.

And then I added one bullet to my notes when I heard you, Mr. Mottl, speak, and your mention that the desire to lower the payroll tax. I wrote down that it shouldn't hurt the middle class. And I think we need to remember that the payroll tax is how we finance Social Security. And unless you have got some way or the committee has some way to ensure that Social Security stays strong, if we do tax reform that takes away the funding for Social Security that hurts all of our constituents, and I would hope that we all recognize how important the Social Security system is for all Americans.

You know, the middle class have been struggling. Incomes haven't kept up with expenses. We all know that. I reference a recent study that was done by the University of Minnesota, the University of Chicago, Princeton, and the Federal Government, and they found that a 27-year-old man today is making 31 percent less than he would have made in 1969. They go on to say that he is unlikely to make up the difference in his lifetime.

So as we turn to tax reform, we really have to focus on those middle class folks. These numbers, these numbers don't jive, and especially if you juxtapose that with some of the numbers that many of our corporate leaders are bringing home. It is not equitable, it is not fair, and it needs to be addressed in our bill.

And tax cuts that are not tax reform are wrong. And tax cuts that aren't paid for don't generate this panacea that some think that it does. We know from the 1980s, we know from the early 2000s, and we know what is happening right now in Kansas that tax cuts don't automatically pay for themselves, and we have to recognize that.

Mr. Rattner, I have a question for you. Can you explain how these large increases to the debt, even for policy that we might otherwise all agree that is good policy, can become a drag on the economy as a whole?

Mr. Rattner. Sure. There have been many, many studies of this done that as the size of the Federal debt goes up and the interest burden on the Federal Government goes up and the crowding out of private capital occurs, because interest rates rise as the Federal Government borrows more and more, all of that is absolutely a drag on economic growth in this country.

It seems like the whole panel agrees that whatever this committee does on taxes needs to take account of its impact on the deficit, and that is where honestly I have a little bit of a problem with what I have been hearing, because I hear we would like to do this, this, and this, but I haven't really heard how we are going pay for all of that.

And the second thing, if I can just make one other comment, that I was struck by Congressman Doggett's comment. I think that we are looking at this in a little bit of isolation. Of course, as I said in my opening remarks, if you cut depreciation, there will be more investment. How much more? We don't know. Will it be enough to pay for it or will it justify it? We don't know. But we also really need to think about this compared to other ways we could, in effect, spend this money. Would the money be better spent on infrastructure? Would it be better spent on job training? Would it be better spent on education? Because the amount of money the Federal Government has for any of these things is limited, and we need to make sure it is spent effectively and look at it across the entire continuum.

Mr. Thompson. Mr. Rattner, can you just further explain, if we cut taxes for the rich and for corporations and we pay for that by adding to the national debt, what does that mean to the middle class families that we represent?

Mr. Rattner. Well, first of all, it is a matter of immediate fairness that you would be giving a benefit to the upper class and to business and very little, as I said earlier, to the middle class. But secondly, we do, as I said in my testimony, have a problem of rising debt, and the middle class will simply have to end up bearing a greater burden of paying for that somewhere down the road in the form of higher taxes if we don't keep our debt under control.

Mr. Thompson. It would cost them money.

Mr. Rattner. It will eventually cost them money.

Chairman Brady. Thank you very much. All time is expired.

Mr. Buchanan, you are recognized.

Mr. Buchanan. Thank you, Mr. Chairman. I want to thank all of our witnesses. All of us have a diverse background that come on this committee. I was in business for 30 years. I built two pretty good-sized companies.

I did want to touch on -- I think we all agree we need to be more competitive on the corporate rate, but I want to touch on passthrough entities and make sure they don't get lost in the mix. You know, I have got a bill that I would like to see close to parity. When you look at corporate rates, at 35, they are not competitive, but on passthroughs it is as high as 44. If you add State income tax in States like California, another 12, 13 percent, it could be 57 percent. It makes absolutely no sense.

So I guess I would like to ask some of the panelists just your thoughts on lowering those rates where they are more competitive, getting it down to somewhat near the corporate rate, I don't necessarily agree with 15 percent, but the difference that would make in terms of growth, in terms of jobs, and also in terms of raising wages. So I will start with the gentleman, Mr. Mottl.

Mr. Mottl. Well, yeah, absolutely. The passthrough issue is big, you know, and I think right now a lot of them are paying around 44 percent. And so, you know, if we go to 20, 25, you know, I think it is just important that it gets lower and closer to the corporate rate, that they are more similar and not so dissimilar and not so penalizing to the small business.

But, you know, of course, on jobs, you know, the more we

can invest, the more we can grow, the more we can hire. You know, I am involved in some training programs in the Chicagoland area, bringing folks out of the inner city, training them for good jobs. And we need this kind of growth. We need this kind of opportunity. And I think if you do the tax reform, you will see that.

Mr. Buchanan. And one of the things that is always concerning to me, especially on passthroughs, a lot of people think maybe you have got 150 employees, you happen to make \$800,000. The owners don't take all that money out. They might take 150 out. The balance of the money goes in to grow and expand the business.

Mr. Farr, you represent a large industry. A lot of these entities are passthrough entities, subchapter S, LLCs. What are your thoughts by the fact that they can keep a little bit more of what they earned in the business, what difference is that going to make, from your experience?

Mr. Farr. It makes a big difference. We have 30,000 people in the United States, across all the States, both Democrat, Republican, plants everywhere. We are very small business oriented. And we use small businesses supplied to us. If they are not healthy and they don't have the money to invest, they are not going to have the most productive equipment, their technology, their quality, and they will lose business as we take it elsewhere. So the small business tax rate needs to come down closer to the corporate tax rate so they have more money to invest to support us as we grow. And that has been one of the big issues the last couple years. They have not had the money to invest to keep up with us, so we are moving and looking for other people to supply us. And that is a big issue for these people.

And I also want to agree that, you know, make a comment that we employ not only high-priced people, we employ low-priced people. We have all different levels of people employed across this company.

Mr. Buchanan. Well, I know in the State of Florida, I think 93 percent of the enterprises are passthroughs type entities.

Mr. Stephens, would you like to add to that?

Mr. Stephens. I think, quite frankly, the competitiveness issue applies across the board. High tax rates makes them less competitive, gives them less money to invest, gives them less opportunity to generate jobs. All that is good for the overall economy and for a large company. It is good for the small business vendors, suppliers, and customers to be very healthy.

Mr. Buchanan. There is actually something out, I think, in the last 10 years or lately, we have got more businesses closing than opening, so we have got to have a tax code that doesn't penalize people.

Mr. Rattner, would you like to add? Again, if you disagree with it, my thought is it is 44 percent, can be up to 44 for a lot of passthroughs, and if you put State income tax, New York, or I am sure Illinois has got a substantial tax, it is a big number. What are your thoughts?

Mr. Rattner. Respectfully, Congressman, I would make a couple of other points. Certainly, lower taxes are good for everybody, if we can find a way to pay for it and if it can be fair. But with respect to passthroughs, let's remember a couple of things.

First, they chose to become passthroughs. They could have been become subchapter C corporations, but they felt that being a passthrough with a single level of tax was advantageous.

Secondly, while by number the passthroughs are vastly small businesses, in terms of where the income is generated, I have seen studies that between 40 and 50 percent of the income is actually generated by either larger businesses or very wealthy individuals. I can tell you anecdotally that I have many friends in the hedge fund world, in the private equity world, in the investment management world who are structured as passthroughs for the reasons I said, and they certainly do not need a tax cut or deserve one.

So I think, while I am sympathetic to the genuine passthroughs, I think the devil will be in the details of you structuring something that actually helps the people who need help without benefiting a lot of rich people.

Chairman Brady. Thank you.

Mr. Peterson, just real quick.

Mr. Peterson. What I would add is it also makes the businesses much more attractive from a credit point of view. Small banks providing credit to small businesses is critical, and that kind of cash being available and capital in the business helps that very much as well.

Mr. Buchanan. Thank you. I yield back.

Chairman Brady. Thank you.

Mr. Larson, you are recognized.

Mr. Larson. Thank you, Mr. Chairman. And I want to thank all the witnesses as well for your expert testimony.

As Rich Neal has spoken, we are very concerned about what is happening to the middle class. As the chairman points out, this is a generational opportunity

for all of us. And as Mr. Roskam said, so we want to make sure that we get this right.

In fact, the last time generationally we took this up, and if you look out into the audience, it was labeled by one author, the battle at Gucci Gulch. And we don't want to see a return to that. And so my first question -- I have two -- relates to all of you, and that is a commitment. Our most recent history in the committee with respect to a major reform had to deal with healthcare. And we believe on this side strongly that we need to return to regular order and that we need to have witnesses like you and an open process throughout where both sides actually participate in the drafting. Because I think as many people have pointed out, without that, we are not going to get the permanency or the long-term consistency that you would like.

And so I would ask you, all of you, and if you give just a yes or no answer, would you be in favor of more hearings open where we get in this arena of the vitality of ideas where we can exchange and work through these or do you think that this should end up in some closed-door process? It is a pretty easy answer.

Mr. Stephens, we will start with you.

Mr. Stephens. Respectfully, Congressman, my expertise isn't in taxes and financial matters, so I will respectfully leave that to those to talk about the healthcare process.

Mr. Larson. But given that is your expertise, wouldn't you like to see the open exchange of ideas?

Mr. Stephens. I think I would hope that that is going on today and everyone appreciates open ideas.

Mr. Larson. Don't you think we need more of that -- it is going on today -- Mr. Mottl?

Mr. Mottl. Mr. Larson, I couldn't agree with you more. More information is always better, but I hope that is what we are having today.

Mr. Larson. Thank you. Thank you very much.

Mr. Farr?

Mr. Farr. I like more dialogue and, hopefully, I don't have to be on another panel and be harassed, but thank you.

Mr. Larson. Well, hopefully, you don't consider this harassment, but I do think --

Mr. Farr. It is special love, let's put it that way. Special love.

Mr. Larson. Mr. Peterson?

Mr. Peterson. I am very pleased that today you have opened the process of starting hearings. I think getting more and more data and analytics out about the impact of the different tax proposals is critical, and how you do that is also valuable and more transparency on the process.

Mr. Larson. Mr. Rattner, let me give you a special thanks. Not only as others have mentioned with respect to the automobile industry, but your charts and graphs, which have been very illustrative in townhalls that I have had, and in your arguments, because I can anticipate that you would also be in agreement about the openness. You did say in your remarks, and you mentioned three things that if you could, in the short time that you have, dwell on. One of them, you talked about how excessively narrow this proposal was, and if you could elaborate on that. The other was you said the need for this to be more holistic, and as in the embrace with the number of the questions from Mr. Lewis to Mr. Thompson about making sure that the Code has got to be more distributionally neutral.

Mr. Rattner. Thank you, Congressman. Yeah, I think those three points are all interrelated in the sense that I think that to simply focus on one or two provisions affecting business as the centerpiece of tax reform is excessively narrow, and that, as I said a few minutes ago, I think that the committee should be -- and I think this gets to your point about openness -- I think having more hearings would be great. And to Congressman Lewis' point, hearing from a wider variety of people would be great.

We are, all five, we may not agree on everything, but we are all businessmen, and there are a lot of other people out there who will have useful views for you as you think about this, but I do think you have to -- I think each of these provisions or pieces of this are just a piece, and I think that as part of the effort, if I were in your shoes, I would be trying to look across the whole spectrum of tax possibilities and things that are within the jurisdiction of this committee and come up with a package that is balanced and fair and that in its entirety

addresses the issues we have talked about, which are the complexity and the loopholes in the Tax Code, the disincentives, and the fairness issues.

Mr. Larson. And that is why you said in its current form it is excessively narrow.

Mr. Rattner. It is excessively narrow.

Mr. Larson. And any thoughts on expanding that beyond -- and I commend the chairman, and I know the people on the other side of the aisle want to get to this. There is broad agreement, but I think, and we had great precedent set by Dave Kemp, which I know people on both sides of the aisle admire his work. I think if we are able to sit down in that manner in this exchange of ideas, in providing as much love as Mr. Farr would like, that we are able to create an opportunity to move the country forward.

Chairman Brady. Thank you. All time is expired.

Mr. Smith, you are recognized.

Mr. Smith of Nebraska. Thank you, Mr. Chairman, and thank you to our witnesses here today. I think this is an important discussion, important conversation that we have. I appreciate the perspectives that you bring, multiple perspectives, I will add, and I think this panel represents multiple perspectives, as well.

I think that as we sift through this, I hear from Nebraskans, as a representative of rural and remote Nebraska, there is a frustration that, you know, perhaps just waiting, and to punt perhaps is not the solution, whether it is fixing our healthcare system, whether it is reforming our Tax Code.

There is an understanding that, and I would say a bipartisan understanding and even consensus, that our country is uncompetitive in the world as it relates to our tax policy. I think it is very important that we come to that realization and move on it in a permanent way as we have already heard.

I know that I hear from constituents who find the death tax, for example, an unfair tax, inherently unfair, double taxation. And there seems to be an idea in Washington that, well, you know, if you narrow that down to few enough people, then that makes it fair. I disagree with that. There will still be people harmed, individuals harmed, certainly family businesses harmed. And I think of family businesses, particularly in agriculture, that are not awash in cash and

liquidity. And I would imagine there are many family-owned businesses that would fall into that category as well.

So I think if we focus enough on doing the right thing for the right reasons, we can get this done. But I can tell you it can frustrate me when I hear various arguments of why not to do it, that I don't think are certainly as important reasons why we need to do this, move forward, involve as many people as we can, and that is what we have been doing. I know the working groups that we have had over time have been instructive. I speak personally on that front of how instructive that was to hear people out in various sectors of our economy. So I am anxious to move forward here. And I think that this time and this conversation is important.

I am wondering if our panelists could perhaps explain to me, I know that Emerson points to Ohio for some expansions. We have facilities in Nebraska, not in my district, that aren't necessarily headquarters for large companies, but we have manufacturing plants. We have various locations of larger companies perhaps.

I was wondering if our panelists, in terms of manufacturing or services, could elaborate on what tax reform might do for individual locations, satellite locations or facilities, and their employees around the country, perhaps starting with Mr. Stephens.

Mr. Stephens. I will give you just a personal experience. I sit on the Chamber of Commerce in Dallas overseeing an extensive number of businesses moving into Texas because of a favorable income tax rate compared to other States.

So what we are talking about here today from a federal policy is happening every day amongst our States. So I would suggest to you that this overall tax reform, bringing down the top tax rate, providing an incentive for investment will generate jobs across the country as it will allow all States to be much more competitive with their foreign competitors as they exist today.

Mr. Mottl. I am from Illinois, and we have the unique example in Illinois, some budget issues there, and businesses are leaving our State as a result of that, and they are concerned. So I think it speaks to, it is a great example that when you do tax reform, you know, if we can get it done in the U.S., you will bring businesses all back to the U.S. to all States.

And I wanted to make a comment. There was a comment made about switching our tax structure. You know, I would love to do that. It would

trigger a huge tax liability to do that. We have a C corp, an S corp, two S corps, an LLC. I would love to get them all aligned so we can even have the fiscal year end on the same date, but to do that, I trigger a tax liability for cash that I don't have.

And there was a comment made, you know, we have had to pay taxes some years, we have triggered a tax liability in unusual years where we didn't really make a profit, but we triggered a tax liability. And these are these crazy quirks in the Code that we really need to address, and it is particularly onerous on small business.

Mr. Farr. So my comment, as I look at AT&T, if they increase their investment, increase their infrastructure of the internet and the uses that we use over the technology of their services, that will increase my investments in those particular areas. So as they invest in Texas, I invest in Texas. They invest in Minneapolis, I invest in Minnesota.

So from my perspective, what I look at is, you know, the tax structure of each State. Would I go to Illinois right now? I get concerned about the health of Illinois right now. So as I look at the various States and where I want to invest, it is around the policies relative to the State, the tax structures, the benefit of the local governments and how they help and work with you. And so that is why we make those investments.

But it also pays off of what AT&T does or what we do. We help each other for those infrastructure investments.

Mr. Smith. Mr. Peterson?

Mr. Peterson. At the base of your questions about the competitiveness of the U.S. economy, we have the best university system, we have the most innovative people in the world. We have a rule of law. We have an energy boom, which attracts many new companies around the world looking at that competitive advantage, but we have a tax system that disadvantages us. Each State obviously has their own competitive advantages and they are clearly going to be looking at that, but there is so many different advantages we have today, but we lose out on many of them because of the broken tax system.

Mr. Smith. Thank you. I yield back.

Chairman Brady. Thank you.

Mr. Blumenauer, you are recognized.

Mr. Blumenauer. Thank you, Mr. Chairman.

Mr. Peterson, you talked about many of the advantages we have in the United States in terms of our economy. I am struck that when we were talking about the various infrastructure investments, one of the problems we have is we have a country that is falling apart, and we are falling behind. Those of you who are involved in the international economy realize, in terms of roads, transit, air investments, the United States is sadly lacking. Sadly lacking.

We just had another report from the American Society of Civil Engineers that suggests that in 5 years we haven't improved the ratings of all the things, it is just the price tag got higher. In the past, we have approached both the previous administration and previous proposals for tax reform, had a little bit of infrastructure stuck in, or some people think repatriation can be sweetened by maybe moving that back into our woefully inadequate infrastructure spending. There is admittedly a little disagreement about repatriated dollars and who benefits, and some people think they have different ideas for it.

But one of the things and, Mr. Farr, I would start with you because Governor Engler and the National Association of Manufacturers supported legislation I had to finally raise the gas tax after 24 years, which wouldn't add to the deficit, which would put millions of people to work from coast to coast, creating jobs in every single State, every single city, and maybe we would be in the process of learning how to legislate again. Do this, you know, kind of flex those legislative muscles. We could have panels like this for a week and listen to the president of the AFL-CIO, the president of the U.S. Chamber of Commerce, the president of the contractors, Governors, South Carolina where the legislature just overrode a veto of their Governor for raising the gas tax, joining 23 other States that figured out how to do this, which we used to do on a bipartisan basis.

Now, I would start with you, Mr. Farr. Do you think there would be any advantage to maybe our taking a little simple tax that anybody could understand, and, in fact, it could be even shorter than the President's tax proposal, that would get the trillion dollars that he wants to spend and that the Senate Democrats agree on that number and get started?

Mr. Farr. As a manufacturer in the United States and a manufacturer across this country, I have three things. I would like to simplify our tax structure to make it more competitive globally. Infrastructure investment is critical. We

move stuff by roads, by rails, by ports, by airports. We have been pushing this for many, many years, and we have not gotten it done. We clearly need to find investments. You will find very few CEOs of companies in the United States that would not say find the money to invest in infrastructure.

And I think those three things, around regulation, around infrastructure, around tax policies to make this country competitive. We compete with all those things hurting us today. We can be better.

Mr. Blumenauer. And my question was do you still support raising the gas tax like we need to do?

Mr. Farr. I still support finding the funds to pay for infrastructure. I mean, I can't --

Mr. Blumenauer. Mr. Rattner, do you have an answer to that?

Mr. Rattner. I certainly support raising the gas tax, and I was like in the car business for a little while. Look, I think the gas tax hasn't been raised in decades, and I think --

Mr. Blumenauer. 24 years.

Mr. Rattner. And you made all the right points, Congressman. And I think as a matter of both infrastructure policy and energy policy, it is crazy for us to have a gas tax at this level and to allow our infrastructure to deteriorate.

Mr. Blumenauer. Mr. Chairman, I appreciate your courtesy having this hearing. I appreciate our panelists raising important issues. I would respectfully suggest that the committee think about a simple subject that we can deal with, have 3 or 4 days of listening to experts who are in local government, State government, the various industries, hear from UPS that they lose \$50 million for each 5 minutes' delay in traffic, invite in some of the Republican legislators from the 23 States that have raised the gas tax to find out why they did it in Wyoming or South Carolina.

I think this is an area that we can actually find bipartisan agreement. We could actually do something, not increase the deficit. Just having a week's hearing from the Trucking Association and AAA. Why do these people agree, raise our taxes? I think it would be good for the committee. I think it would be good for the country, and, who knows, this might be something we could break the logjam, do something to jump-start the economy, and that would help ease

some of the other issues that we are talking about, because it would certainly increase productivity, and it might be fun.

Thank you, Mr. Chairman.

Chairman Brady. Thank you.

Ms. Jenkins, you are recognized.

Ms. Jenkins. Thank you, Mr. Chairman. This has been a very informative hearing. And I thank all of you on the panel for giving us your time today.

Mr. Mottl, I know you are from Illinois, but when I was hearing your testimony, I felt like I could be listening to a story of a small business owner in any small town in my congressional district in Kansas.

You just mentioned in response to my seatmate's question, that for tax purposes your company that simply employs about 80 people has divided the company into one C corporation, two S corporations, and an LLC? And as a CPA who did tax planning, I would just want to applaud you for the creativity for your back office folks and your tax team.

However, I think it begs the question: Should our Tax Code be so administratively complicated that a business like yours should have to engage in so much work in order to achieve just a workable tax rate at the expense of simply growing your business? And to be more pointed, would you trade this highly complex system full of loopholes and surprises at every turn for the certainty of permanent, modern, simple, and a fairer tax system that allows you to grow your business?

Mr. Mottl. Well, thank you for that question. I couldn't appreciate it more. You know, like I said, the reason we have those complex structures -- and, yes, in some cases it works for us; in other cases it is hindering us, and I cannot change it. I have inherited this. We are a 100-year-old business, right? The C corp came from the 1970s. The S corps came from the 1990s, and they were all done during the time that there was tax changes going on all the time and reasons to do these things, but I would love to simplify it.

Like I said, I would love to have one fiscal year end, but I would trigger -- I am a 100-year-old company. We have retained earnings on the balance sheet, not necessarily cash, but it would trigger a huge tax liability to do that. In fact, I

am also --you know, in the business I am here talking today we talked about women and minorities. You know, my sisters both help me run the business, and we would like to transfer ownership to myself and my sisters so we would become a woman-owned business. In order to do that, we would trigger, again, a huge tax liability. So we can't afford to do this.

I would love to make these changes. So I would trade in a second all this mess, all this complexity, and all the time we spend on it for a simple reduced system. And, again, businesses are not opposed to paying taxes. The transportation tax is a great example. You know, I think consumption taxes is an important focus. Why are we taxing income? We want income. Let's tax other things. You should tax the things you don't necessarily want to have, not the things you do want to have. Thank you, ma'am.

Ms. Jenkins. Excellent. Thank you.

And maybe for some of the us rest of you, I think it has been reported that American businesses spend about 3 billion hours and \$150 billion complying with this outdated burdensome Tax Code that is on the books.

Could each of you just comment quickly about the costs associated with filing your returns and about the opportunity cost, what does it mean to your business to lose that kind of time and resources? Mr. Stephens?

Mr. Stephens. So to put it in reference, our shareholders put up about \$240 billion of capital for us to run the company, and they get about \$12 billion or about \$2 a share in dividends. And we pay about \$4 a share or \$24 billion in taxes in the United States every year. It is a number that is disclosed in our annual report. So our shareholders get half of what Federal, State, and local governments do here in the United States, even though they are putting up all the capital for the business.

We have about 300 people who work full time in our tax department. We have a budget of about \$100 million a year for that tax department, and we file over 250,000 tax returns in the U.S. So it is an extremely complex system that causes a diversion of funds that would otherwise be available to invest into complying, and we take pride in our compliance in complying with the law.

Ms. Jenkins. Thank you.

Mr. Farr?

Mr. Farr. I don't have the specific numbers, but I know how many people operate doing these taxes, and we have hundreds of people in the United States and around the world operating to fill out the tax reforms and compliances and making sure we are doing it right. And therefore, as I said earlier, I would love to take that money and reinvest it in another part of the company. I mean, from my perspective, what we look at is we are trying to invest to grow, and I have to allocate those resources. One of the allocations is tax compliance and paying the taxes and all the forms we fill out. So clearly, you could take that and put it somewhere else, invest in the company for growth or technology for new products. So it is a huge burden for us and something we have to do by law, and I sign it by law.

Ms. Jenkins. Okay. Thank you.

Chairman Brady. Thank you. Is expired.

Mr. Kind, you are recognized.

Mr. Kind. Thank you, Mr. Chairman. I want to thank the witnesses for your testimony today. Very helpful. And hopefully, Mr. Chairman, this will be the one of many hearings that we have moving forward on the complexity of taking a serious run at this Code for the first time in over 30 years.

But first, Mr. Peterson and Mr. Rattner, let me start with you. I don't think you had an opportunity to answer Mr. Levin's question about whether you think it is important for us, if we do take a run at comprehensive reform, that we do it in a fiscally responsible manner, that we look at certain expenditures that we can close down in order to help pay for a simplification and a lowering of rates at the end of the day.

Mr. Peterson?

Mr. Peterson. Yes, thank you. First of all, I am looking now at the different tax plans in a way that, as you work through them yourselves, you will find ways to ensure that we can pay for them, that they are in addition to being permanent and comprehensive, that they are also fair and find a way to ensure that we have paid for it through them, right?

Mr. Kind. Mr. Rattner?

Mr. Rattner. Yes. I think I have made clear my view about the fact that we should not have a tax proposal or a tax bill that increases the deficit when it is

scored using conventional means. We can have a debate about dynamic scoring, but I would not want to see that be part of the equation to come up with a tax plan that doesn't increase the deficit.

Mr. Kind. You know, there is, I think, great consensus in Congress, and perhaps throughout the Nation, that it is long past due for us to take a run at the Code, over 30 years, because it is antiquated, it is outdated, it is too complicated, it is less competitive right now. The compliance costs are ridiculous. And this is an opportunity for us to do it.

My fear, quite frankly, though, as we approach this is the easy default position. When we get into the complexities and how difficult the tradeoffs have to be made, is that Congress oftentimes lapses at the end of the year with a need to try to get something done and just cut rates, don't pay for it, declare victory, go home. If that is where we ultimately end down on this, what would each of you think, would that be a success for this Congress or a failure of missed opportunity?

Mr. Stephens?

Mr. Stephens. A comprehensive plan that lowers rates and encourages investment would be a win with a prudent tradeoff for all financial considerations. That would be a win, yes.

Mr. Kind. Mr. Mottl, again, if we end up, though, just cutting rates, not paying for it, declaring victory, is that a success or a missed opportunity, in your mind?

Mr. Mottl. I agree with you, Mr. Kind. And, again, that is why I am proposing that we also do a goods and services or some other type of board or adjustable VAT tax. That is how you pay for it. You broaden your base. And, again, I am proposing this offsetting credit on the people's income -- the taxes that they pay on their wages. You know, it is 15 percent for the average American worker that they pay in federal taxes.

And I know there is some concern about Social Security. You know, the first year that -- it is on the bottom of the statement. I read it every year. The first year that there is not going to be enough funds to pay benefits is the first year I am eligible for benefits, so I share your concern about funding Social Security, and that is why my proposal is an offsetting credit.

You keep the Social Security taxes on the payroll and those go into a bucket, but from another bucket from the goods and services tax there's a plus, there's a credit. So you protect that dedicated cash flow that is so important, so important for Social Security.

Mr. Kind. I appreciate it.

Let me just move on with another question since I'm running out of time. One way of building bipartisan support I think in this place is something that Mr. Blumenauer touched upon, is tying tax reform into a major infrastructure reinvestment plan. As one of the leaders in the New Dem Coalition in this House, we are 61 strong right now, just yesterday, we sent a letter to President Trump asking him to consider doing -- approaching tax reform with a tie-in with infrastructure investment.

And, Mr. Chairman, I would ask for unanimous consent to have our letter submitted for the record at this time.

Chairman Brady. Without objection.

Congress of the United States
Washington, DC 20515

May 17, 2017

President Donald J. Trump
The White House
1600 Pennsylvania Avenue
Washington, DC 20500

Dear President Trump,

As Members of the New Democrat Coalition, we are committed to working toward bipartisan policies that create jobs and grow the economy in every town and city across the country. In the coming months, we have an opportunity to find agreement on a visionary plan that brings our infrastructure system into the 21st century and once again makes American businesses the most competitive in the world.

America's network of transportation, energy, water, broadband, and civic infrastructure was once the envy of the entire world. And yet, today, it is crumbling all around us. The National Highway System, one of the crowning human achievements of the 20th century, is badly in need of repair and is not keeping up with the projected growth in the American economy. Mexico and Canada are outcompeting American ports because they are making huge investments to accommodate Post-Panamax ships, and many of our airports pale in comparison to those in Europe and Asia. Our water and energy pipelines are outdated, inefficient, and in many places, a danger to the American people. Our electric grid is also deeply vulnerable to attack and needs a nationwide upgrade.

Put simply, this is the result of a federal government that has failed to invest in the basic needs of the American people. For too long, we have underinvested and relied on short-sighted, stop-gap measures that don't provide the level of funding we need to support a world-class economy. According to the American Society of Civil Engineers 2017 Report Card, U.S. infrastructure has a cumulative grade of "D+" and needs trillions of dollars of investment by 2025. Similarly, our tax system has not been updated for three decades and now hinders U.S. companies from maintaining an international competitive edge. America's workers deserve better.

We agree with your call to make a major investment of at least \$1 trillion in infrastructure. Additionally, we believe this should be coupled with reforming our tax code in a fiscally responsible manner. We encourage you to work toward a plan that includes a significant investment in infrastructure, including direct federal spending that is paid for in part by a deemed repatriation in comprehensive tax reform. Members of the New Democrat Coalition have led efforts along this line that have gained significant bipartisan support. Combining these efforts would be a win-win for American workers and our economy. Specifically, this investment should provide a combination of direct funding and innovative financing that addresses rural and

Val B. Demings

Val Butler Demings
Member of Congress

BF

Bill Foster
Member of Congress

Josh Gottheimer

Josh Gottheimer
Member of Congress

Colleen Hanabusa

Colleen Hanabusa
Member of Congress

Denny Heck

Denny Heck
Member of Congress

Jim Himes

Jim Himes
Member of Congress

Bill Keating

Bill Keating
Member of Congress

Rubén J. Kihuen

Ruben J. Kihuen
Member of Congress

Derek Kilmer

Derek Kilmer
Member of Congress

Ron Kind

Ron Kind
Member of Congress

Ann McLane Kuster

Ann McLane Kuster
Member of Congress

Rick Larsen

Rick Larsen
Member of Congress

Sean Patrick Maloney

Sean Patrick Maloney
Member of Congress

Gregory W. Meeks

Gregory W. Meeks
Member of Congress

Seth Moulton

Seth Moulton
Member of Congress

Stephanie Murphy

Stephanie Murphy
Member of Congress

Donald Norcross

Donald Norcross
Member of Congress

Tom O'Halleran

Tom O'Halleran
Member of Congress

Ed Perlmutter

Ed Perlmutter
Member of Congress

Scott H. Peters

Scott H. Peters
Member of Congress

Jared Polis

Jared Polis
Member of Congress

Mike Quigley

Mike Quigley
Member of Congress

Kathleen M. Rice

Kathleen M. Rice
Member of Congress

Cedric L. Richmond

Cedric L. Richmond
Member of Congress

Mr. Kind. Mr. Rattner, I know you haven't been the biggest fan of deemed repatriation in the past, but we do have a ton of money that is parked overseas not being utilized or being used efficiently. And one of the ideas that we have been focusing on within the New Dem Coalition is having a fixed rate deemed repatriation dedicated for infrastructures. Part of the revenue stream that we need to get going on this. Do you have any opinion about that?

Mr. Rattner. Sure. I have not been the biggest fan of deemed repatriation because the evidence doesn't suggest it would make much of a difference. We tried in 2004. It didn't really make a difference. There is a lot of cash on companies' balance sheets here now that they are not investing. But in return for getting critical money for infrastructure, I would support either deemed repatriation or actual repatriation tax if that money were channeled for useful purpose simply to be able to get going on the infrastructure issues.

Mr. Kind. Yes, Mr. Farr.

Mr. Farr. I think, you know, the reason why it didn't have much impact, it is a one-time impact. It goes back to permanence. And so I fundamentally believe if you have a policy just like our European policy is -- so they -- everyone brings the money back; you pay a simple tax on that -- that money will come back to the United States, and it will be invested in the United States. My perspective: Having that money here is a good thing.

Mr. Kind. Hopefully, we will end up at the end of this process with a much more simplified, more competitive Tax Code, but also fair for working families, for small businesses, family farmers back home too. And that is the goal at least, Mr. Chairman.

Thank you. I yield back.

Chairman Brady. Thank you.

Mr. Paulsen, you are recognized.

Mr. Paulsen. Thank you, Mr. Chairman.

I want to thank, also, all the testifiers today. This has actually been very enlightening testimony.

Look, from my perspective, I continuously hear from Minnesota companies about the importance of having major tax reform that is permanent, that

promotes investment, that lowers rates. And it will boost paychecks. It will increase jobs. It will help the economy. I hear that all the time.

We know the larger companies that I have in my area: It is the three Ms of the world, the General Mills, the Cargills, the larger institutions that employ so many people. But it is also these small businesses, these Main Street businesses that people have never heard of, but they are so important as the engine of the economy. I think of Steinwall company, which is a plastic injection manufacturer that I recently had a chance to tour in my district, or the Baldinger Bakery that produces the buns for McDonald's looking for a more simplified Tax Code, or even the more recent example of a letter I received from Dawn, a small business owner in Loretto, Minnesota, who writes in, saying: We have a once-in-a-lifetime/generation window of opportunity to unleash a strong economy and to repair and simplify the Tax Code that is helping hold back our small-business economy right now.

What I think is really striking about these messages and what you shared today is there is an acknowledgment that all of our job creators, both big and small, are in this together. And so, simply put, regardless of whether you work at a large or a small company, these businesses and the men and women who are working alongside them each day will benefit from fixing a broken Tax Code. We are talking about lowering the rates, having permanent reforms so you can plow more money into their paychecks and more money into their investments and higher wages.

And so, Mr. Stephens, you had mentioned right off the bat, this is about unleashing economic growth. It is about -- it is a key driver in investment.

Mr. Mottl, you had mentioned three different types of tax filings you have to do and the importance of leveling the playing field.

And, Mr. Farr, you have talked about the importance of manufacturing with two-thirds of manufacturers particularly paying under that high individual tax rate.

I will just start here. And we have all shared the perspective already. But it is well documented, Mr. Stephens, that our current high corporate income tax rates really does reduce domestic investment and entrepreneurship as well. And how would new investments made as a result of a 20-percent rate affect communities? How would that help communities? What might it mean to the local suppliers, again, which I think Mr. Farr talked about, the contractors, the vendors, that you partner with in your operations? Or, more

importantly, what might that 20 percent rate mean to those individuals you currently employ or might look to hire in the future?

Mr. Stephens. Thank you for the question. Quite frankly, it would have a very direct, immediate, positive effect on our vendors, on our suppliers, and, quite frankly, on our employees. As you put more dollars to work in capital investments, you generate demand for jobs. Whether you generate demand for technical work in engineering design, architectural work, you put to work demands on research for new technologies and new services.

All of those items would have additional demand so that the supply that is out there would go to work. So more people would go to work, and in the cases of many of the people, their wages would go up because there is more demand for their services.

This, then, would start that cycle that comes back to demand for our services, demand for mobile phone services, television services, broadband services. So it has a virtual cycle. But by the same token -- I think this is really important -- State and local governments would see an immediate uplift in their prosperity because it would generate jobs. It would generate payroll taxes. It would generate sales. It would generate sales taxes. It would generate investments in assets that generate property taxes. And, once again, that generates additional demand for our services and other large companies' services. So it would have this cycle of continual growth.

That is what is so important. As we have this extremely high rate and investments are moving offshore and they will stay there for the longer term, we are missing out on that opportunity. So acting quickly to get that done now will be an important answer.

Mr. Paulsen. So keeping headquarters here, keeping innovation here, lifting our economy for everyone is going to be a long-term boost with permanency, right?

Mr. Mottl. I will just keep going right down the line.

Mr. Mottl. Just briefly, you know, you mentioned the business in your district that makes the buns and the one that does the plastic. You know, the purpose of those businesses is to bake the buns and make the plastic parts. The secondary effect is, hopefully, they make a profit, right? And so I believe that if we help these businesses be better at what they are doing, have more capital to do that, they will invest in making more buns, making more

parts. Hopefully, as an offset, they make a profit as well. But, keep in mind, the primary purpose is to do what they do, and if you give them the resources to do it, they will do more of that.

Mr. Paulsen. Mr. Farr.

Mr. Farr. Three comments. We have two facilities in Eden Prairie, one in Shakopee, one in Chanhassen. We are investing right now in Shakopee. We are moving jobs back into the country. And it will help, obviously, from a technology jobs standpoint. It helps with education. It helps employment. It helps everything around that area.

So, from my perspective, it really spreads out and helps the community in a big way, just like it hurts the community when we leave.

Mr. Paulsen. Mr. Farr, I visited both those facilities, and I heard the same message there.

Thank you, Mr. Chairman.

Chairman Brady. Thank you.

So, Mr. Pascrell, just a note to members, so after your questioning, we will move to 2-to-1 ratios going forward.

Mr. Pascrell, you are recognized.

Mr. Pascrell. Thank you, Mr. Chairman.

Good afternoon. I want to thank all the members of the panel.

Each of you are CEOs or senior vice presidents. I want you to think about something I am going to say now: You know what your effective tax rate is now. And I am sure you have done the numbers. If the Ryan-Brady plan becomes the law, what will your effective tax rate be?

You see, we have a problem. I listened to the chairman open up this meeting today, this hearing. And I listened very carefully, as I usually do, to the chairman. He mentioned three things in his introduction. He mentioned the corporate tax rate. Ten years ago, Democrats on this committee pushed for a lowering of the corporate tax rate to 25 percent. Secondly, he mentioned the immediate expensing, write it off. That is the second thing he mentioned. And

the third thing you mentioned, Mr. Chairman, is that businesses are eager for tax reform.

The problem with what you said, Mr. Chairman, is tax reform does not only pertain to the businesses of this country. Tax reform refers to everybody who pays, in some manner, shape, or form, Federal taxes in some form or other.

We have a problem here, because in the last 30 years, we have moved -- and I want Mr. Rattner to respond to this, if he would, in terms of something he said before -- we have moved from an even tax system of taxing assets and taxing incomes. That is not the case anymore.

I believe it is somewhere in the high 30s, 30 percent, of taxing income and down into the 20 percent of taxing assets.

And I want Mr. Rattner to tell all of us assembled here what that actually means in terms of what someone takes home in their pocket, whether they are poor or middle class or on top of the mountain.

Mr. Rattner. Well, Congressman, I think what you are referring to is that the 1986 Tax Act made taxes on investment income and taxes on earned income the same, at 28 percent. And since then, they have diverged, and they are obviously 39.6 on earned and 23.8 if you include the ObamaCare tax.

Mr. Pascrell. Would you repeat those numbers, the final numbers, the last two numbers?

Mr. Rattner. I believe it is 39.6 is the top rate on earned income and 23.8 on investment income.

Mr. Pascrell. What do you think of that?

Mr. Rattner. I have a rather heretical view of it. And I am actually a huge beneficiary of it, because I am in the investment business and so --

Mr. Pascrell. Well, all of you are.

Mr. Rattner. Well, some of them are -- they may actually work and earn money. I am an investor.

And so I am a substantial beneficiary of the 23.8-percent rate, which, as you know, the proposal now is to eliminate the 3.8 and make it 20.

Mr. Pascrell. That is right.

Mr. Rattner. I personally think it is a mistake. I have been in business investing for 35 years. I have had tax rates, as we talked about before, at 28. I have had tax rates over 40. I have had tax rates at 15 on investment income at one point. None of it has affected by one iota how I conducted my life or my business. I see no reason why I should be paying 23.8 on my so-called unearned income whereas I am paying 39.6 on my earned income.

I think I would actually support raising all of the taxes on unearned income as part of a way to pay for some of the things that we have been talking about today.

Mr. Pascrell. Mr. Chairman, I hope you listened to what he just said. Because this tax reform that is put before us is phony and hypocritical, worse. It sends the wrong message to the poor -- if I am bold to use that term here -- and the middle class at the same time.

What we are doing is saying to the American people: We are going to make your lives better. We are going to increase your income and your salaries. You are going to be in a better position now if we help the business community primarily.

I want to help the business community, by the way. But I will not vote for tax reform that simply is directed and targeted at those who are at the engine. I want to take care of the people, also, that are in the back cars and maybe the caboose.

And that is the problem we have in our tax system right now. Yes, we need a change. But it has got to cover everybody, period.

I yield back.

Chairman Brady. Thank you.

Mr. Marchant, you are recognized.

Mr. Marchant. Thank you, Mr. Chairman.

I appreciate the witnesses being here today.

Mr. Stephens, your company, AT&T, has a huge facility in my district. And we appreciate the fact that Texas is the headquarters for AT&T.

At the end of the day, it is going to be the job of every member of this committee to go back to its constituency and say to it: This is a major tax reform plan, please support it, and have me convince them that it is a good thing for them.

Let's take a situation where you three or four companies call your employees and call your vendors into a big auditorium and you get up in front of them and say: This is why the tax reform plan in Better Way is a better thing for this company, and it is also a better thing for you as the employee or the vendor.

And I would like to know how you would go about doing that?

Mr. Stephens.

Mr. Stephens. Congressman, we are here to support the comprehensive tax reform. We are for it because it will increase investment. Increasing investment increases jobs. When you increase jobs, you increase wages. You give people -- what they care about is their net take-home pay and it will go up because it will be demand, higher demand, for their services.

And the reason we are for it is because, as those working class individuals are fully employed and employed in greater numbers, the demand for our services will grow. And if our revenue lines grow and we have to pay additional income taxes on that, we will be glad to do it. But it is a cycle that helps everyone, as well as their local school district, as well as their local police department.

It also helps those with getting broadband and other services out because those additional investment dollars will go into those infrastructure investments, certainly for our company.

So this is a benefit for all to make us more competitive with the rest of the world because we are not today.

Mr. Marchant. Thank you.

Mr. Mottl.

Mr. Mottl. I couldn't agree more with that. You know, I was reminded that this room seals when the doors close. This is a secure room. So we are kind of in a bubble here. And I think that we are talking, in general, about being in a bubble. You know, the rest of the world has gotten competitive, has changed the way they do taxes. And if we don't change the way we do taxes, we are not competitive. And that is what it is about, getting the people at the back of the train on board, bringing the jobs back here, bringing the businesses back here so small businesses, large businesses, can be profitable and can do it here in America. So I hope we can do this and get globally competitive and look out of the bubble.

Mr. Farr. I agree a hundred percent with the first two statements.

I would add that I would say: Look, if we make investments around the world; if we have a competitive tax rate here in the United States, it will increase our investment right here in the United States. It will come into the calculation of making those investments right here in the United States.

I also agree you can't just do business taxes- to our Congressman over here- you have to do individuals. Individuals have to see a benefit from this. You can't just make this for wealthy and for business people. You have to make this across the board. This is our chance.

But if we have more money from a lower tax rate as a company, we will invest more money, because our job is to grow and invest, not to collect cash, but to grow and invest. And that is what we would do.

Mr. Peterson. When I talk to our employees about the comprehensive tax reform that I know all of you are going to do, I am going to tell them we just got a raise, our company just got a raise. Instead of spending \$560 million a year on taxes, we are going to pay less. And what are we going to do that? With that raise, we are going to spend it, and we are going to invest it. It is like being in a 100-yard dash, and right now, we are starting 20 yards behind. We are running a 120-yard dash against the rest of the world who is running a hundred yard dash. And this is going to put us back at the start line at a hundred yard dash.

Mr. Rattner. I would agree with everything that has been said before. So I won't repeat it. But I would just say this one other piece, which is I think there is enormous urgency around this. We all understand the political calendar. This is the beginning of a new administration. There is a window in which things, hopefully, normally get done. Then we are into midterms, and

then we are into reelection cycles and the pace tends to fall off. And I think if we miss this opportunity, if we don't come together and find common ground, and all of us are willing to make compromises, we will all regret this later.

Mr. Marchant. I agree with that. And I would say to all of the businesses that are listening to this, that are watching this very closely, we intend to do tax reform. It is our number one goal.

And we are going to need your help at the end of the day to communicate with your employees that this is a good thing to do, and they need to pick up the phone and call their Congressman and say: Please vote for this.

Thank you.

Chairman Brady. Thank you.

Dr. Davis, you are recognized.

Mr. Davis. Thank you very much, Mr. Chairman.

And I, too, want to thank all of our witnesses.

As I have listened to a very intense and some would probably say one-sided kind of conversation -- not by intent -- but, you know, there is an old saying in Illinois where I come from. It says: If you fool me once, shame on you; fool me twice, shame on me.

I have been listening to theories about trickle-down economics ever since I have been able to read and ever since I have been able to hear. And I have never found a way yet where the trickle trickled enough to really assure that the middle class was being protected in the same way that one would expect anybody from a different class or another class trying to protect that interest entity.

I think the information that we have heard sounds great. But it also comes from not enough diversity. It just keeps coming back to what John said earlier. And I was wondering, if there were other individuals being asked the same question, what kind of answer would we get? It is kind of like asking the question: Is it fair for birds to eat worms? You ask the bird, you get one answer. You ask the worm, you get a different answer. Now you have got to determine which one is right, which one is correct. Whose interests are being protected? Or is there a way to protect both? Is there a way to prevent there being losers and

winners? Is there a way for the middle class to look at the proposals that we have seen and say, "Yes, this will give me the assurance that my status in life is going to be protected"?

And so, Mr. Rattner, let me ask you, the tax cuts -- and we haven't heard much about how to pay for them. And I believe that everything that you get, you got to pay for one way or the other.

But how do the middle and working classes benefit from basically the Republican tax plans and proposals that we have heard about?

Mr. Rattner. Congressman, I think, first, as I said earlier, in terms of direct benefit, it is de minimis. For an American making \$50,000, a family, an average American, it would be a \$1,000 tax cut compared to a \$25,000 tax cut for someone in the top 1 percent. So there is no real meaningful direct benefit.

You would have to believe that all of the business cuts that have been discussed here would have secondary and tertiary effects that would benefit those people. And I would certainly agree there would be some benefit. I think it is very, very indirect. And I think that, before this committee should recommend such a package and make the contention that it helps the average American, I think a good bit more study would have to be done to actually document what we are talking about in terms of dollars. Because I think you would find that the cost of those tax cuts -- which, again, as we have discussed, have yet to be paid for, relative to the benefit to the average worker may not line up properly.

Mr. Mottl. Congressman, you and I are neighbors in Illinois. And I am not sure if I am the robin or the worm or the dirt there underneath it all, but I would welcome you to come to my business anytime. We have hired quite a few folks out of your district. We have put them through training programs. And we are hopefully giving them that better life. I couldn't believe more in what you are talking about, and I would love you to come and ask those folks yourself. Any time you are welcome.

Mr. Davis. Thank you very much. And I will look forward to doing that. We are appreciative of every effort that is made to try and help even the playing field.

Thank you very much. And I yield back.

Chairman Brady. Thank you.

Mrs. Black, you are recognized.

Mrs. Black. Thank you, Mr. Chairman.

And I want to thank all the panelists for being here today. This is a very interesting conversation.

The way I break this down is there are four factors that actually drive growth. One is the labor supply. The other is the physical capital. The other is human capital. And then fourth is innovation. So when we look at economic growth here in the United States, it really has been held back. It is been held back over the last several years.

And part of that is because of the size and the complexity of our Tax Code. That is one reason.

Regulations, onerous regulations, that are put in place, certainly do help or do work a part of holding back that success.

And for years, we have seen a low labor force participation rate. I know we will read the newspaper, and it will say, well, unemployment is down. But we know that only about 62 to 63 percent of those able-bodied workers that could be in the workplace are actually in the workplace. So we have seen low participation rates. And that certainly isn't helping people at the lower or the middle income, to not have that.

We have seen weak capital investment. Why is it that people aren't investing so that we can see a growth in manufacturing and other industries and sectors?

And, essentially, no wage growth.

So these are pieces and parts that actually are affected by the Tax Code and would be affected as we make those changes.

I do want to focus on, as many of the others here have, is the real reason for this, in my opinion, is that we need to unlock the opportunity and the prosperity for the American workers. That should be the goal at the end of the day. And I know from my own experience -- I am a small-business owner -- that human capital is the most important part of my business enterprise, having good employees that we pay good wages to, both to help our business succeed but also to make sure that our employees prosper. That is very important in our model, and I hear that from you all as well.

And so we have got to look at ways to strengthen our people so that they have the skills and the training so they can compete and succeed in the global economy and ultimately to enjoy the benefits of their hard work.

Mr. Farr, I want to turn to you. Your testimony speaks to the vital role of manufacturing and what it plays in our economy. I have a lot of manufacturing in my district, and I say amen to that. What are the kinds of tax policies that create not just more manufacturing jobs but better jobs and higher paying jobs?

Mr. Farr. I think one of the key issues I talked about is the research and development tax benefit, because that is going to be our lifeblood of the future. And manufacturing is changing, and we are --

Mrs. Black. Uh-huh.

Mr. Farr. -- going to have to reeducate all of our workforce.

Mrs. Black. Amen.

Mr. Farr. And we are spending millions of dollars right now, because without them, we won't have a manufacturing facility. The research and development credits are very important.

American companies are very innovative. We are the most innovative in the world. And by having that ability to stay ahead of that foreign competition, it allows us to compete even though we have the highest tax rate, some of the highest regulations, and some of the weakening infrastructure we talk about. So innovation around R&D tax credit would really make a big difference for us. We are willing to give up other things. But that, from my perspective, is the lifeblood of what makes American manufacturers competitive.

Mrs. Black. And if you do better, do your employees do better?

Mr. Farr. Our employees do a lot better.

Mrs. Black. And why is that? Because you need good employees to run your business. Without them --

Mr. Farr. Because we invest in education.

Mrs. Black. That is right.

Mr. Farr. We invest in our employees. We invest in local education --

Mrs. Black. All works together.

Mr. Farr. -- the money back in.

Mrs. Black. So, Mr. Peterson, just really quickly, on a similar note, you described the increasingly important role of the service sector. Are there tax policies that you have thought of that would, again, create not just more service industry jobs but also high-quality jobs with better pay?

Mr. Peterson. We would definitely look at the service industry creating high-paying American jobs for all Americans. And one of the ways that we look at this is related to the territorial system specifically.

The way intellectual property and intellectual capital is developed, it can move anywhere. It is not like a manufacturing plant. Manufacturing plants take a lot more of what you talked about, physical capital as well as financial capital, to make a decision on. But it is very easy to move people and to move intellectual property. Our tax laws today incentivize people to develop intellectual property probably in the United States but then move the ownership of it offshore.

The territorial system is one that is most important to get the benefit of that intellectual property, that ownership, and the tax back in the United States.

Mrs. Black. So what I hear you saying is that, as we have in our business experienced, that the better we are able to do, the better we are able to treat our employees, which that boat that rises is rising for both the employer and the employee. So this Tax Code is here so that we can make sure that they both get married together and that we see that the Americans, all the way across the board, are doing better because our Tax Code has released those dollars and the energy to have the economy move ahead.

So thank you so much. I yield back.

Chairman Brady. Thank you.

Mr. Kelly, you are recognized.

Mr. Kelly. Thank you, Chairman. And thank you all for being here.

First of all, I would not be here today if it weren't for actions that took place in 2009 where one of the dealerships, one of our franchises, actually, under the car czar -- by the way, Mr. Rattner, you are not a car guy. I am a car guy. You are a hedge fund guy. To me, a hedge fund is the guy who plants shrubs. That is what I save money for at home.

Don't take that the wrong way. No, don't take it the wrong way. I mean this sincerely because. I have never done your job. You have never done mine. But I know the reason that I am here today is because one of my franchises was taken away because of the United States Government, not because of something I did wrong. It is that simple.

All of you that actually come from the private world, when I look at what is going on -- and there is not one person -- because all we are talking about today, is there a need for pro-growth tax reform? And, without a doubt, everybody says: Yes, there is. There is. It is unquestionable.

Then, the next thing is: So what is fair, and how do we address fairness, and how do we define fairness, and is it really the best for everybody?

I have got to tell you. I have looked at this every which way we can, from death taxes. We are third generation right now. I want to see it go to a fourth generation. And I don't know that we can.

And, Mr. Mottl, I am with you. We are a C corp. We are also an S corp. That wasn't a decision we made on our own. The government helped us make it. So as we look at all these things -- and when it comes to pro-growth, it better be pro-growth. I am just really concerned that a country that is going to have record revenue still can't come close, can't come close, to paying its spendings. You couldn't do it in your business, and none of us could do it at all.

And, Mr. Rattner, you are concerned about deficits. I am greatly concerned. I know that what when President Bush left office it was almost \$10 trillion and when President Obama left office it was almost \$20 trillion. So the concern with that is immeasurable. I don't know how it grew that fast, but it did.

Pro-growth. Pro-growth. In your estimation of where you sit -- and I know we compete globally now. So it is kind of foolish to think we can do this on our own. We have to look at the model we now exist in. All of these different items that we are talking about today, is there any of them that you disagree with as far as growing our economy and making sure that all of you folks -- that

pay every penny, by the way, of what this government uses to run these wonderful programs comes from you. I have told the chairman many times there has been years I have not paid a penny in taxes. It is not because I understood the Tax Code. It was because I didn't make any money. And one of those years was in 2009 when the annual sales rate for automobiles, by the way, went from \$16 million to \$9.5 million. That is a hell of a hit. So it wasn't a matter of policy at that time. It was a matter that the world was upside-down.

So anything that you disagree with what we are doing or what we are attempting to do -- because we all agree that if you are healthy, the country is healthy. You are able to hire people. You are able to educate people. You are able to participate in your communities. And, more importantly, you are able to fund every single government spend that we have out there. Anything that you disagree with? Anything that you say we should be doing faster other than getting this to an end?

Mr. Farr.

Mr. Farr. The only thing I would say you got to do faster is we need to get our global competitive tax rates equal to our competitors around the world. We are losing jobs every day the more we sit here with this big difference. This is a big issue. I will tell you right now, I invest constantly around the world, and these changes are really big issues to us as a company. And if we don't get this back in line, we are going to continue to lose jobs, and we are going to fall further and further behind. This is very important to us in this country. I am an American. I manufacture in America, and I live in St. Louis, Missouri.

Mr. Kelly. Perfect.

Yes, Mr. Stephens. Or Mr. Mottl. It doesn't matter. You are all doing the same thing --

Mr. Stephens. Congressman, the only thing I would add is urgency is important. And let's not let perfect be the enemy of the good. We are willing to make tradeoffs. We understand that there are tradeoffs to be made, that this is -- there are multiple interests that have to be accounted for, and we all accept that. Please, with urgency, don't let the perfect be the enemy of the good.

Mr. Kelly. Thank you.

Mr. Mottl.

Mr. Mottl. One quick thing, just, you know, how important it is to make this easy for small business. You clearly get that.

But, you know, we talked about deficits also. These other countries that are being very competitive, they are not so worried about deficits. They are worried about getting the jobs, getting the industry, and getting the stuff there. So it is a tough problem. I am on this side. But it needs to be dealt with.

Mr. Kelly. Mr. Peterson.

Mr. Peterson. I am encouraged that we have begun this process and that we are having this hearing. And this is going to be hard. But because it is hard doesn't mean we shouldn't do it.

Mr. Kelly. Mr. Rattner.

Mr. Rattner. I am a shrub. So I don't know if shrubs are allowed to talk.

Mr. Kelly. You and I have been together before. But I got to tell you: I wish I could have sent you the letter I got taking away a family-owned businesses because of somebody's whims. Okay? So I don't want to get into that right now, although we are.

But I am going to say this -- I am reclaiming my time. Thank you all for being here. And this is the first step in you being here before -- you are the revenue producers. We are the spenders. You are the producers. Thank God we are finally getting the private sector in front of us right now to let everybody in the world know how we do improve our country. So thank you for being here.

We can talk later, Mr. Rattner.

Chairman Brady. Thank you.

Ms. Sanchez, you are recognized.

Ms. Sanchez. Thank you, Mr. Chairman, for holding our very first hearing this Congress to discuss what I consider to be the most pressing legislative issue, and that is our severely overdue tax reform effort.

And I want to echo our ranking member's statement that lasting, comprehensive tax reform means absolutely nothing if it doesn't put the middle class first. And I would really urge that this be a bipartisan effort.

I continue to hope that we can work on a bipartisan package unlike the recent healthcare reform attempt, because it is very frustrating to sit and find areas of common belief but not have your voice or your opinions heard.

And while it is impossible to highlight everything that I think should be a priority for this committee as we continue on this path toward tax reform, I am going to try to hit on a couple of key notions. First of all, I want to reiterate a point that I have made many, many times. Tax reform needs to be comprehensive and not piecemeal. We cannot fix the Code for one group of people, leaving countless others worse off because of it.

We also can't cut taxes for the richest of the rich and assume that somehow that will magically grow the economy. You cannot cut your way to growth. That has been tried, and it has failed miserably.

My biggest fear in this process has always been a final tax reform package that puts American workers and the domestic businesses that employ them on an even more unequal footing in our Tax Code. Our Tax Code is woefully out of date. But how we get from here to a revamped Tax Code really deserves some thoughtful deliberation. And we really need to roll up our sleeves and get our hands into the nitty-gritty of what is good policy.

The process also requires some thoughtful feedback from those who are going to be most affected by the changes that we will eventually make, which is why I hope that we won't continue to have hearings where we only have panelists who represent a narrow set of interests.

And I would love to ask the panel, rhetorically, how many of you are the sole or primary caregiver for an aging parent or a dependent child? How many of you are single heads of households? How many of you struggle at the end of the month with whether or not to pay your utility bill or go by groceries for your children?

I think that those perspectives deserve their time in the sun here to have their perspectives voiced as well. When we get one narrow swath of perspectives, I don't think that that does anything good for a thoughtful and robust discussion about how tax reform should move forward in a way that is fair.

I have often said that our Tax Code reflects our priorities as a country, and we need to create an environment for good-paying jobs to flourish and allow families to be able to save and have some financial security.

You want to talk about uncertainty. Many American families face an existential uncertainty from day to day, which is very different than business planning uncertainty.

Now, during my time on this committee I have been proud to work on legislation in a bipartisan fashion to try to help ease the burden of child- and eldercare costs. And it is my hope that the committee will consider those financial responsibilities and strains on families, and the nuts and bolts of those proposals, as we work to update our Federal code.

Beyond that, working families are only able to meet their needs at home when they are able to earn a decent wage at work. And while this panel seems to focus on the competitiveness of our countries -- and I am not taking that away. That is an important priority. I don't disagree that we shouldn't focus on how to make our companies competitive. But we also have to keep in mind: How do we help working families be successful as well? And it is not just about cutting the corporate tax rate. We need to look at what policies really help those struggling working families.

Questions that working families deal with, the ability to afford quality childcare or to purchase a home or to save for retirement, those should be a focus of this committee right now.

Right now, we are forcing families to make impossible choices, and I believe that by highlighting those tough issues, we will force this committee to be a little bit more thoughtful in its approach to tax reform.

With that, I have one question. Mr. Rattner, I want to know if you could speak to how addressing the problems that middle class and working class Americans face, how could that benefit the economic impact across the board?

Mr. Rattner. I think, Congressman, that would be a huge plus, because, as I have said before, there is a supply side to the economy, which is what a lot of the investment issues we have been talking about focus on, and there is the demand side. And to the extent that middle class people have more resources, are more able to go out and buy things, then that is obviously a big plus for economic growth.

Chairman Brady. Thank you. All time is expired.

Mr. Renacci, you are recognized.

Mr. Renacci. Thank you, Mr. Chairman.

And I want to thank all the witnesses for being here as well.

It wasn't that long ago that I probably could have been sitting on the other side there with you as a businessman for almost 30 years.

Mr. Rattner, I also have to say that the only reason I am here is my profitable business, my car dealership, one of them, was taken away from me during the car czar days. And, by the way, there were 53 employees in that business -- it was profitable -- who were hard-working, struggling Americans, like some of my colleagues want to talk about, that I had to let go when the business was shut down. So we have to remember, when government interferes, people get affected. And the Tax Code is affected.

And the one thing I want to talk to you about, I want to talk to you about another person that I represent. It is that 24 year old that starts out his first business. He or she starts out, and they don't have any money. So they borrow some money. They write off the interest. They start hiring people. They don't take a paycheck. They don't take a paycheck. And they hire those hard-working, middle class Americans. And they start to grow it, and then they have to look at their business, and they say: Wait a minute. I can't hire any more people, because I have got this tax burden. So I slow down on my hiring, and I have got to pay my tax burden to the Federal Government. So you can't grow and you can't bring more people on. That is a business that is not represented in the panel.

But the truth of it is that is the hard-working American that needs to be talked about as well. And, by the way, 34 years ago, that was me. I started my first business with nothing. I was a hard-working, middle class person, barely making ends meet. But I was able to live the American dream, and the Tax Code did get in the way. So the good thing about today is I heard agreement from everyone.

Here are the things I heard agreement about: We need to lower taxes. We need a territorial system. We need to make sure the U.S. is more competitive. And there is a cost to doing nothing in the form of businesses and jobs leaving. That is so important.

Now, the burden of the Tax Code, as I am aware of, corporations don't pay taxes. You all know that. Corporations pass it on.

So the more taxes you pay, you are passing it on to the individual. It is the consumer. And we have to look at that because that is higher prices to the consumer.

So here is what I really want to do. I want to get to the bottom of this. The real relief from the corporate rates going down will be to wage earners, consumers, and shareholders.

We do have the highest tax rate in the world. And because we have highest tax rate in the world, companies are leaving because they are not competitive. We know that. I am hoping the American people are watching this, because that is the truth. And I think all of you would agree with this. We have the highest tax rate in the world.

When companies leave, we lose tax revenue. We lose tax revenue. We lose tax revenue. The United States Government loses tax revenue.

So we have to become more competitive. The way we become more competitive in a global economy is dropping our tax rates. Would you all agree with that? Do you all agree we got to lower tax rates? Good.

Because that has to be the driver. We have to lower tax rates. And the disparity, really, between the income, between these tax rates, is what is driving us. So tell me, would you all agree -- because I want top end now. We can get into the weeds later. But on top end, you all would agree we have to lower our tax rates? Everyone here? You all would agree that we need to have a territorial system? You all would agree that the U.S. has to become more competitive with a lower tax rate? You agree? And you all agree that we can't do nothing.

So, I mean, we do have some agreement here, bipartisan agreement, which is great, because if we can get this economy moving, it is going to be so much better for the people, those hard-working American families.

So this is the concern I have, and I -- tell me what you think we should do immediately. I mean, immediately.

And I would like to hear an answer from everyone here. What should we do immediately? Because tax reform is difficult.

Mr. Rattner, I will start with you.

Mr. Rattner. Look, unfortunately, I think it is a package. I think you need a comprehensive package that addresses all the various issues we have been talking about today. So I don't think going in now and cutting the corporate tax rate to 15 percent or 25 percent and saying, "Okay, we have done our job," is anything remotely like a solution. I think you guys have a huge job on your hands with thousands of pieces. So I don't think, unfortunately, you can do it today or tomorrow or the next day. I think you need to take some time and do it right.

Mr. Peterson. Well, my thinking would be we have to be bold, and as you go through this process, as we just heard, it is complicated. There are thousands of pieces. But let's be bold, and let's get everything on the table, and let's fix it.

Mr. Farr. I agree. We need to be bold, and we need to bring all the constituents in, the smaller people, the people in the factory, all the way up to the board rooms. And we need to think about all the impact to these individuals and what it means. But we need to reinvest in America. Get the money back in America.

Mr. Renacci. Mr. Mottl.

Mr. Mottl. Lower it, simplify it, and change the way you collect it.

Mr. Renacci. Mr. Stephens.

Mr. Stephens. Lower the rate, create a cycle of virtuous investment, and do it right away.

Mr. Renacci. Thank you all for being here. I appreciate every one of your testimony. Thank you.

Chairman Brady. Thank you. The gentleman yields back.

Mr. Holding, you are recognized.

Mr. Holding. Thank you, Mr. Chairman.

Mr. Peterson, in your testimony, you pointed out numerous times the competitive flaw in our current worldwide tax system versus a territorial tax system. And this is an extremely important point in an area we obviously need to address in tax reform. Everyone has agreed to that. I don't think that I have taken a single meeting where someone has argued against addressing our

international Tax Code. While other countries have moved to a territorial tax system, we are one of the last remaining countries to tax the worldwide profits of U.S.-headquartered companies. Others include Greece, Chile, Mexico, and South Korea.

Now, in even more exclusive company, we are only one of two countries, Eritrea being the other, to tax the worldwide income of U.S. citizens that live and work in foreign jurisdictions.

Now, we stand in even more exclusive because we are the only country, the only country, that has, through its Tax Code, put both our companies and our citizens at a competitive disadvantage on a global stage. It is pretty remarkable when you think of it.

So, Mr. Peterson, you are the CEO of a company with global operations. Could you give me your firsthand perspective on how our Tax Code has affected the international competitiveness of both U.S. companies abroad as well as the ability for you to hire Americans for jobs in overseas operations?

Mr. Peterson. Thank you.

On the first point about some of the competitiveness, let me give you a couple of examples. In my testimony, I mentioned that we pay a tax rate of well over 30 percent, and we have competitors pay in the teens. We have a competitor who is based in Canada that operates globally, one of our largest competitors, that pays a rate of about 12 percent. There is another one of our competitors that did an inversion and moved their operations to the United Kingdom and went from a 30-percent tax rate to a 12-percent tax rate.

In addition to that, I mentioned earlier, recent acquisitions by companies moving all of their offshore cash into international operations and doing acquisitions overseas.

We are competing on a global scale. We pay the 30-percent rate. They pay 12, 15 percent rates. This is something that we feel every time we go out and have a situation where we are competing in the markets.

Our employees when we move expatriates around the world or we try to hire Americans in other markets -- they have a tax advantage, obviously. We pay our employees the same rates, which means that, for us, it is also an increased cost. We would like somebody to have the same net income and that means that we are paying for, also, their tax assistance when they are overseas. So

there is an additional burden for us to have Americans when we move them overseas.

Mr. Holding. Well, this example makes sense to you. I have a friend who works in mergers and acquisitions. They were buying a company in Hong Kong. And they were looking at moving some U.S. citizens to Hong Kong to work in executive positions there at this newly acquired company. And my friend was telling me it would cost 40 percent more to hire a U.S. citizen to do the exact same job in Hong Kong.

Mr. Peterson. That would be the right increase. Whether you are looking at people from United Kingdom, Australia, New Zealand, or from Singapore, Hong Kong, et cetera, there are always going to be about a 40-percent cost differential to hire an American.

Mr. Farr. I did this. I got paid \$125,000 a year. It cost the company \$500,000 a year to have me in Hong Kong. That is the real cost of having an American international.

Mr. Holding. All right. You know, I have also found -- I have always been struck -- you know, you go to a foreign country as a Member of Congress, and we always want to meet with the American Chamber of Commerce there in the country, whether it be Hong Kong -- we are talking about Hong Kong. And often we go there, and we don't see Americans there. But we will see British there or New Zealanders there or Australians there as executives in U.S. companies based overseas. So I think when we address the territorial -- the global -- the territorial system, we need to address how our citizens are treated as well, particularly for their earned income, and look at that as a residency-based taxation and align our citizens, along with our companies, as to how the rest of the world treats them for tax purposes.

So, with that, Mr. Chairman, I yield back.

Chairman Brady. Thank you.

Ms. Sewell, you are recognized.

Ms. Sewell. Thank you, Mr. Chairman.

I want to thank all of our guests today.

This is a critically important first hearing. I am a new member of the House Ways and Means Committee. And I can tell you that the people that I represent sent me to Washington to try to be a part of the solution, not a part of the problem. And I am really excited that we are having a hearing today about tax reform.

You know, I think it is really important that the tax reform be comprehensive and truly be a tax reform.

I am a true believer that our Tax Code is in dire need of meaningful reform. I have no doubt that, by working together in a bipartisan manner, both parties have a once-in-a-generation chance to really pass comprehensive tax reform that will benefit the middle class, small businesses, and hard-working Americans across this country.

You know, my concern, though, is that the current administration's plan doesn't seem to be a product of collaborative work. I think it is really important -- and you have heard us echo this a couple of times. And I know that our chairman is listening, and I know that he, too, understands the value of collaborative work. We all want this tax reform to truly be lasting and not just a mere one-off.

Every day, I am honored to represent my home district of Alabama, the Seventh Congressional District. The median income in my district for a family of four is \$38,000. But I know what is possible with a little bit of resources and a whole bunch of opportunities from this district. I get to live it every day. The challenge, of course, is to try to figure out how we can promote viability, great opportunities for both businesses and workers. I know that, by sitting in a collaborative manner, that we can achieve both, that there can be winners/winners and not just winners and losers.

But I have to say that I was quite concerned that what we are looking at in this current tax proposal is just more tax cuts and not true tax reform. I find it to be telling that we have been in this room for the last 3 hours almost talking about comprehensive tax reform and Vice President Pence just tweeted 20 minutes ago: I know that this President will sign into law the most consequential tax cuts in American history.

It can't just be another tax cut, gentlemen. It needs to truly be comprehensive tax reform. I know the folks that I represent have been waiting for trickle-down economics to trickle down to them. And the spigot is always off

by the time it gets to rural America. And I think we have to figure out a way to make this work.

So my question, I guess -- my first question is to you, Mr. Rattner. We talked about making sure that any tax reform is deficit neutral. I would like to talk a little bit about how we can make it distributionally neutral as well. Can you talk a little bit more about sort of supply-side economics, which you said, like trickle-down economics, doesn't trickle down to the middle class and to the working class? So can you talk a little bit about making sure any kind of comprehensive tax reform that we consider is also distributionally neutral?

Mr. Rattner. Sure, Congresswoman. And thank you for your comments.

And I would say a couple of things. First of all, I agree that it needs to be comprehensive tax reform, not just tax cuts, regardless of what the distributional effects are. I would recognize that the President, in his plan, does propose to simplify the deductions on the personal side. We can debate what should or shouldn't be in there. But I think certainly that is a step in the right direction, and we should commend him for doing that.

My problem is the distributional effects. I mentioned before that 83 percent of this tax cut on the individual side goes to the top 20 percent of Americans, an average of \$25,000 each; 50 percent, a full 50 percent, of this tax cut would go to the top 1 percent, an average of \$317,000 each. So that doesn't seem fair to me, and I don't think it is complicated to fix that. It is simply a question of what rate cuts do you give to what level of Americans. And it is just making some adjustments to those formulas. I don't think it is terribly complicated. It is just something we need to do.

Ms. Sewell. Mr. Farr, I am a firm believer that our Tax Code should incentivize the type of behavior we want to see. For me, I know that the future of work in the rural parts of my district is really quite scary. And so incentivizing apprenticeship programs and workforce development and workforce training is really important. Each Congress, I try to introduce bills that reflect that. Can you discuss the roll tax reform can play in helping companies like Emerson promote workforce development?

Mr. Farr. For sure. First of all, you have to know, I am a nine iron from Ferguson. And we put \$12 million into Ferguson for the last 2 years, including an apprenticeship program for the high school kids. I went out and raised \$2 million in funding. I think you find businesses do this, and we don't really need incentive from Federal Government. We want to help our communities. So I

think you will quickly find out that businesses, if they are really engaged in the community, will do it. And I do this -- and I tell you what, Ferguson is much better today than it was 2 years ago.

Ms. Sewell. Thank you, Mr. Chairman.

Chairman Brady. Thank you.

Mr. Schweikert, you are recognized.

Mr. Schweikert. Thank you, Mr. Chairman.

You know, when we all sit down here, we always have a series of things we think we want to ask. And this is to all my brothers and sisters sitting up here on the dais -- maybe I am being pathologically optimistic -- and outside, look, some of the political banter that seems to be obligatory to throw out, if you actually hear from the right and the left here, I think there is sort of a universal understanding that we need big, bold, comprehensive tax reform. This discussion, if you actually look at what we are doing, you know, and look -- I don't know whatever noise is out in the rest of the world, take a look at our documents; this isn't just about rates. This is big time reform.

And so, look, I have a personal fixation on this concept of velocity in our society. How many of our brothers and sisters out there, all up and down the tree, if you actually look at, like, the last 10, 14, 15 years, how little movement there really has been from different sort of stratifications. And that is a crisis for society when you don't see that movement.

I am desperately hoping for all of you as entrepreneurs and investors that a comprehensive plan, as we are moving forward, is great for the society from, you know, the person entering the workforce to the person that just wants stability and wants opportunity.

Mr. Farr, one of the things I wanted to come to you about was, when you also look at investments around the world and you are making that decision of -- you know, your shareholders, those -- what is in this tax plan, our tax plan, that makes you decide it is going to happen here in North America? What are we doing right, and what would you change?

Mr. Farr. One of the panelists said, I think education in the United States is truly unique. We have a unique education system that drives innovation and

technology. And I think if you continue to encourage that under this tax plan, that is very important.

Secondly, I think getting the tax rate down so when I look at my tax cost to do business in the United States versus England versus U.K. or China or wherever that is, getting that tax rate down, that takes it off the table. The productivity, the education, the strength of the U.S. worker is very strong. And that is very important.

Mr. Schweikert. Okay. So that is your baseline. Now we are coming to you and saying we are about to do comprehensive tax reform for our society. Does the expensing, do the rates, what are the drivers that say you are going to continue to invest in our communities?

Mr. Farr. I think all those come into play. From the standpoint -- the acceleration of the depreciation makes a big difference. From the standpoint of the recovery, the cash we put in and putting that cash back out into other investments. I think the tax rate from the standpoint of how much cash we pay in Federal taxes, State, local taxes makes a big difference. But, again, I think having infrastructure, having all these things come into play. I will go through 20 issues relative to making a decision. It is not just tax.

Mr. Schweikert. Okay. So it is unified theory. But, right now, our job is to --

Mr. Farr. Tax.

Mr. Schweikert. -- get the tax -- and then we have -- and we will have other things we have to do.

Mr. Mottl.

Mr. Mottl. Yes.

Mr. Schweikert. You made a comment before that you had to change your business model or your production line, your research, multiple times because you keep losing your customers. Could you put a little more definition on that?

Mr. Mottl. Yeah. Well, for almost a hundred years, we primarily served the telecom industry. It was my great-grandfather's account. And I watched as other countries made a very competitive environment for the people that made the chips, the boards, and all those little pieces that go in the electronics. And

then they no longer needed me to make a housing here to hold those boards and electronics. It went overseas to another country. So, you know, I watched that industry leave.

You know, for a while, we did some automotive work. There were some issues, as has been mentioned. We watched that change and disappear. Now that type of work is leaving.

Mr. Schweikert. Okay. So, in many ways, you are sort of speaking to where I was trying to go before. It is more -- there is also a cascade effect. And for all of us here, we sometimes get fixated on a single point in a complex plan and not understanding there is sort of a unified theory where, you know, this affects this, this affects that, that touches here.

And this is not just business. I mean, we are also, you know, looking at how we deal with the passthroughs, also individual rates, and how it all sort of unifies together.

For AT&T, what is the single biggest driver to get you as one of the biggest players in the world to make large capital investments in this country?

Mr. Stephens. The two biggest drivers would be the tax rate and the immediate expensing, but, quite frankly, the biggest driver would be those changes as they impact my customers.

Mr. Schweikert. Okay.

Mr. Stephens. Because right now, just as Mr. Mottl mentioned, we are losing customers who are taking their business overseas. The work that he talked about in the auto industry went overseas where I am not the primary provider. When he talked about those microboards and other equipment being manufactured overseas, I lost that customer.

So for us, let's be straight, we really believe that doing these changes will generate small business and medium-size business activity, and that will benefit us through the revenue line.

Mr. Schweikert. Thank you, Mr. Chairman. I yield back.

Chairman Brady. Thank you.

Mrs. Walorski, you are recognized.

Mrs. Walorski. Thank you, Mr. Chairman. Thank you, gentlemen, for being here.

I am grateful to represent Indiana's Second District. We are one of the largest manufacturing districts in the country. Very proud of the folks in our district. We have a lot of manufacturers, farmers, a lot of moms and dads that are just trying to pay bills and trying to get their kids through school and through college.

And I have heard from so many CEOs in my district that the American economy has succeeded in spite of our Tax Code. It hasn't helped it. And I wanted to be a part of this committee, and I am grateful to be a part of the committee to actually be looking at this. And I want to just run a couple of quotes past you on what folks in my district have said.

Barry Baldwin is a tax preparer. He talks about why it is important to lower the rates, and we have had this discussion for 3 hours on rates. And my question to you when I get there will be on rates and the issue of permanency and why it is so important to you that we don't do something that would damage, you know, your interests in tax reform by not making this permanent. But Baldwin, the tax preparer, says: "More money in people's pockets, leading to more spending. More spending creates more jobs. More jobs increase the tax base."

Gary Fox, he is a managing partner for a tax services firm in my district called Crowe Horwath in South Bend. He said: "Small and middle market companies are unable to keep capital and invest in their business with the current tax rate environments." He said: "Lower rates will allow for better capital investment. Capitalization increased full-time employment."

And then since we are a manufacturer, we manufacture nearly all the RVs in the country and worldwide, and we also manufacture boats. So Peter Barrett, senior VP of Smoker Craft said that tax cuts will allow his company to hire more workers, raise wages for their 600 employees, create new training programs, expand their plant, and make new capital equipment purchases. None of those things, he said, happened in a vacuum.

So you have heard from my district. I have heard from you. And you touched on this a little bit earlier why lower rates are so important. But I guess when we talk about the benefit of lower rates, and you touched a little bit on the issue of permanency, I just think it is important that as we talk about this, we talk about what the distractions can be if this isn't permanent. And that is how I

would like to hear your response, the issue of permanency and why it should be a top priority.

Mr. Stephens.

Mr. Stephens. So for most of the large companies, capital investments are multiyear projects. It takes years to go from the start to completion. And so as the rules change, as inconsistencies change, as the rules change, once again, for our customers and so we see demand for our services change, it makes things inconsistent and it puts higher risk. Higher risk makes people in our world be more careful with their investments. It is just a prudent responsibility we have to our shareholders.

So whether that inconsistency is in tax rates or uncertainty, whether it is in regulatory conditions, all that goes to uncertainty. Uncertainty leads to less investment.

Mr. Mottl. I think I have spent some time in your district visiting some of those RV manufacturers. Goshen, Indiana, is out there?

Mrs. Walorski. You bet. Right in the middle.

Mr. Mottl. I love it out there. Great area.

But, you know, the thing about the concern and the risk of constant changing, you know, we talk about here in Congress we can't get things done because of the distraction maybe going on, right? There is no air in the room. It is the same thing in business. If we are constantly concerned about changes and who is going to jerk our chain next, we don't do anything. We freeze up and pause. So I think it is so important to have a consistent policy.

You know, also, I have heard a lot about supply side things. You know, we are really talking here about -- I am not an economist. I am a manufacturer. But we keep hearing about supply -- we want to generate demand, demand for American workers, demand for training, and demand for skills. I have a skilled workforce shortage in my area, and I can't hire the people to run the machines --

Ms. Walorski. As do we.

Mr. Mottl. -- that we need. And so I have had to raise wages. So if we can create more demand, you will see a lot more of that. Thank you.

Mr. Farr. The key issue you hear, you have got a medium, small, large business here. We are all interconnected, so whatever happens to one happens to the other. And I think the permanency is very, very important because we do make long-term plans, and if we have the risk issue that it is going to go away next year, then we will factor that in, we will slow it down, maybe spend less money, but it does have an impact.

Why the rates are important is because I operate in a global marketplace. Like I said, over half my sales are outside the United States. My major competitors are German, French, German, French, maybe a Japanese. They all have lower rates. And if we have higher rates, I lose business.

I just recently lost an acquisition in Germany to a French company for a \$500 million acquisition. Same forecast. My tax rate is 37 percent, his tax rate is 20 percent. And I lose every day of the week.

Mrs. Walorski. Mr. Peterson.

Mr. Peterson. Tax is a major expenditure for us, as I mentioned, \$560 million last year in the U.S. If we knew what the cost was going to be and it was lower than that and we are able to predict it over the long run, we can have a completely different planning cycle and also invest for the long run. Permanency is absolutely critical to this package.

Mrs. Walorski. Mr. Rattner?

Mr. Rattner. I would just -- I would certainly echo that, but I would also just mention something the committee is well aware of, which is that achieving permanency creates an additional burden in terms of how this package is constructed in terms of the legislative process, particularly in the Senate that you are all obviously very well aware of.

Mrs. Walorski. Thank you, Mr. Chairman. I yield back.

Chairman Brady. Ms. DelBene, you are recognized.

Ms. DelBene. Thank you, Mr. Chair. And thanks to all of you for being here with us today.

I have been spending time collecting feedback from my constituents about what tax reform means to them. I represent a very diverse district in Washington State with industries ranging from a booming high technology sector to life

sciences and agriculture, and I can tell you that my constituents are asking for a middle class and small business tax relief, not massive unpaid for tax cuts for the wealthiest Americans and large corporations.

I heard from a mom who is struggling to pay tuition for three children in college and could use just a little bit of relief. I heard from a small business owner who is spending \$12,000 a year on a CPA to help him navigate the complexities of the current Tax Code instead of putting that money back into his business. And he still is paying a high tax rate.

There are countless stories. We have heard some here today just like this across my district and across the country from hard-working people who just want a bit of fairness and simplicity out of tax reform. And we have talked about simplicity. We have talked about certainty, also very important. We have talked about competitiveness. Now I want to talk a little bit more about fairness and true impact.

And so I want to share some data about what happened after the Bush tax cuts. According to a U.S. census report, median household income in 2007 was lower than it was in the year 2000. And according to the Bureau of Labor Statistics, employment and wage and salary growth were lower than in any previous post World War II expansion.

So, Mr. Rattner, I wanted to ask you what should we take away from what happened after the Bush tax cuts?

Mr. Rattner. Well, I certainly did not think the Bush tax cuts were well advised. We had a surplus when President Bush arrived. We effectively squandered it, created deficits, and as you pointed out, with no meaningful positive economic impact. So I think the lesson of all that is not to do it again.

Ms. DelBene. And how should that inform us going forward as we look at tax cuts in particular?

Mr. Rattner. Well, that should inform us, first and foremost, that they should be deficit neutral. And that you all, you are not in charge of all spending obviously, but you need to somehow with your colleagues make sure that the total package that ends up going through is deficit neutral using reasonable assumptions.

And, secondly, while I think there is a benefit in reducing rates generally, we should also -- for example, there was a discussion about R&D and the

importance of that. We should also look to -- I am not in favor of huge numbers of gimmicks or overly targeted tax cuts, but we should make sure the Tax Code is creating the incentives we want it to create, not just to invest but to train, to educate, and so on and so forth.

Ms. DelBene. Thank you.

Mr. Stephens, you said, I think pretty straightforward, more investments equal more jobs, in your testimony. In a 2016 New York Times article entitled, "Gearing Up for the Cloud, AT&T Tells Its Workers: Adapt or Else," it really talks about AT&T shifting its business towards more of a digital and computing-based business. But there is also a quote in that article that said executives estimate that eventually AT&T could get by with one-third fewer workers due to automation, et cetera.

So while you work with your workforce to train for the jobs of the future, if you are also going to have one-third less of a workforce due to automation or technology changes, that means that more investments may not mean more jobs or more workers. And so I am concerned about the idea that investment alone is always going to equal new jobs as we talk about the new economy. And I wonder if you would comment on that.

Mr. Stephens. Sure. What we are doing at AT&T is our business is changing. If you are like my children, you don't have a dial tone phone at home, you use your mobile phone. And it has happened across the country. We have gone from about 55 million of those dial tone phones down to about 25 million. So business changes. And so we need less people to take care of, you know, a 40, 50 percent loss in that customer base.

What we are doing, though, is we are giving those individuals the opportunity to retrain themselves. We use nanodegrees. We have partnered with Georgia Tech University for an online programming, at the company's cost, to give our employees an opportunity to train themselves in the next generation of products and services.

Ms. DelBene. And so I just want to -- I understand that retraining, it just still means there are less jobs, and so more investment may mean less jobs. And because I am running out of time, I just think it is important that we have an honest conversation about what technology means for the workforce and where we should be putting resources to make sure that we actually have an economy that really works for everyone.

And I am out of time, and so I just want to yield back, Mr. Chair.

Chairman Brady. Mr. Curbelo, you are recognized.

Mr. Curbelo. Mr. Chairman, thank you very much for this hearing, and I thank the witnesses. I am also grateful that my colleagues have expressed broad bipartisan support for a comprehensive permanent and revenue-neutral tax reform.

We have the opportunity to reform and streamline existing programs in the Tax Code, like education incentives that will give families more flexibility in saving for their children; promoting greater access to cleaner, more efficient energy technologies; and seeking solutions for the people of Puerto Rico, who face a demoralizing economic outlook.

But for me, Mr. Chairman, tax reform is about expanding freedom and opportunity for the American families of today and those of the future. I think about my immigrant parents and how they were able to come to this country and earn success. When they first arrived, it was tough. My mom helped her mother run a small fabrics business. On some days, my dad sought food and couldn't find any. Yet thanks to the possibilities afforded to them by the American economy, they were able to earn more, put away some money, buy an apartment, and start a family. The social safety net back then was not as expansive as it is today, but opportunity was boundless.

My wife and I think about our own two daughters. I want to make sure they grow up in a country where they can find their own success and blossom. The decisions we make in this committee in the coming months will make that either more or less possible.

I think of all those young people who went to college and can't find quality jobs, and small businesses back in South Florida, the mom-and-pop bakeries and small restaurants where I often stop by in the mornings to grab my shot of Cuban coffee. Will our country offer them the opportunity to grow and invest? Or will we just sit back and watch opportunity in our country diminish?

There is good news in the blueprint for every Florida family. My State could see as many as 97,220 new jobs and an estimated gain in after tax income of \$4,248 per household, according to the tax foundation. Counties like Miami, Dade, and Monroe, which I am privileged to represent, I think especially stand to benefit given the entrepreneurial culture there.

To our witnesses today I have one question very unique to my area. Miami, south Florida, is often called the Gateway of the Americas. There is so many opportunities, so many ways to access different markets from Miami. However, we also face competition from all those countries in Central South America, Europe, and really all over the world, because Miami is becoming a meeting point for people and goods from all over the world.

Mr. Farr, given your perspective for those entrepreneurs in Miami who are creating jobs, who are innovating, who are opening new markets for American products, what is the difference for them between permanent comprehensive reform and short-term tax cuts?

Mr. Farr. Thank you. First of all, we use Miami as our gateway into Latin America, so I couldn't resist.

Mr. Curbelo. Thank you.

Mr. Farr. I mean, the big impact for people starting up is having a know the tax rate will allow them to make those long-term investments. I mean, when you start a company up, you are putting money on the line and it is going to be there for a long time, and you want to know what that tax structure is going to be. And I think that is very critical for these young people starting up these companies, having the permanence, having the knowledge of what that tax rate is going to be, what the rules are, and make them simple. For small companies they have to be simple. I have hundreds of tax lawyers and tax accountants to deal with this, but in small companies you have got to make them real simple, keep the rates low, and they will invest and grow, and that is how it works.

Mr. Curbalo. Thank you, Mr. Farr.

Mr. Stephens, I want to offer you the opportunity to send a message to the American worker. We all know how frustrated the American worker is. A lot of people in this country just don't feel like success is attainable for them. A lot of these young people go to college, get a degree. They were promised that they would be able to find a good job and they can't find one today. And a lot of these people have watched over the last 7, 8 years this economic recovery where the wealthy have done quite well, the statistics show that, yet lower- and middle-income Americans have struggled.

Some of these people might be watching this hearing today. Maybe one or two of them. Hopefully more. What do you have to say to them? Why is this

important to them? How can comprehensive, bold, permanent tax reform improve quality of life for middle- and lower-income Americans?

Mr. Stephens. So for all businessmen the question of investments comes down to what returns they can make, and when the government takes 40 percent between the Fed and State and another location takes 20 percent or less, it makes it very difficult to make the decision to invest here.

If we balance that out, if we make that competitive, those investments will come here. This will be the biggest jobs bill that this committee could support, because with those dollars of investments comes the opportunities to do research, do innovation, do construction.

Mr. Curbelo. So tax reform equals more and better jobs?

Mr. Stephens. It is a jobs bill first and foremost.

Mr. Curbelo. Let's leave it at that.

Thank you, Mr. Chairman. I yield back.

Chairman Brady. Thank you.

Mr. Bishop, you are recognized.

Mr. Bishop. Thank you, Mr. Chairman, and thank you for the opportunity to be here on this very important hearing, and thank you for your tenacity in pursuing this package of tax reform measures.

Gentlemen, thank you so much for your testimony here today. Thanks for sticking it out with us. I am the last of the group. Ms. Chu and I will be the last. And so much has been discussed. We all have the same interests. We want to deliver comprehensive tax reform, and we think in this case the blueprint in front of us will deliver profound tax relief to all Americans, and that is what we are hoping to see.

I am from Michigan. Lots of great things going on in Michigan, but manufacturing is very important. It is our life blood. And I want to share with you a letter and an article that I read in New York Magazine on May 15 from a gentleman by the name of Mark Schmidt, who is also the president of a company called Atlas Tool. They are out of Roseville, Michigan. His testimonial on the existence of the tool and die industry is alarming. Given the

fact that this is America, we can't afford this to happen, but he suggests that the United States manufacturing sector is dying. The tool and die business in particular is gone. His business, which is full of employees with high skills, and their well-compensated workforce is being choked off. And it is because we have done nothing to level this playing field.

And I would just like to know, given the short amount of time that we have, and I know you can't do everything to give solutions here, but his suggestion is that the Chinese prices are so low that they cannot afford to buy their major dies from anywhere else. The major manufacturers. And he lists why they are low, and most of it has to do with China subsidizing their businesses.

He also said that the industry has lost approximately 70 percent of its companies and 80 percent of its skilled jobs. And the most alarming thing in his conclusion was "our industry will soon lack sufficient capacity to supply the free world's automotive market." If that doesn't send off bells and whistles, and if that doesn't tell us that this is absolutely the most urgent thing that we can be doing right now in terms of public policy, I don't know what will.

So I guess I will start with you, Mr. Mottl. This is your namesake, so I better make sure that I ask you first what you think about this, and if there is anything that we can do right now that would address this problem.

Mr. Mottl. Well, thank you, Mr. Bishop. I know the company. As soon as we get their phone calls, we send them the right way, and I hope they reciprocate. But, you know, the issue you are talking about is exactly what has happened in my business too. And, you know, the problem is -- well, I don't know if it is a problem, but we need to make a profit here, and we are competing against companies that don't need to make a profit. Their banks will keep giving them loans and loans and loans just to have full employment.

So the Chinese just flew their first jetliner. You know, I talked about the industries I have lost. Now I am in aerospace and I am in medical, so I am worried what is going to happen to the aerospace industry when they have to compete against a company that has no need to make a profit, only to corner the market. And that is a fine strategy for that country, and kudos to them for pursuing it, but how can we engage in a different way so companies like Atlas Tool and my Atlas Tool can be competitive, we can create demand. I think it is right here in this room. We are talking about it today. Thank you.

Mr. Bishop. Thank you very much.

Mr. Farr, I know you are --

Mr. Farr. Oh, I am ready to go on this one. I tell you what, we have lost so much of our industrial base because of our antiquated tax policies, and we have allowed these companies to leave. We have allowed technology to leave.

President Roosevelt took over our two facilities in manufacturing in 1939 for one reason: all our tool and die makers. He took over all our plants and almost put us out of business during the war, because we couldn't make motors anymore. But this technology is leaving, and we have got to figure out how to invest back in this country, again, not only to lower taxes, but put money back in education, into R&D. We can compete against the Chinese if we have a level playing field. Americans want to compete to win, and I believe that wholeheartedly.

Mr. Bishop. Thank you, gentlemen.

Mr. Chairman, I know you are pressed for time, so I yield back.

Chairman Brady. Thank you, sir.

Ms. Chu, you are recognized.

Ms. Chu. Mr. Rattner, I would like to ask you about tax reform as it relates to small businesses. For every year that I have served in Congress, I have served also on the Small Business Committee, and it is because I truly believe that small business is the key to the American dream. In fact, my grandfather came to California with nothing but opened up a small Chinese restaurant and it just had a handful of employees. It was not a fancy place. But he worked day and night and night and day, and it was enough to keep the family going.

Now, the Trump tax plan slashes the tax rate for passthrough entities from the current rates to a rate of 15 percent, claiming that this is a tax cut for small businesses. But just this week, the Tax Policy Center found that over three-quarters of the benefits of this cut would accrue to the top 1 percent of earners. In fact, the top 1 percent, 1 percent would see their after-tax incomes climb to \$76,000.

So, Mr. Rattner, could you elaborate on how and why this tax cut would be so beneficial to the wealthiest few?

Mr. Rattner. I am sorry, Congresswoman, just that last part, elaborate on what?

Ms. Chu. How this tax cut would be beneficial to the wealthiest.

Mr. Rattner. Well, as I said before, there are many wealthy people, and I think the study you cited seems to have put together some data, but there are hedge funds, there are private equity funds, there are businesses, not really small businesses, there are publicly traded firms that are taxed as passthroughs with billion dollar plus market capitalizations, and they would all receive that 75 percent, I think you said, of the benefits of this.

And so I think that the idea of lowering the tax rates for true small businesses is certainly a worthwhile goal. But I express some skepticism about the ability to address the passthroughs in some way where you leave one group on one side paying their fair share and the other group on the other side getting some benefit. I think it is a very, very hard thing to do. And I think, frankly, our current system with the passthroughs is probably a better system but without lowering the rates to 15 percent, because I think that would confer too many benefits on the wealthy.

Ms. Chu. In fact, let me follow up on that, because so many people refer to the passthrough income as if it were all small business income, and, in fact, many have argued that this type of rate reduction is critical to the success of small businesses.

But can you tell us what kinds of businesses would qualify as passthroughs? Are there any distinctions drawn between the mom-and-pop restaurant or wealthy lawyers and lobbying firms? For instance, would the Trump organization be a passthrough?

Mr. Rattner. Trump organization would be a passthrough, but as we know, he doesn't pay a lot of taxes anyway, so I am not sure how much benefit he would get.

The administration has said that it would address the problem that you and I are both talking about of excessive, undeserved benefits going to very wealthy individuals or very, very successful large businesses, but they have produced no specifics. And as I said, I am personally reasonably skeptical that there is a way to draw those lines to give benefits to those who truly deserve them without having a lot of leakage, so to speak, to people who don't deserve them.

I have many friends who are in the investment business who operate as passthroughs, and I don't see any reason why they or I should get a 15 percent tax rate.

Ms. Chu. Let me turn now to the Kansas model. I was very interested to see that in 2012, Kansas cut taxes dramatically. They, in fact, exempted passthroughs from paying any State income tax at all. They cut the taxes on profits for more than 100,000 businesses. In fact, the largest benefits were for upper middle class households, and there was massive revenue losses. Kansas was then forced to raise the sales tax, get pension payments, and even shortened the school year to save money.

Can you comment on what is happening in Kansas and how could we avoid this pitfall on the Federal level?

Mr. Rattner. I am not an expert on Kansas, but I think it highlights a critical issue that we have talked about in this committee hearing but I think really needs to be front and center, which is that there is no free lunch, unfortunately. That you can't simply -- Kansas was, in effect, a supply site experiment. We will cut taxes massively. We think there will be so much economic activity, it will somehow make up for that lost revenue, and it didn't happen. And it hasn't happened in the past with tax cuts at the Federal level either.

Tax cuts are fine, but they do not pay for themselves, they simply don't. And that is the lesson that this committee needs to be mindful of. And in constructing its tax package, it should be deficit neutral using reasonable economic assumptions. So all the things that we all advocate, you all have to find way to pay for them.

Ms. Chu. Thank you.

Chairman Brady. Thank you.

Mr. Rice, you are recognized.

Mr. Rice. Thank you, Mr. Chairman.

Before I came here, I was chairman of Horry County Council in Horry County, South Carolina, and I saw firsthand how counties compete vigorously to attract investment by industry through regulatory changes, tax changes. And in States like South Carolina, for example, one of the top five States to do business, have

done the same thing to attract -- to be more competitive and to attract investment, and it has worked. BMW, Boeing, Volvo, Mercedes, and on and on and on.

But what has our country done? You know, where our country fails to recognize, we argue about, you know, maintaining this level of revenue or that or how these benefits are going to be disbursed through society, but the fact that we have got to recognize is we are in a global competition. You know, we can change a lot of laws here in Washington, but one law that we can't change is economic law. And we can't change the law of economic competition.

I have a question. Mr. Mottl, I thought your testimony was right on point about the border adjustment and the VAT and why other countries have done that. They agree to lower tariffs in trade agreements and then they put in VATs, and it is simply a disguised tariff. And it puts us at a huge disadvantage.

Mr. Mottl, just assume this scenario. If you have got an American company paying a 35 percent tax rate, and you have got a European company, an Irish company paying a 13 percent tax rate in a VAT, and they both compete to buy the same materials, they both make the same product, and they both compete globally for the same customers. Can you tell me the end of that story?

Mr. Mottl. The one with the VAT tax is going to win because they refund that money when they export it.

Mr. Rice. The American company is either going to go bankrupt or they are going to get bought by the Irish company, right?

Mr. Mottl. Absolutely, sir.

Mr. Rice. Mr. Rattner, do you disagree with that?

Mr. Rattner. I don't disagree with that, but I think we have to recognize that the VAT would have a number of consequences and uncertainties.

First of all, it will be a massive upheaval in our economy as certain companies benefited --

Mr. Rice. But we also recognize -- we also have to recognize there is 150 or 40 other countries around the world, including every single major industrial country, including every one of our competitors that are doing the exact same

thing. And how can we sit here on our hands and put our American companies at a disadvantage to those?

Mr. Rattner. It is not completely one-sided. We have State and local sales taxes, which function as a form of VAT, admittedly at a lower level. But remember that this is all predicated on some very uncertain adjustment in the dollar, which if it does not happen, would involve raising prices very, very substantially for middle- and working-class Americans who typically buy a higher percentage of their goods imported from people like we do.

Mr. Rice. Income tax cuts. If the currency doesn't adjust fully, there will be some increase in prices. Based on these tax foundation estimates, their incomes will go up by \$4,000 a year, far more than these potential sales costs would.

You know, the size of the American middle class and their income level has really declined, and it is not a recent phenomenon. It has declined in the last 8 years. It declined 8 years before that and 8 years before that. It has been going down since 1990. Twenty years. The last time the Code was revised was 1986. I wonder if there is some maybe correlation there.

The decline of the American middle class and the growing income inequality that we all fuss about is a direct and foreseeable result of the continued deterioration of America as a place to do business. Our Tax Code puts American companies at a disadvantage, and that translates to the loss of millions of middle class American jobs.

If we truly want to grow the middle class, if we want to give them a raise, if we want to reduce income inequality, we must make our Tax Code competitive in the world. That has got to be our number one goal.

I yield back, Mr. Chairman.

Chairman Brady. Thank you, Mr. Rice.

Mr. Higgins, you are recognized.

Mr. Higgins. Thank you, Mr. Chairman.

Just a couple of things. You know, the American economy, we are 5 percent of the world's population, we are about 23 percent of the world's economy. We have the strongest economy in the history of the world, but despite all the macroeconomic indicators pointing up, job growth, low unemployment, growth

in the stock market, we lost 6 million manufacturing jobs in the past 15 years. 56,000 factories have closed.

We just had an election where two unconventional candidates rose pretty quickly on both sides. Now, Donald Trump, our current President, beat 16 established Republican candidates. Hillary Clinton on the Democratic side was challenged by a 73-year-old socialist from Vermont who garnered 12 million votes and won 21 primaries or caucuses.

There is something underlying that isn't being addressed, and I would argue that it is income inequality. And regardless of our political persuasion, we all have a major stake in this.

Let me give you an example. Between 1945 and 1980, we had productivity gains in the American economy by 97 percent. Real income and wages go at the same time by 95 percent. There was shared prosperity. Economists would call that a virtuous cycle or circle of growth. And the American CEO felt it was their responsibility to balance the economic interests of all of the stakeholders, the shareholders, the owners of businesses, the managers and the employees and the communities within which these corporations operated.

Between 1980 and present, we have had productivity gains in the American economy by 89 percent. Real income and wages have grown by 9 and three-quarter percent. So if you are looking for the cause of the political disruption that people just voted for, it is that underlying issue of economic inequality.

Now, I think a lot of people would view that personally and say, well, you know, that means more taxes for me, and I oppose that. I don't think that is necessarily the case. I think we can reach a point at which we can move our tax policy out of a political realm. Perhaps that is naive. But tax policy either works or it doesn't.

You know, I think supply side is discredited. The new term for that is "dynamic scoring" that basically says that tax cuts will pay for themselves. Tax cuts do not pay for themselves, ever. So I think what we need to do is address what is going on here in the American economy because, as I said, people voted for disruption.

Mr. Rattner, let me just say this to you: Supply-side trickle down dynamic scoring says let's give the very wealthy a big tax cut, and that money will find

its way back into the economy in new business investment, in job growth, right? Wrong. It hasn't worked.

Today, American companies are holding \$2.5 trillion abroad, an increase of nearly 20 percent in the last 2 years. It is 14 percent of the American economy. United States companies are holding \$1.94 trillion in cash domestically. Zero yielding money markets are holding \$2.66 trillion in investor cash, and banks are holding over \$2 trillion in excess reserves in the Federal Reserve. Taken together, that is over \$9 trillion.

Why isn't that money finding its way in the American economy? And why would massive tax cuts to the wealthy have any measurable difference in what it hasn't done historically, Mr. Rattner?

Mr. Rattner. I think there is a number of complex reasons around what you are saying. First, I think the issues with manufacturing in the U.S. are not simply a function of the Tax Code. There is a whole variety of factors that have caused us to lose quite a number of our manufacturing jobs, particularly the rise of other countries being able to do what we do.

Secondly, as you point out, there is an abundance of capital in this country. What there is a lack of are investment opportunities. Some of that may have to do with the Tax Code, a lot of it has to do with the perception that our economy is not growing that fast, there isn't that much demand, and so why build a factory to make something if you don't have people out there with the money to buy it.

I see we are out of time, so I will stop there.

Chairman Brady. Thank you.

I would like to thank our witnesses for appearing before us today. This is a discussion about how we grow jobs, grow paychecks, and the U.S. economy, and the role tax reforming is doing that. You have made all a very compelling argument for bold tax reform, permanent tax reform and doing it now.

So I want to thank you for being here today. Please be aware the members of the committee have 2 weeks to submit to you written questions to be answered later in writing. Those questions, your answers, will be made part of the formal hearing record.

And again, on behalf of the committee, thank you. The committee stands adjourned.

[Whereupon, at 1:41 p.m., the committee was adjourned.]

MEMBER SUBMISSIONS FOR THE RECORD

Assessing the House Republicans' "A Better Way" Tax Reform

Alan Auerbach

University of California, Berkeley

Laurence Kotlikoff

Boston University

and

Darryl Koehler

The Fiscal Analysis Center

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Overview of the House Republican Tax Plan

The House Republican “A Better Way” tax reform¹ plan includes a significant redesign of our business tax system. It effectively would replace the corporate income tax with a 20 percent destination-based business cash-flow tax. Proprietorships, partnerships, S corporations and other pass-through entities would face a distinct schedule with a top rate of 25 percent on pass-through income, leading to a need for provisions to limit the ability of high-income households to move income from the new top 33 percent personal rate to the 25 percent rate.

The reform would also streamline and significantly simplify personal income taxation by eliminating the Alternative Minimum Tax, unifying the tax treatment of personal asset income (taxing half of personal asset income), eliminating exemptions, eliminating the deductibility of state income and property taxes, raising the standard deduction and modifying the child-tax credit. In addition, the plan moves from seven to three income-tax brackets, with the top rate lowered from 39.6 percent to 33 percent.

This paper examines the reform’s potential impact on revenues, inequality, and fiscal progressivity.² The plan’s proposed reform of business taxation is particularly significant for potential U.S. investment. Current net domestic investment is quite low -- just 5 percent of net national income. In 1950s it was roughly three times higher.³ Although it is formally a “worldwide” tax system, today’s U.S. corporation income tax primarily taxes U.S. and foreign corporations on income earned from investing in the United States.

There is a significant debate about the size of the marginal U.S. effective corporate tax rate both in absolute terms and relative to rates in other countries. Mintz and Chen (2014) suggest that the United States has one of the world’s highest marginal effective corporate tax rates. (See figure 1). Gravelle (2014, 2016) suggests otherwise. Mintz estimates that the comprehensive (federal, state, and local) marginal effective corporate tax (METR) on investing in the U.S. would fall from 34.6 percent to 16.1 percent as a result of the tax plan.⁴ The Tax Policy Center estimates the tax plan would lower the federal part of the METR from 24.0 percent to 8.8 percent.⁵

Gravelle sees a much smaller decline. Mintz’s estimate of the METR includes state corporate income, property, and other taxes. Gravelle measures only the federal METR. Gravelle estimates the current federal METR at 5.7 percent, falling to – 4.7 percent under the House tax plan.⁶

¹ https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf

² We do not consider the plan’s proposed elimination of the estate and gift tax.

³ Our net national saving rate is also roughly one third of its average value in the 1950s. But domestic investment, while correlated with national saving, is not determined by national saving. This is clear from the historical record on current account deficits. In 2003, for example, foreign investment in the U.S. exceeded investment by Americans in the U.S. (i.e., it exceeded total net national saving). Recently, the current account deficit has shrunk.

⁴ See <https://taxfoundation.org/competitiveness-impact-of-tax-reform-for-the-united-states/>

⁵ See table 8 in

https://taxlawjournal.columbia.edu/article/an-analysis-of-the-house-gop-tax-plan/#_Toc476651282.

⁶ This is Gravelle’s (2017) estimate.

Although the absolute values of their METRs differ dramatically, the implied percentage decline in the cost of capital are somewhat closer.⁷ Mintz foresees a 28.3 percent decline in the overall cost of capital. The TPC expects a 20 percent decline in the federal METR. And Gravelle estimates a 9.54 percent decline in the federal METR.⁸

If the highest of these estimates is on the mark, the tax plan could significantly increase U.S. investment and wages, with an eventual real wage increase possibly as high as 8 percent, according to dynamic simulation analysis based on the Global Gaidar Model.⁹ In our analysis we consider no dynamic feedback on U.S. wages as well as this optimistic 8 percent wage-increase dynamic feedback scenario, in order to explore the range of possible outcomes.¹⁰

The tax plan permits businesses to expense (immediately write off) the cost of their new investment. The proposed new corporate income tax also features border tax adjustments to ensure that companies no longer have an incentive to either move their operations or to shelter their profits abroad. The resulting tax is a *cash flow tax* because it taxes all revenues earned from

⁷ The percentage change in the cost of capital is calculated at the change in the METR divided by 1 minus the initial METR.

⁸ If inclusion of non-federal corporate components to the METR raised Gravelle's METR under the current system from 5.7 percent to 20.7 percent, her percentage fall in the cost of capital would be 11.35 percent, which is still far lower than the 28.3 percent decline estimated by Mintz.

⁹ An 8 percent increase is generated in the Global Gaidar Model by reducing the U.S. corporate tax by 53.5 $((34.6-16.1)/34.6)$ percent holding marginal taxes of other regions of the world constant and maintaining fixed U.S. debt to GDP during the transition. GDP also rises by close to 8 percent. Development of the Global Gaidar Model represents joint work of Laurence Kotlikoff and a team of American and Russian economists. It is a 17-region, 90-period version of the original Auerbach-Kotlikoff dynamic life-cycle CGE model. The model covers all regions of the world, incorporates the latest United Nations demographic projections, and is calibrated to the most recent IMF data. Benzell, Kotlikoff, and Lagarda (forthcoming 2017) uses the Global Gaidar Model to study the dynamic impacts on the U.S. and other regions of the House tax plan. Unlike other studies of dynamic feedback arising under the House tax plan, the Gaidar Model captures the size of the U.S. economy relative to the global economy. This matters for properly assessing the magnitude of capital inflows to the U.S. in response to corporate tax reform.

¹⁰ We say "optimistic" for five reasons. First, other regions could respond to the U.S. move to a cash-flow tax by reducing their corporate tax rates or adopting the new U.S. business tax system. Second, Mintz's calculation of the reduction in the effective marginal corporate tax rate under the House tax plan may be overstating the change. While there is a standard method of calculating marginal effective corporate tax rates, researchers differ on their assumptions about weighting different types of capital goods as well as the degree of marginal debt finance. Third, the various modeling assumptions in the Global Gaidar Model might produce more sensitive capital flows than would result from alternative assumptions. Fourth, our estimate of an 8 percent rise in wages in the Gaidar model is predicated on the maintenance of the current U.S. debt to GDP ratio through time. If the Gaidar Model's assumption of a very quick transition to higher U.S. investment and, therefore, higher wages, with its associated addition to revenues, is inappropriate, U.S. debt to GDP could rise. If not reversed, this would produce a smaller than 8 percent increase in real wages in the Gaidar Model. We should add, though, that in at least one respect the model's assumptions might underestimate the growth of US domestic investment and hence real wages. The model excludes discrete location decisions regarding investments that yield rates of return in excess of the required returns. Empirical evidence (e.g., Devereux and Griffith, 1998) suggests that such decisions are responsive to international tax rate differentials, which would increase substantially in favor of the United States, which would impose a tax rate of zero on domestic-source income under the proposal. Fifth, if more investment entails more automation it could, as in Sachs and Kotlikoff (2012), lower, not raise wages.

sales within the U.S. less all costs.¹¹ Costs include outlays on goods, including investment goods, whether imported or produced locally, as well as all wages. Mathematically, this business cash flow tax is equivalent to imposing a subtraction-method, destination-based Value Added Tax (VAT) with an equal-rate subsidy to wages.¹²

Since a household's current and future consumption is financed by its current and future wages plus its current net worth, the combination of a VAT and a wage subsidy is effectively equivalent to taxing initial wealth as well as the future returns to capital in excess of the required market rate of return. This makes the business tax reform a significant progressive element of the overall tax plan, which offsets some regressive features of the tax plan's personal income tax reform, notably the reduction in the top rate from 39.6 percent to 33.0 percent.

This paper assesses the revenue effects, progressivity and work incentive effects of the Better Way tax plan. We also consider a modification of the tax plan, namely one that also eliminates the ceiling on Social Security's FICA payroll tax. We distinguish below between *the tax plan* (the House Republican tax plan) and *the modified plan*, which includes lifting the FICA ceiling.

Lifting the FICA ceiling would generate more revenues and raise progressivity relative to both the current system and the tax plan. It would help shore up Social Security's finances and, potentially, enhance political support. But it represents just one of many ways to modify the tax plan, and is in no way linked to the House Republican plan.

Methodology

To measure the effects of the tax plan as well our modified tax plan on revenue, inequality, progressivity, and work incentives we ran all households sampled in the Federal Reserve's 2013 Survey of Consumer Finances (SCF) through *The Fiscal Analyzer* (TFA). TFA is a detailed life-cycle consumption-smoothing program that incorporates both borrowing constraints and lifespan uncertainty as well as all major federal and state tax and transfer programs.¹³

In the course of doing its consumption smoothing, TFA determines each household's expected present value of remaining lifetime spending, where the term *expected* references averaging over different longevity outcomes and spending encompasses all expenditures, including terminal bequests net of estate taxes. The impetus for focusing on remaining lifetimes, rather than just the current year, comes from standard life cycle economic theory, which postulates that people care about the future, not just the present.

The lifetime budget constraint facing each household is given by

$$(1) S = R - T,$$

¹¹ The House business cash flow tax is similar in many respects to that proposed by Auerbach (2010) as well as The Growth and Investment Tax Plan proposed in 2005 by The President's Advisory Panel on Tax Reform (see <https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Fix-Tax-System-2005.pdf>)

¹² The border adjustment can be implemented by having firms simply exclude revenues earned from exports and costs incurred from imports.

¹³ See Auerbach, Kotlikoff, and Koehler (2016).

where S references the present expected value of a household's remaining lifetime spending, R stands for remaining lifetime resources (the present expected value of remaining lifetime labor earnings plus its current net worth) and T stands for the present expected value of remaining lifetime taxes net of transfer payments received. The average net tax rate, t , is defined by

$$(2) t = T/R,$$

and the marginal net tax rate, m , is given by

$$(3) m = \Delta T/\Delta R,$$

where ΔT references the change in the present expected value of net taxes associated with an increase of ΔR in the present expected value of resources. Thus, if the expected present value of a household's spending is, for example, 65 percent of remaining lifetime resources, its average net tax rate, t , equals 35 percent. And if earning, say, another \$10,000 this year changes T by \$3,000, the marginal net tax rate is 30 percent.

Average remaining lifetime net tax rates tell us not only the net share of their resources that households surrender to the government. They also tell us about the progressivity of the fiscal system. If average net tax rates rise with the level of resources, the fiscal system is progressive. If they fall, the system is regressive. If they are independent of the level of resources, the system is proportional.

This paper, like our prior studies using TFA (Auerbach et. al., 2016, Auerbach et. al., 2017), calculates inequality and the progressivity of the fiscal system on a cohort-specific basis. Specifically, we consider inequality by looking within 10-year age cohorts at the share of total remaining lifetime spending attributable to households falling within different within-cohort percentiles of remaining lifetime resources, R . To measure progressivity, we again look within cohorts, but at average remaining lifetime net tax rates rather than at shares of the cohort's total remaining lifetime spending.

We use cohort-specific analysis to consider inequality and progressivity because failing to do so amounts to comparing apples with oranges. Ranked by remaining lifetime spending, older cohorts would look poorer than younger cohorts simply because they had shorter remaining lifespans. And remaining lifetime net tax rates of older cohorts would appear lower than those of younger cohorts simply because the elderly would receive no credit for net taxes paid in the past and appear to be subsidized because they are collecting or will start to collect Medicare, Medicaid, and Social Security benefits sooner than younger cohorts.

Modeling the Current Tax System

Auerbach et. al. (2016) and Auerbach et. al. (2017) discuss TFA's modeling of the current tax system. We take several steps here to match the Congressional Budget Office's 2017 revenue projections. First we inflate all dollar amounts reported in the 2013 SCF data by nominal average

wage growth between 2013 and 2017.¹⁴ Second, we inflate all wage and self-employment income by 9 percent to match the CBO's 2017 projected FICA tax receipts.

Third, we assume a corporate tax rate to match CBO's 2017 corporate revenue projections as closely as possible. We levy this corporate tax on the model's assumed pretax return to stock holdings. Stock values have risen faster than wages between 2013 and the present. In addition, the SCF respondents appear to underreport their stock holdings. Third, the CBO's makes various assumptions about corporate income-tax collections in reaching its 2017 projected total. Finally, not all corporate equity is held directly or indirectly by US households, but in our analysis we are assuming that there is no shifting of the corporate tax to others, either domestically (e.g., US workers) or abroad (e.g., foreign shareholders). To capture all of these factors, we simply set the corporate tax rate in the TFA to reproduce the CBO's 2017 corporate tax total.

Fourth, the SCF asks respondents what they specified as taxable capital gains, dividends, and interest income on their 2012 individual tax returns. We used these data (adjusted for wage growth) in calculating personal¹⁵ income taxes under both the current tax system and the House tax plan. In the case of taxable capital gains income, we formed, by cohort and resource decile, total reported (realized) capital gains divided by total stock holdings. We vary these capital-gains, income-realization rates through time as respondents move from one age cohort to another. We engage in an identical resource-specific decile procedure to determine respondents' shares, as they move from one age group to another, of stock holdings out of total financial assets.

Modeling the Better Way Tax Plan

As mentioned, the business tax part of the House Republican tax reform effectively implements a tax on wealth. According to Burman et al. (2017), based on estimates using the Tax Policy Center model, the plan's cash flow tax is close to revenue neutral ignoring changes in revenues arising during the transition from the current to the new business tax system.¹⁶ Since the Better Way tax plan leaves many transition details unresolved, it seemed best, to measure its long-run consequences, simply to ignore transition revenue effects and form our calculations assuming the cash flow tax generates the same revenues as the current corporate tax system.

Since the cash flow tax represents an implicit tax on consumption financed out of wealth, we capture its impact by introducing a one-time tax on wealth in TFA. This tax is assessed only on net financial wealth; i.e., its base excludes home equity since the tax plan, like the current tax system, does not treat the receipt of imputed rent on owned homes as business income. We set the rate for this net financial wealth tax at 13.6 percent. This tax rate was chosen because it

¹⁴ <https://www.ssa.gov/oact/cola/AWI.html#Series> reports Social Security's average wage index series through 2015. We assume the same growth rate for 2015 and 2016 as that reported for 2014.

¹⁵ In both procedures, we assume that respondents in resource decile j will remain in resource decile j as they move from one ten-year age bracket to another.

¹⁶ According to Table 2 in their paper, the corporate tax provisions would reduce revenues slightly, by a total of \$192.5 billion over the decade 2027-2036.

reduces TFA's 2017 total consumption spending by roughly \$315 billion, which is the amount of 2017 corporate tax revenues generated by TFA under the current tax system.

On the personal income tax side, we follow the tax plan with respect to all specified details. One detail that is not clearly specified is how the tax plan will prevent high tax-bracket households who receive pass-through self-employment and other income from declaring all their income as business income to permit its taxation at 25 percent. The Better Way tax reform document hints at the implementation of a limit on such behavior. Our guess of how this limit would be imposed is the implementation of a ceiling on the share of income that would otherwise be taxed at a rate above 25 percent that can be declared business income. We set the share of such income that cannot be claimed as business income at 25 percent. (Assuming a higher share would lower our estimated revenue loss from the proposal.)

TFA-Generated 2017 Revenues Under the Current Tax System

The CBO projects 2017 personal income tax, FICA tax, and corporate income tax revenues of \$1.651 trillion, \$1.150 trillion, and \$320 billion, respectively.¹⁷ TFA's corresponding 2017 tax revenues estimates are \$1.791 trillion, \$1.104 trillion, and \$330 billion, respectively. Thus, relative to the CBO, TFA is 8.48 percent high in estimating federal income taxes, 4.00 percent low in estimating FICA taxes, and 3.12 percent high in estimating corporate income taxes.

Findings

Revenues

Absent dynamic feedback (DF) effects, the House tax plan loses \$212 billion in revenue on an annual basis, according to our methodology. With DF effects, which we again stress appear to represent an upper bound for wage growth under the plan, there is an annual revenue gain of \$38 billion. With DF effects and the lifting of the FICA ceiling, there is a \$328 billion annual rise in revenues.¹⁸ These potential revenue changes need to be compared with our model's baseline total federal revenue (including just corporate and personal income taxes) of \$3.272 trillion. Absent DF, the tax plan produces 6.5 percent less federal revenue. With the posited DF response, the revenue gain is 1.2 percent. And with the modified tax plan, which includes elimination of Social Security's FICA taxable earnings ceiling, the revenue gain is 10.0 percent.

Spending Inequality

We present results for the 40-49 year-old cohort as the findings for other cohorts are quite similar. Figures 2 through 5 consider spending inequality under a) current law, b) the tax plan

¹⁷ <https://www.cbo.gov/about/products/budget-economic-data#7> provides the CBO's projections as of January 2017.

¹⁸ This last estimate is in a sense even more optimistic than the basic DF estimate and should be regarded with caution, as it assumes the same growth in wages even though individuals above the FICA ceiling face higher marginal tax rates on their labor earnings.

with no DF, c) the tax plan with DF, and d), the modified tax plan with DF. The figures also show inequality in net wealth.

As figure 2 shows, remaining lifetime spending is less unequal than is net wealth. This is due to a more equal distribution of human wealth as well as the progressivity of the fiscal system. Under the current system, the top 1 percent (measured in terms of R) of 40 year olds own 19.0 percent of the wealth, but account for only 11.5 percent of the spending. In contrast, the poorest 20 percent account for only 2.5 percent of total cohort wealth, but 6.3 percent of cohort spending.

As figure 3 indicates, the House tax plan, absent any DF increases in labor income, increases the spending share of the richest 20 percent from 51.0 percent to 51.6 percent. It raises the spending share of the top 1 percent from 11.5 percent to 11.7 percent. The poorest 20 percent experience a fall in their spending share from 6.3 percent to 6.2 percent. These are relatively small changes in the distribution of spending, although they do represent a small shift toward greater inequality.

An increase in wages by 8 percent, considered in figure 4, makes no difference to the spending share of the top quintile, which remains at 51.6 percent. But it reduces the spending share of the top 1 percent from 11.7 percent to 11.6 percent. The fact that higher labor income does so little to alter spending inequality may be surprising. But there is considerable inequality in labor income, especially when one considers the different labor income trajectories of labor income for those with different resource levels.

Figure 5 shows that our modified tax plan in the presence of DF reduces the spending share of the top 1 percent to 11.0 percent, a small decrease from its 11.5 percent value under the current system. The top 20 percent now get to spend 50.8 percent of total cohort spending, a bit less than the 51.0 percent share under the current system. The spending share of the bottom quintile falls slightly from 6.3 percent under current tax provisions to 6.2 percent.

Average Remaining Lifetime and Current-Year Net Tax Rates

Table 1 shows average remaining lifetime net tax rates under current law and the three tax reform cases.¹⁹ The fact that all rates are negative for the lowest quintile and rise sharply with the percentile levels of remaining lifetime resources indicates that the U.S. fiscal system is highly progressive. It remains highly progressive in each of the three reform cases. But the tax plan without DF lowers the average remaining lifetime net tax rate for the lowest quintile by .5 percentage points while lowering it by 3.0 percentage points for the top 1 percent. The second, third, and fourth quintiles experience cuts in their average remaining lifetime net tax rate, but these cuts are smaller than the 2.7 percentage-point cut experienced by the top quintile. Adding DF effects to the mix raises the average net tax rate dramatically for the lowest quintile – by 5.9 percentage points relative to the current system. At the same time, average net tax rates for other quintiles rise as well. For the top 1 percent, the reduction in the average net tax rate of the top 1 percent relative to the current system falls to 1.4 percentage points.

¹⁹ As discussed in Auerbach, et. al. (2016), traditional current-year tax rates are unreliable guides to either average or marginal net tax rates because they omit future net tax payments and resources.

The last row of table 1 presents average tax rates under the modified tax plan with DF. There is, as expected, no change to average tax rates at the bottom end of the resource distribution. But lifting the FICA tax ceiling raises average tax rates of the rich. Indeed, those in the top 20, top 5, and top 1 percent of the resource distribution end up with higher average remaining lifetime net tax rates than under the current tax system. For the top 1 percent, the increase in the average remaining lifetime net tax rate is 3.1 percentage points relative to the current system.

Remaining Lifetime Median Marginal Net Tax Rates

Table 2 considers median remaining lifetime marginal net tax rates for our four cases. The marginal net tax experiment we consider involves one-year increase in earnings of the household head by \$1,000. Recall, if the present value of remaining lifetime spending rises by, for example, \$700, we measure the marginal remaining lifetime net tax rate as 30 percent.

The House tax plan without DF significantly reduces median remaining lifetime marginal net tax rates for all five quintiles. For the poorest quintile, the median marginal tax falls by 3.4 percentage points. For the top 1 percent, the median rate falls by 9.6 percent points. Adding DF to the mix makes little difference to the median marginal net tax rates in the bottom two quintiles. But moving to the modified tax plan raises median marginal rates above their initial level for the third quintile and roughly back to their current values for the fourth quintile, top quintile, top 5 percent, and top 1 percent.

Impact on Spending

Table 3 shows the impact on percentile-specific average remaining lifetime spending of the tax plan. With no dynamic feedback, all percentile groups are better off, but the average spending increase is highest at the top – 4.56 percent for the top 1 percent compared with 0.33 percent for the bottom 20 percent. Adding DF effects produces more significant spending gains for all percentile groups, particularly for the highest resource groups. Now the bottom quintile experiences a 2.05 percent average spending increase. The top 1 percent see their average spending rise by 9.49 percent. These spending changes are more equitably distributed under the modified tax plan. The poorest 20 percent still experience, on average, a 2.05 percent spending increase. But for the top 1 percent average spending now rises by only 2.71 percent.

Why the House Tax Plan May Be More Progressive Than Our Calculations Suggest

In this analysis we've made a traditional assumption that owners of U.S. corporations bear 100 percent of the burden of the current corporate income tax. But given the mobility of capital, some of the burden of the corporate tax may fall on workers. Indeed, the Congressional Budget Office estimates this share at 25 percent in its own distributional calculations. And other studies (e.g., Fehr, et. al., 2013) suggest this share could be substantially higher, even potentially greater than 100 percent.²⁰ Were we to model the current corporate tax as falling in part or in full on workers, the tax plan would be more progressive than we've portrayed. Consequently, our results on the

²⁰ This possibility arises because the impact of the corporate tax on U.S. investment and, thus, real wages, depends on the marginal rate of corporate income taxation. In contrast, corporate revenues depend on the lower average rate of corporate income taxation.

tax plan's progressivity should be viewed as having at least one bias against our finding that the plan is somewhat less progressive than the current tax system.

Conclusion

The House tax plan represents a significant reform of our tax system and its business tax provisions have the potential to increase wages by encouraging domestic investment. The business tax reform effectively replaces a tax on asset income with a tax on wealth. On balance this is a progressive move that offsets certain regressive elements of the personal tax reform.

With no dynamic feedback effects, the House tax plan will, we estimate, reduce federal revenues by \$212 billion on an annual basis, ignoring the additional revenue costs of transition provisions. With a strong feedback to wages (an 8 percent wage increase), the reform will raise \$38 billion annually. One way to help ensure revenues don't fall is to couple the House tax plan with the lifting of the ceiling on Social Security's FICA tax.²¹ Ignoring any adverse behavioral response to higher tax rates on labor income, doing so will raise annual revenues by \$328 billion assuming wages rise by 8 percent. Eliminating the FICA ceiling would help shore up Social Security's finances. As things now stand, the system is 32 percent underfinanced and faces a \$32.1 trillion unfunded liability.²²

The House tax plan would slightly worsen U.S. inequality as measured by the share of cohort-spending done by the rich. Were the modified tax plan chosen, inequality in spending would remain close to where it is under current tax provisions.

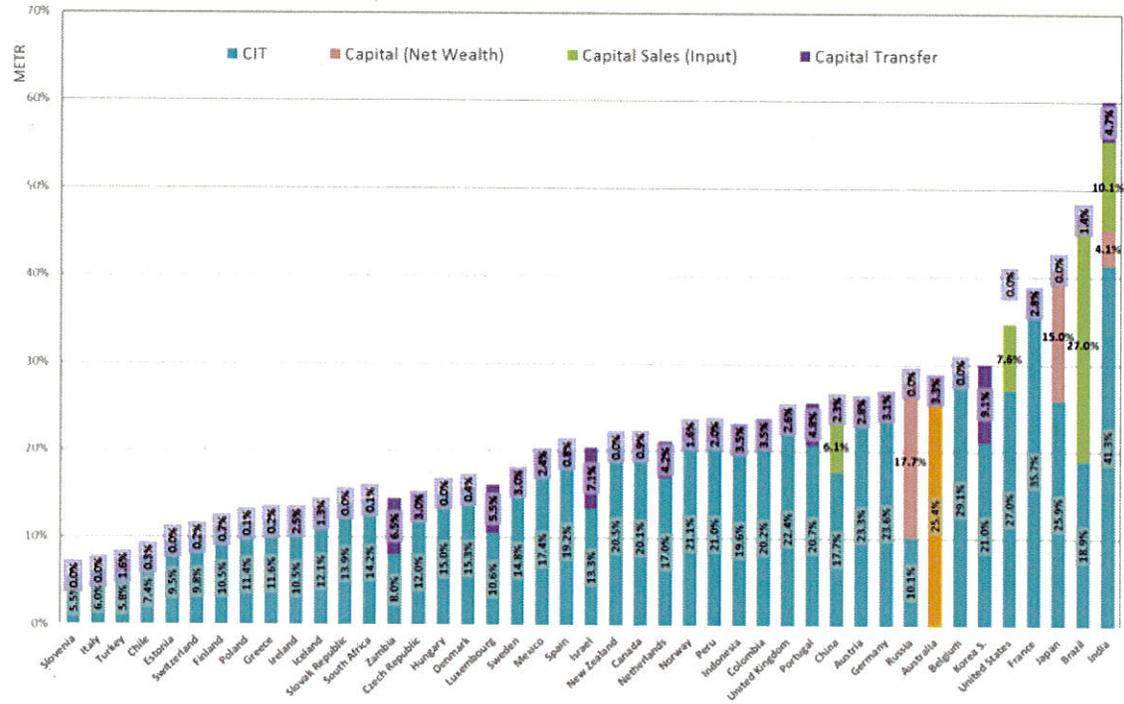
Work incentives would improve for all resource groups under the House plan, with the biggest improvement for the rich. However, given that the plan, absent sizable dynamic feedback, produces a revenue loss, one would want to take into account any incentive effects of whatever provisions are eventually adopted to offset a potential revenue loss. For example, the adoption of the modified tax plan would leave the rich facing roughly the same marginal net tax rates as under the current tax system.

The House tax plan represents a revenue gamble. If the economy responds as one might optimistically hope, revenues will be close to if not exceed their current values. Moreover, wages as well as GDP will be significantly higher. If the economy does not respond, the House tax plan will materially increase the federal deficit. One alternative, considered here, which greatly reduces the risk of lost revenues but retains the potential for significant economic growth, is to couple the House tax plan with the elimination of the ceiling on Social Security's FICA tax. In addition to raising revenues, this modification of the House tax plan would make the proposed tax reform more progressive.

²¹ An important caveat with respect to lifting the FICA tax ceiling is that doing so may reduce the labor supply and, thus, taxable labor income, of high earning workers.

²² https://www.ssa.gov/oact/tr/2016/VI_F_infinite.html

Figure 1
 Marginal Effective Corporate Tax Rates Across Countries, 2017*



*Source: Jack Mintz, School of Public Policy, University of Calgary,
http://www.minerals.org.au/file_upload/files/publications/With_global_company_tax_reform_in_the_air%20C_will_Australia_finally_respond_FINAL.pdf

Figure 2 Current Law, Net Wealth and Lifetime Spending by Resource Percentile Range, Ages 40 - 49

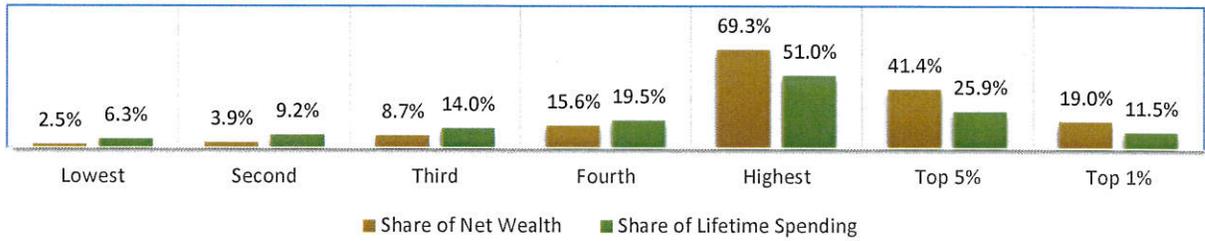


Figure 3, House Tax Plan, No Dynamic Feedback, Net Wealth and Lifetime Spending by Resource Percentile Range, Ages 40 - 49

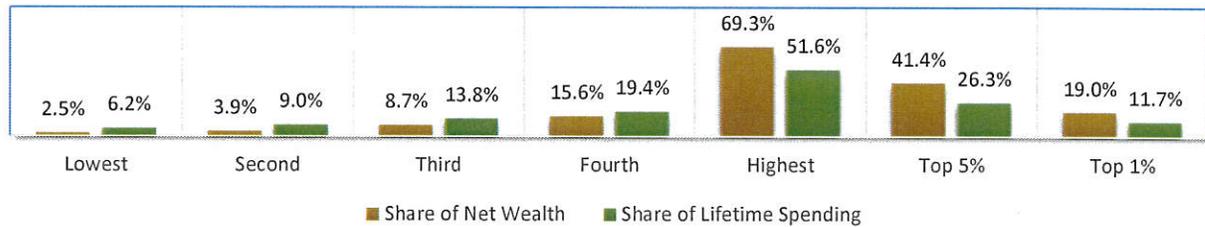


Figure 4 House Tax Plan with Dynamic Feedback, Net Wealth and Lifetime Spending by Resource Percentile Range, Ages 40 - 49

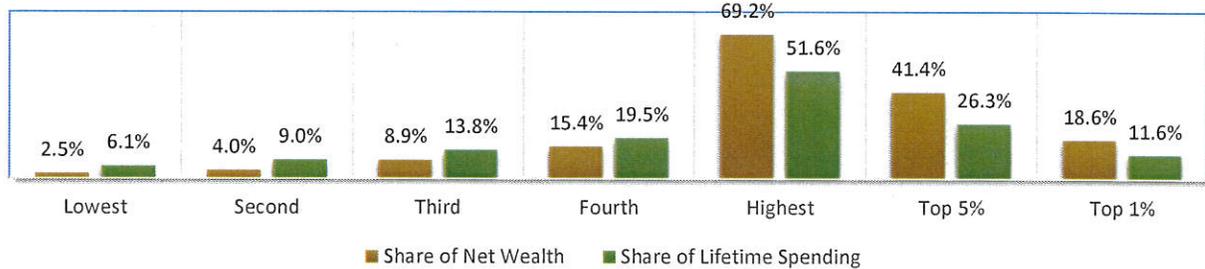


Figure 5 House Tax Plan with Dynamic Feedback and Elimination of FICA Tax Ceiling Net Wealth and Lifetime Spending by Resource Percentile Range, Ages 40 - 49

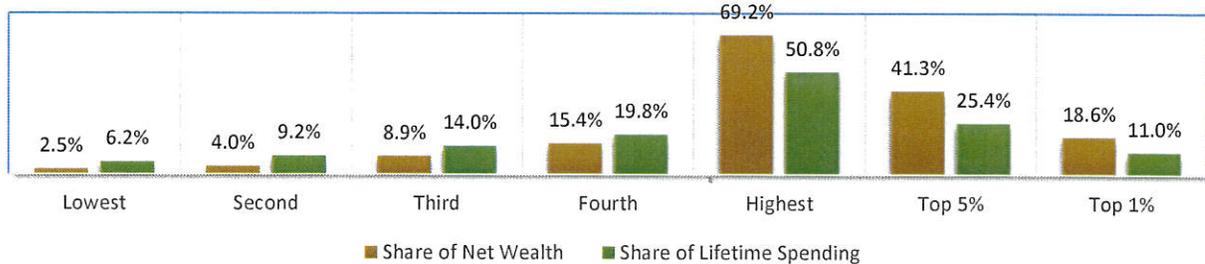


Table 1
Average Remaining Lifetime Net Tax Rates

	Bottom Quintile	Second Quintile	Third Quintile	Fourth Quintile	Top Quintile	Top 5%	Top 1%
Current Law	-52.7%	4.3%	12.1%	18.8%	28.2%	30.7%	33.9%
Tax Plan	-53.2%	3.2%	10.7%	17.1%	25.5%	27.8%	30.9%
Tax Plan with 8% Wage Increase	-47.3%	5.0%	12.1%	18.6%	26.3%	28.5%	31.5%
Modified Tax Plan* with 8% Wage Increase	-47.3%	5.0%	12.1%	18.7%	29.4%	32.9%	37.0%

*House Republican tax plan with no ceiling on Social Security's FICA tax.

Table 2
Median Marginal Remaining Lifetime Net Tax Rates

	Bottom Quintile	Second Quintile	Third Quintile	Fourth Quintile	Top Quintile	Top 5%	Top 1%
Current Law	37.4%	34.8%	36.7%	42.9%	44.8%	47.2%	50.7%
Tax Plan	34.0%	31.7%	33.9%	41.5%	40.9%	40.9%	41.1%
Tax Plan with 8% Wage Increase	33.2%	31.7%	37.7%	41.1%	40.4%	41.1%	41.3%
Modified Tax Plan* with 10% Wage Increase	33.2%	31.8%	38.9%	42.0%	44.6%	47.9%	49.8%

*House Republican tax plan with no ceiling on Social Security's FICA tax.

Table 3
 Percent Increase in Average Present Value of Remaining Lifetime Spending
 Relative to the Current Tax System

	Bottom Quintile	Second Quintile	Third Quintile	Fourth Quintile	Top Quintile	Top 5%	Top 1%
Tax Plan	0.33%	1.14%	1.58%	2.12%	3.76%	4.22%	4.56%
Tax Plan with 8% Wage Increase	2.05%	5.50%	5.35%	6.61%	8.28%	8.48%	9.49%
Modified Tax Plan* with 10% Wage Increase	2.05%	5.50%	5.31%	6.52%	4.92%	3.53%	2.71%

*House Republican tax plan with no ceiling on Social Security's FICA tax.

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Hardlines / Broadlines Retailing

Tax-Math Update: Price Increases Needed to Offset BAT - Who Has Pricing Power?

Following up on our detailed December analysis looking at the impacts of proposed tax policy changes on our coverage universe (including the Border Adjustment Tax, lower headline corporate tax rate, and interest/capex deductibility changes; see our note "[Tax-Math Olympics](#)"), the big question is how retailers make up for the lost tax deduction of imported goods. JPM US Chief Economist Michael Feroli [indicates](#) that the impact of BAT will be fully offset if the USD appreciates 25%, thus making imports cheaper (though we could run into issues with dollar-denominated contracts). The other path is price increases.

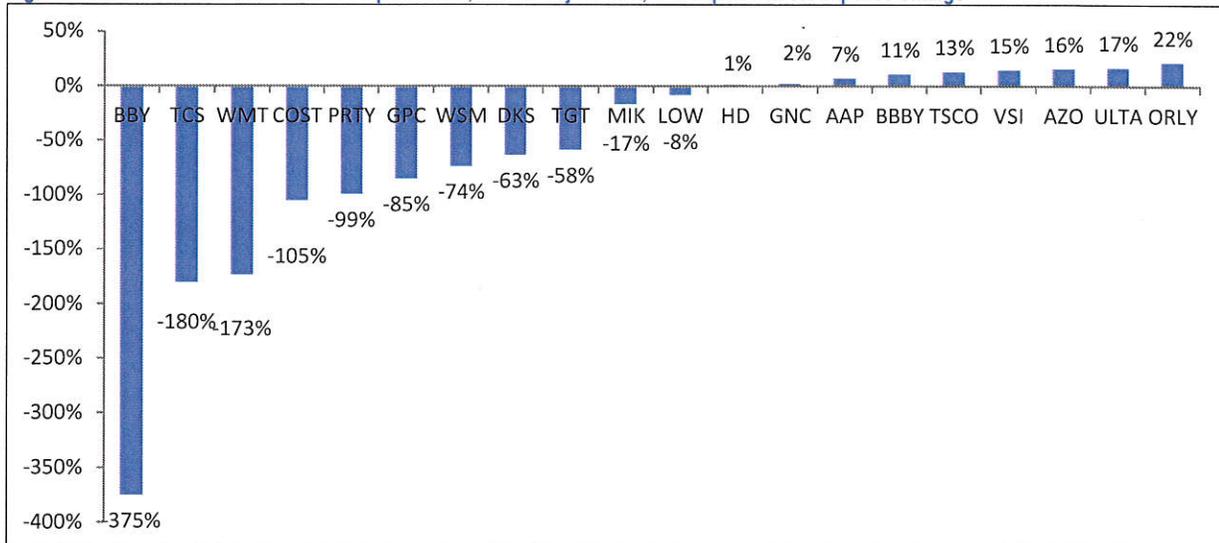
- **Retailers, on average, would need to raise prices by 5% to offset the negative impact of BAT, with some retailers as high as 14% (BBY) and some at only 1% (GNC/VSI).** As shown in Figure 1, we estimate the highest price hikes need to be done by BBY (14%), PRTY (11%), WMT (9%), and WSM/TCS (8%), while some of the lowest hikes need to be done by the auto-parts retailers (2%). This range follows the overall impact of the BAT, with high gross margin businesses with primarily domestic sourcing (e.g., TSCO) seeing a lift while low GM sectors with higher imports (e.g., BBY, WMT) needing bigger price increases. *See Figure 1 below.*
- **The question we often get asked is who has pricing power in our universe.** Clearly, we believe [home improvement](#), TSCO, ULTA, and [autoparts](#) have pricing power. We also believe that [DKS](#) might, so long as the key brands enforce minimum pricing and manage the channels. Also retailers with small tickets like [MIK](#) and [PRTY](#) seem to have a clear path for a large portion of the assortment. However, we question if the world of [electronics](#) (brands and the online competition) will have the discipline, and [home furnishings](#) seems similarly challenged. [The grocery world](#) seems precarious. First, you have companies like COST who live on price disparities. Second, we recall the impact of the hard discounters in the UK during the inflationary period around the financial crisis where mainline grocers raised prices but the hard discounters kept it low. This seemed to open the floodgates of share loss and WMT has first-hand experience of that with its Asda banner.
- See Figure 2-4 for a recap of results from our previous note detailing the impact of proposed tax changes and email us if you would like a copy of our working file containing the calculations.

Figure 1: Price Hike Needed to Offset Border Adjustment Tax Impact on PAT

Price Hike Needed to Offset BAT Impact on PAT	
BBY	14%
PRTY	11%
WMT	9%
WSM	8%
TCS	8%
DKS	7%
GPC	7%
COST	5%
TGT	5%
MIK	4%
ULTA	3%
HD	3%
LOW	3%
AAP	2%
TSCO	2%
AZO	2%
ORLY	2%
BBBY	2%
VSI	1%
GNC	1%

Source: J.P. Morgan estimates.

Figure 2: All-in Effect on PAT with 20% Corp Tax Rate, Border Adjustment, and Capex/Interest Expense Change



Source: Company reports and J.P. Morgan estimates.

Figure 3: Impact to PAT by Layering on the Capex Inclusion and Interest Expense Exclusion at 20% Tax Rate

Ticker	Effective Tax Rate 2017E	Reduction in Effective Tax Rate @20% Corp Tax	% Increase PAT (adjusted for geographic mix)	Incremental Tax (on 20%) from Border Adjustment	% Increase PAT (adjusted for geographic mix)	Incremental Tax (on 20%) from Interest/Capex	% Increase PAT (adjusted for geographic mix)	New Effective Tax Rate as % of EBT	% Increase PAT (adjusted for geographic mix)
AAP	37.8%	-17.8%	28.6%	17.9%	-22.4%	-4.7%	5.9%	33.2%	7.3%
AZO	34.9%	-14.9%	21.3%	7.6%	-8.9%	-3.9%	4.5%	23.7%	16.0%
GPC	36.5%	-16.5%	21.2%	79.6%	-81.2%	3.1%	-3.2%	102.7%	-85.0%
ORLY	36.7%	-16.7%	26.4%	7.3%	-9.1%	-4.5%	5.6%	22.8%	22.0%
BBY	35.8%	-15.8%	22.9%	282.7%	-328.6%	-8.0%	9.3%	294.7%	-374.9%
COST	35.2%	-15.2%	13.9%	143.4%	-106.2%	-13.5%	10.0%	149.9%	-104.8%
TGT	35.5%	-15.5%	24.0%	60.3%	-75.3%	-7.0%	8.8%	73.2%	-58.5%
WMT	32.3%	-12.3%	13.3%	180.5%	-165.6%	-8.4%	7.7%	192.1%	-173.2%
BBBY	37.0%	-17.0%	25.4%	14.4%	-16.9%	-4.9%	5.7%	29.5%	11.2%
MIK	35.0%	-15.0%	20.4%	27.1%	-29.9%	0.1%	-0.1%	47.2%	-16.6%
TCS	39.0%	-19.0%	25.9%	159.2%	-165.2%	-7.8%	8.1%	171.4%	-180.2%
WSM	37.5%	-17.5%	28.0%	72.4%	-90.5%	-8.9%	11.1%	83.5%	-73.7%
HD	37.0%	-17.0%	23.8%	17.0%	-18.8%	-0.9%	1.0%	36.1%	1.2%
LOW	37.7%	-17.7%	26.1%	25.4%	-29.2%	-2.2%	2.5%	43.2%	-8.2%
GNC	35.0%	-15.0%	14.6%	12.5%	-9.9%	0.2%	-0.1%	32.7%	2.2%
VSI	39.0%	-19.0%	31.1%	16.9%	-21.1%	-7.1%	8.8%	29.8%	15.1%
DKS	38.0%	-18.0%	29.0%	67.7%	-84.6%	-10.5%	13.1%	77.2%	-63.2%
TSCO	36.7%	-16.7%	26.4%	15.5%	-19.3%	-7.2%	9.0%	28.3%	13.3%
ULTA	38.0%	-18.0%	29.0%	17.4%	-21.8%	-10.0%	12.5%	27.4%	17.1%
PRTY	37.0%	-17.0%	23.1%	89.3%	-95.5%	0.7%	-0.8%	110.0%	-99.2%

Source: Source: Company reports and J.P. Morgan estimates. Note that we iterate the impact of lower corporate tax of 20% on each scenario. So, the Border Adjustment and capex/interest expense adjustment are layered on top of a lower corporate tax separately, before finally aggregating the impacts of all three in the final two columns.

Figure 4: Estimated Overseas Direct Sourcing

	% of COGS Sourced Overseas
TCS	76.0%
BBY	75.0%
PRTY	75.0%
WSM	67.0%
WMT	50.0%
DKS	45.0%
GPC	40.0%
MIK	30.0%
TGT	27.5%
COST	25.0%
ULTA	20.0%
HD	17.5%
LOW	17.5%
AAP	15.0%
AZO	15.0%
ORLY	15.0%
TSCO	12.0%
BBBY	10.0%
GNC	10.0%
VSI	10.0%

Source: Company reports and J.P. Morgan estimates.

Retailing/Broadlines & Hardlines

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US Daily: What Would the Transition to Destination-Based Taxation Look Like? (Mericle/Phillips/Struyven)

- A key feature of the House Republican [blueprint](#) for corporate tax reform is a proposed switch to destination-based taxation. In today's note, we discuss how the transition to destination-based taxation would work and the bumps that might be felt along the way.
- Under an idealized version of the transition, the dollar would appreciate enough to offset the impact of the tax change, resulting in no impact on prices, margins, or trade flows. Even in this case, a large and abrupt change in exchange rates would deliver a sizeable hit to US residents' foreign wealth and could create risks of dollar-denominated debt problems abroad.
- An alternative transition scenario featuring partial dollar appreciation, higher inflation, a hit to the profit margins of US net importers, and higher net exports appears more likely. Industries with low margins and high import shares such as apparel would be particularly vulnerable to the change. A gradual phase-in of the new system could help, but creates its own risks.
- While destination-based taxation offers meaningful benefits, the transition to the new system could have unintended consequences, regardless of how adjustment takes place. In light of the uncertainty regarding the potential effects of such a policy, and the opposition it has already provoked, we think that Congress is more likely to move away from the destination-basis tax proposal.

A key feature of the House Republican [blueprint](#) for corporate tax reform is a proposal to switch to destination-based taxation. Last week, we discussed the [details](#) of the proposed change, which is currently being debated in the House. In today's note, we discuss how the transition to destination-based taxation would work and the bumps that might be felt along the way.

The practical effect of switching to destination-based taxation would be that US firms would exclude export revenues but would no longer deduct import costs when calculating their tax base. The economy would adjust to the new system during a transition period through some combination of changes in nominal exchange rates, price levels, corporate profit margins, and trade flows.

We begin by describing an idealized version of the transition as it has been presented to Congress. Proponents of destination-based taxation cite [economic research](#) showing that symmetric border adjustments should not affect trade flows. For example, [Auerbach and Holtz-Eakin](#) argue that "Border adjustments do not distort trade, as exchange rates should react immediately to offset the initial impact

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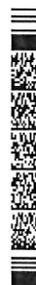
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of these adjustments. As a corollary, border adjustments do not distort the pattern of domestic sales and purchases.” In theory, the border adjustments would initially make imports less competitive and US exports more competitive, reducing demand for imports and increasing demand for exports. This would cause dollar appreciation, reversing the initial effect on competitiveness and trade flows.

If financial markets anticipate this new equilibrium, proponents argue, nominal exchange rates should react immediately to offset the impact of the border adjustment. For example, assuming a 20% statutory tax rate, a US company selling an imported product for \$100 with no profit would need to increase prices by \$20 to continue operating without running an after-tax loss. For a \$20 decline in import costs to offset the impact of the \$20 increase in taxes, the dollar would need to appreciate by $1/(1-\text{tax rate})$, or 25% in this example.

If dollar appreciation were immediate and perfectly calibrated, there would be no effect on consumer prices, profit margins, or trade flows.¹ Moreover, there would be no differential impact on firms with low vs. high import cost shares or low vs. high profit margins. To illustrate this, Exhibit 1 provides examples of income statements for various types of firms under each tax regime. Under current law, taxes are assessed on total sales minus total costs. Under a destination-based border-adjusted tax, taxes would instead be assessed only on domestic sales minus domestic costs. For net importers, this results in a much larger tax burden, as shown in the first column of Exhibit 1. However, because the dollar appreciates, the firm’s import costs—when measured in dollars—decline, offsetting the larger tax burden. As a result, after-tax profits are identical in the two tax regimes. In the case of net exporters, shown in the second column of Exhibit 1, lower revenues measured in dollars are offset by a smaller tax burden, again resulting in no change to after-tax profits after the switch to destination-based taxation.

¹ .The examples assume that the world prices of both imported and exported goods are set in foreign currency units and are unchanged after the switch to destination-based taxation.



Exhibit 1: The Transition to Destination-Based Taxation under Full Nominal Exchange Rate Adjustment

		Type of Firm					
		Net Importer	Net Exporter	High Import Share	Low Import Share	High Profit Margin	Low Profit Margin
Current Law	Exchange rate (foreign currency per \$)	1	1	1	1	1	1
	Domestic sales in \$	100	0	100	100	100	100
	Foreign sales in foreign currency	0	100	0	0	0	0
	Total sales in \$	100	100	100	100	100	100
	Domestic costs in \$	45	45	0	90	25	49
	Foreign costs in foreign currency	45	45	90	0	25	49
	Total costs in \$	90	90	90	90	50	98
	Tax burden at 20%	2	2	2	2	10	0.4
After-tax profit	8	8	8	8	40	1.6	
Destination-Based Taxation	Exchange rate (foreign currency per \$)	1.25	1.25	1.25	1.25	1.25	1.25
	Domestic sales in \$	100	0	100	100	100	100
	Foreign sales in foreign currency	0	100	0	0	0	0
	Total sales in \$	100	80	100	100	100	100
	Domestic costs in \$	45	45	0	90	25	49
	Foreign costs in foreign currency	45	45	90	0	25	49
	Total costs in \$	81	81	72	90	45	88.2
	Tax burden at 20%	11	-9	20	2	15	10.2
After-tax profit	8	8	8	8	40	1.6	

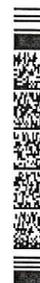
Source: Goldman Sachs Global Investment Research

We see two reasons to be skeptical about this smooth picture of the transition process. The first reason is that even an adjustment that did occur entirely through nominal exchange rates would create large risks. As noted above, the required dollar appreciation would be very large: 25% if the statutory corporate tax rate were reduced to 20%, and even higher if the statutory rate were reduced by less. Such an abrupt change would result in large negative wealth effects for US residents and the risk of potentially serious dollar-denominated debt problems abroad.²

The second reason is that we think it is unlikely that nominal or even real exchange rates would in fact adjust so quickly and perfectly. Our [FX strategists](#) have shown that many Asian central banks have intervened to stabilize exchange rates. The combination of pegged exchange rates in many trading partners with price stickiness implies that real exchange rates would not adjust as smoothly as implied by current policy proposals. While [Desai and Hines](#) have found that floating exchange rates respond to news about changes in US tax-based export incentives, the past moves were of a vastly smaller magnitude.

Instead, we think it is more likely that the transition to destination-based taxation in the US would result in meaningful but imperfect dollar appreciation and price adjustment. In the near term, such an incomplete change in real exchange rates

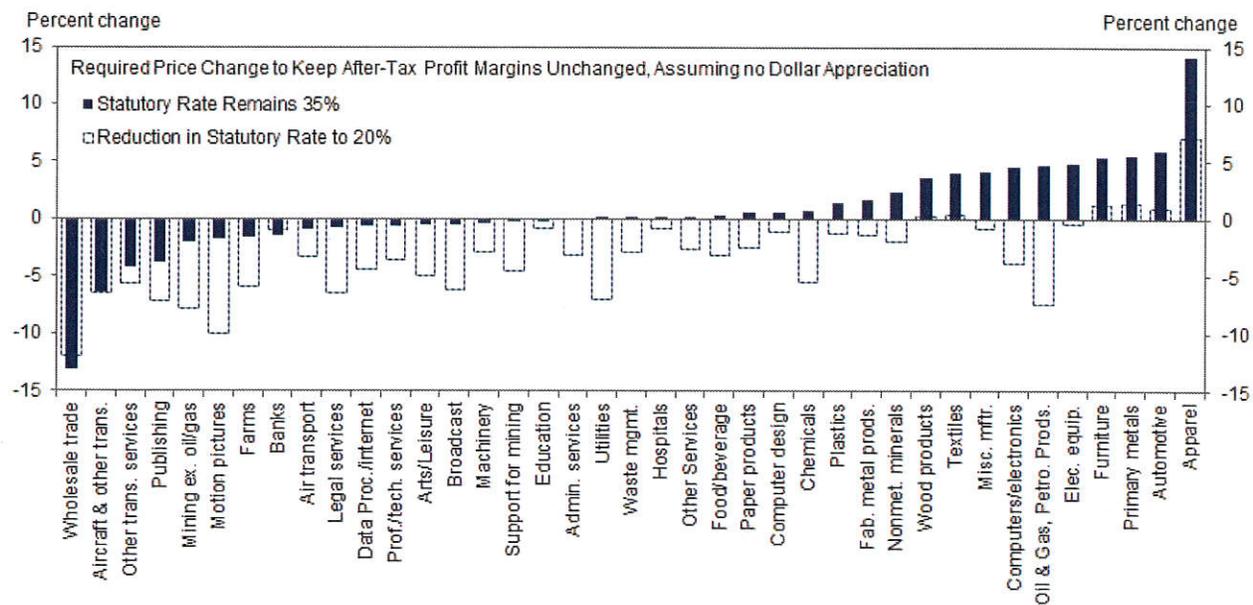
² There are two offsets to concerns about dollar denominated debt problems abroad. First, some firms have offsetting dollar revenue exposure. Second, the net impact on total foreign wealth would be positive, possibly allowing some governments to tax beneficiaries and subsidize threatened firms. Even so, we think such a large and abrupt change would create meaningful risks in places with large dollar liabilities.



could result in lower profit margins for US importers and a decline in the US trade deficit. This scenario would have a number of economic consequences. Higher consumer price inflation could lead to tighter monetary policy, though Fed officials might downplay the impact as a transitory influence. Pressure on margins from the policy shift could be substantial, challenging the solvency of some net importer firms that were in good financial condition prior to the sudden policy change. Finally, reduced import demand and increased export demand would initially boost US output, but could invite retaliation, especially since the new US rules are unlikely to be judged to be WTO compliant, in our view.³

It is very difficult to know in advance how adjustment during the transition period would be split among the various margins. We can, however, assess which industries would be most vulnerable to a less elegant transition than described in Exhibit 1. We measure an industry's vulnerability as the consumer price change that would be required to keep after-tax profit margins unchanged, assuming no change in exchange rates (the magnitudes would be smaller under partial dollar appreciation). We also repeat the calculation under the assumption that statutory corporate tax rates simultaneously fall to 20%. These vulnerability measures, shown in Exhibit 2, are increasing in the net import share and decreasing in margins, both of which we measure using data from the input-output tables. We caution that these are industry averages, and in every industry there will be firms whose vulnerability is much greater.

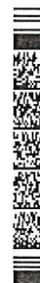
Exhibit 2: Industries with High Net Import Shares and Low Margins Would Be Most Vulnerable



Source: Department of Commerce, Goldman Sachs Global Investment Research

We draw three conclusions from Exhibit 2. First, the required price increases would be fairly large for some net importing industries and probably very large for some

³ Of course, the strongest complaints would presumably come from countries with pegs, who would have the option of relaxing their pegs.



firms in those industries, meaning that some compression of profit margins for the biggest net importers seems likely. Second, a simultaneous reduction in the statutory tax rate to the 20% level proposed by House Republicans would substantially cushion the blow, allowing after-tax profits to hold steady while prices adjusted over a more realistic time horizon.⁴ Third, apparel stands out as a uniquely vulnerable industry.

To summarize, we see such a large and abrupt change in corporate tax policy as likely to be somewhat disruptive, however it occurs. Even adjustment entirely via nominal exchange rates would create meaningful risks, especially risks abroad that US policymakers would have limited power to mitigate. The more likely scenario of partial dollar adjustment could lead to some combination of higher US inflation, sizeable hits to the profit margins of net importers, and a shrinking trade deficit that could prompt retaliatory trade policies. Could a gradual transition to destination-based taxation alleviate these risks? For example, what if one-third of import costs and export revenues were ignored the first year, then two-thirds the second year, before full implementation in the third year?

A gradual phase-in would probably do little to reduce the side-effects of sudden dollar appreciation because most of the dollar response to even a staggered policy should occur upon announcement, not implementation, assuming it is credible. It could, however, reduce short-run pressure on the profit margins of US net importers, reducing the risk of making currently viable firms insolvent. But staggering implementation creates risks of its own: if the dollar appreciated more quickly than policymakers anticipated, gradual phase-in would actually benefit net importers and harm net exporters because importers' costs would fall more quickly than their tax bills would rise and exporters' costs would rise more quickly than their tax bills would fall, the scenario shown in the top-right box of Exhibit 3.

Exhibit 3: A Gradual Phase-in of Destination-Based Taxation Does Not Eliminate Transition Risks

		Phase-in of New Destination-Based Corporate Tax Regime	
		Immediate	Gradual
Exchange Rate Adjustment	Immediate	Importers: Neutral	Importers: Higher margins
		Exporters: Neutral	Exporters: Lower margins
	Gradual	Importers: Lower margins	Importers: Roughly neutral
		Exporters: Higher margins	Exporters: Roughly neutral

Note: We assume price adjustment provides an incomplete offset.

Source: Goldman Sachs Global Investment Research

⁴ If combined with other proposed measures that would make the overall tax revenue impact more neutral, such as the elimination of net interest deductibility in favor of full capex expensing, the required price changes would rise.

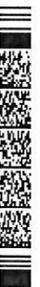


Proponents of a switch to destination-based taxation note that it would allow the US to reduce its relatively high statutory rate and reduce the incentive for firms to report profits in countries with lower tax rates. These are meaningful benefits with strong bipartisan appeal. But the transition to the new system would invite a range of risks, regardless of how adjustment takes place. These costs might be worth bearing, but they have already provoked opposition from those who fear incomplete adjustment of real exchange rates, including both concerned net importers and free-traders who worry that partial adjustment will amount to protectionism. Largely for these reasons, we think that Congress is more likely to ultimately move away from the current destination-basis tax proposal.

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Disclosure Appendix

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We, Jan Hatzius, Zach Pandl, Alec Phillips, David Mericle, Daan Struyven, Karen Reichgott and Avisha Thakkar, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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17-5 Effects of Consumption Taxes on Real Exchange Rates and Trade Balances

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Abstract

This paper examines the effects of border-adjusted consumption taxes (mainly value added taxes or VATs) in a sample of 34 advanced economies from 1970 through 2015. We find that the real exchange rate tends to rise by the full amount of any consumption tax increase, with little effect on the current account balance and modest offsetting effects on the trade and income balances. Case studies suggest that adjustment comes initially through prices. We note that the border-adjusted cash flow tax of the House Republicans differs in important ways from consumption taxes used in our study, which raises the possibility of a slower adjustment process with temporarily larger trade effects.

JEL codes: F31, F32, H20

Keywords: VAT, border tax adjustment, exchange rate adjustment, current account adjustment

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INTRODUCTION

As the United States considers moving to a destination-based cash flow tax, there is growing concern about the impact of the proposed border adjustment on trade.¹ Border adjustment on sales taxes, which tax imports and exempt exports, is a common way of taxing only goods consumed in a country. Most countries perform such border adjustments on value added taxes (VATs). US states effectively border-adjust sales taxes, which apply to all goods consumed in a state, irrespective of where they are produced.

Economic models imply that border adjustment does not affect trade patterns or the trade balance because the real exchange rate (RER) adjusts. But many producers and market participants fear that border adjustment will be protectionist, raising costs and disrupting supply chains. A critical question thus is: Does border adjustment generate an offsetting movement in the real exchange rate or does it work like a tax and export subsidy and raise the trade balance?

We attempt to answer this question by examining the experiences of countries that have implemented VATs and other border-adjusted consumption taxes.² We do it in three ways. First, we examine movements in the RER, the trade balance, and other variables around the dates that countries first implemented a VAT. Second, we use cross-country time-series regressions to examine long-run correlations between consumption tax rates, the RER, and various measures of external balance, while controlling for other variables that would be expected to move the exchange rate and trade. Finally, we consider a handful of case studies.

Overall, our results support the basic theoretical conclusion that RER movements fully offset border-adjusted consumption taxes, including the VAT. Our results also suggest that a large share of the movement in the RER comes via consumer prices. In particular, increases in VAT rates temporarily increase inflation, which permanently changes the RER. There is little evidence of any significant effect of border-adjusted consumption taxes on the current account balance, although there may be different effects on the components of the current account. Most of the adjustment occurs within three years.

The destination-based cash flow tax proposed by the House Republicans³ differs in important ways from border-adjusted consumption taxes used in other countries. In particular, under the border-adjusted cash flow tax (CFT), tax rates vary depending on the firms' labor cost share and international exposure. This key difference implies that the channel of RER adjustment is likely to be different. As Auerbach et al. (2017) note, a VAT requires an increase in consumer prices relative to wages, which may explain the adjustment pattern seen in the data. In contrast, because labor costs can be deducted, a CFT does not

1. "Destination-based" refers to the tax being levied based on the location of the consumer. By taxing imports and exempting exports, border adjustment enables a tax to focus on consumers within a country.

2. The paper focuses on VATs in the event study and on consumption taxes, nearly all of which are border adjusted, more broadly in the regression analysis.

3. *A Better Way: Our Vision for a Confident America—Tax*, June 24, 2016, https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf.

require a change in consumer prices relative to wages, so any adjustment may be more likely to come through the nominal exchange rate. The House proposal would tax gross cash flow at 20 percent, which implies a 25 percent tax rate on cash flow net of the tax, and would require a 25 percent RER appreciation in equilibrium.

Although appreciation of the nominal exchange rate would facilitate domestic economic adjustment, it might disrupt the global financial system given the dollar's dominant role in finance. Alternatively, the special role of the dollar could mean that the nominal exchange rate responds only partially to trade pressures, especially if other countries resist the corresponding depreciation of their currencies. Limits on dollar appreciation force adjustment to come through US prices and wages. It would take time for prices and wages to reach a new equilibrium, because wages are set in advance through contracts and the Federal Reserve may not accommodate the full shift. Whether adjustment eventually comes through a 25 percent appreciation or a 25 percent increase in wages and prices or some combination of the two, these adjustments are large, and much larger than the events studied in this paper.

When a VAT is increased, domestic prices often go up almost one for one. As a result, exporters and importers remain indifferent between domestic and foreign markets because the increase in the tax is offset by the increase in the domestic price. In contrast, when a CFT is implemented, the price pressures will vary across industries and even across firms within industries unless the nominal exchange rate adjusts quickly. In the absence of nominal exchange rate adjustment, the result is likely to be a temporary stimulus to domestic production and an improvement in the trade balance.

WHY SHOULD THE REAL EXCHANGE RATE ADJUST TO VALUE ADDED TAXES?

Consider a country implementing a VAT or final sales tax on goods sold domestically. Imports face the tax but exports do not. The process of adjustment depends on the extent to which the tax leads to higher consumer prices. We consider two extreme cases, one in which consumer prices rise by the full amount of the tax, and the other in which consumer prices do not rise at all.

When consumer prices rise by the full amount of the tax, the nominal exchange rate does not need to adjust. The price of exports, which are not taxed, does not rise, and they continue to be sold in foreign markets at the same local price as before. The price of imports, which are taxed, rises by the same amount as domestically produced goods. Assuming that the tax revenue is transferred back to consumers, perhaps through a reduction in other taxes, consumers maintain their total consumption spending.⁴ Moreover, consumers don't have to switch between imports and domestic products because their prices have risen

4. As our focus is on the border adjustment, the relevant comparison is the same tax system, with or without border adjustment. Shifting from a corporate tax to a consumer tax, as proposed in the House blueprint, would likely affect saving and investment. A tax increase designed to reduce the fiscal deficit would also have real effects because consumers would have lower after-tax real incomes.

equally. The trade balance is thus not affected. The RER, which is the exchange rate–adjusted ratio of consumer prices at home to consumer prices abroad, rises by the full amount of the tax.

When consumer prices do not change—because of monetary policy aimed at maintaining stable prices and/or reductions in other business taxes that lower the local cost of production—the nominal exchange rate must appreciate. If it did not, firms would have a strong incentive to increase exports because they would be able to sell them abroad at the same price as at home and avoid paying the tax. Imports, on the other hand, would face the tax but would not cost any less than before. The increased supply of exports and reduced demand for imports would create an imbalance in the foreign exchange market, which would push up the value of the domestic currency. An appreciation exactly equal to the tax rate rebalances the foreign exchange market and keeps exports and imports, and thus the trade balance, unchanged.

A country's trade balance is equal to the gap between domestic saving and domestic investment. If the government returns consumption tax revenues to households, its saving does not rise and households have the same after-tax real income as before. Consumption taxes do not affect the after-tax return on saving or the cost of capital, so there is no reason to expect any change to private saving or investment. Thus, with full RER offset and a constant fiscal balance, border-adjusted consumption taxes should not affect saving, investment, or the trade balance (Feldstein and Krugman 1990).

A uniform VAT rate on consumption is important because it prevents distortions. If the tax is levied more heavily on some products, then there will be an incentive to shift away from those goods. In practice, most countries exclude some services, such as education, government, and health, as well as basic foodstuffs. Doing so is problematic because it encourages a shift toward these generally nontraded goods.⁵ Another distortion arises because tourists should pay the tax rate of their home country but in practice pay the tax rate of the country they are visiting. When these tax rates differ, demand shifts toward the country with the lower tax rate.

Exempt sectors and tourism tend to represent a sizable share of consumption. The VAT revenue ratio measures the extent to which the tax covers all goods and services. It is defined as actual VAT revenue divided by revenue that would be collected if all consumption were taxed at the VAT rate. It equals 1 if the VAT is broad based and properly administered. It is less than 1 if some sectors are untaxed or if collection is uneven. It can exceed 1 if some export rebates are absent or if a country has a tourism surplus.

As shown in table 1, even among OECD countries, VAT revenue ratios are well below 1, averaging just 0.55, and have remained roughly unchanged over the last decade.

The difference between a VAT and a border-adjusted CFT is that price adjustment is more complex under a CFT. To the extent that the nominal exchange rate does not appreciate quickly and fully, prices of imports and goods with imported content are likely to rise substantially. It is less clear what happens to

5. The exceptions also generate incentives for tax fraud by mis-invoicing some taxable goods as nontaxable. They may also push some transactions into the informal economy.

other goods. To fully adjust to the tax, both prices and wages have to rise. Given labor contracts, adjustment could take longer than with a VAT.

In contrast, if adjustment comes through the nominal exchange rate appreciation it could neutralize the border-adjusted CFT more rapidly. Given the dollar's status as the world's premier reserve currency and a major target of pegged exchange rates, it is not clear how far or fast adjustment would proceed through this channel.

PREVIOUS STUDIES ON THE ECONOMIC EFFECTS OF CONSUMER TAXES

A few studies examine the effect of VATs on trade flows, employment, and prices. Desai and Hines (2005) use data from 168 countries for 1950–2000 and find that countries with a VAT export 10 percent less and have lower overall openness than countries without a VAT. They also find that subsidiaries of US multinationals in VAT countries tend to export less. They argue that exports are lower because VATs tend to be higher on traded goods than nontraded goods (as shown by the relatively low VAT revenue ratios reported above), which pushes production and consumption into nontradables. Incomplete VAT rebates to exporters compounds the shift of resources toward nontradables.

Nicholson (2010) uses panel data from 12 years, 29 industries, and 146 countries to examine the effect of VAT and US corporate income tax on US competitiveness. Like Desai and Hines, he finds that VATs tend to reduce trade, both imports and exports, and that the effects differ across sectors. He also finds that VATs in developing countries tend to affect US exports but not imports and interprets this finding as evidence that VAT may be disproportionately applied to goods entering a country, acting as a barrier to trade. He also explores the relationship between the US corporate income tax and foreign VATs in a cross section gravity model. The results show reduced US exports and expanded US imports in country-industries where corporate taxes are highest and VATs are present, offering some evidence that border adjustments in other countries coupled with existing US corporate income tax hurt US competitiveness.

The study most closely related to the proposed border adjustment on a cash flow tax is by De Mooij and Keen (2012), who examine the economic effects of shifting taxation away from labor and toward consumption. They show that such fiscal devaluations have large short-term positive effects on employment and trade balances, especially in eurozone countries. Because each euro member's currency is determined by the group, no single member can appreciate to offset these events. Effects on noneuro countries are slightly smaller and not as statistically significant, although positive short-run effects remain.

A larger body of literature focuses on the price effects of implementing a VAT.⁶ The studies find that in countries where a VAT replaces sales taxes there are no price effects; in contrast, in countries where the share of revenues from consumption taxes increases, there tends to be a one-time increase in prices. Studies

6. See Zodrow et al. (2010) for a summary. Benedek et al. (2015) find similar results.

that examine rises in VAT rates find that prices tend to rise almost one for one with VAT rates. Overall, the results are consistent with a full one-time offset of VAT in the price level.

Methodology and Data

We take two approaches. First we look at the effects of a new VAT on prices, real exchange rates, and trade balances, both on average across countries and on a few specific cases. The advantage of this approach is that these are big events, often with large increases in the tax and the associated border adjustment. The disadvantage is that other taxes are being phased out, some of which may be border adjusted. The VAT is often part of a larger reform package, which may confound exchange rates and trade balances. In addition, in many cases a VAT is implemented in response to a fiscal crisis.

The second approach is a more comprehensive econometric analysis, which focuses on fluctuations in consumer taxes over time and across countries. The advantage of this approach is that it allows us to control for other factors that affect exchange rates and trade balances. The disadvantage is that factors besides policy changes, such as changes in consumption of taxable goods, may cause fluctuations in the goods and services tax share of consumption. To minimize the effect of cyclical changes in consumption, which may fall more heavily on highly taxed goods, we focus on long-run relationships in the data.

Most of the data are from 34 OECD countries.⁷ Data on current account balances and net international investment positions are from the External Wealth of Nations dataset.⁸ Missing data are filled in from the International Monetary Fund's (IMF) *World Economic Outlook* database where available. We exclude a few observations from transition economies in Eastern Europe before 1995 out of concern about the reliability of the initial posttransition data. We also exclude Luxembourg because its role as a financial center and electronic commerce hub distorts its measured consumption tax rate.⁹

The data are annual from 1970 through 2015. Data for many countries are missing in the first half of this sample; 2015 data are missing for a few countries.

In principle, the RER depends on relative consumption tax rates at home and abroad. For the regression analysis, we use bilateral RERs based on consumption deflators between each country and a fixed partner country and measure the relative consumption tax rates as the ratio $(1 + \text{home tax rate}) / (1 + \text{partner tax rate})$. Control variables are also expressed relative to partner country values. The partner countries are either the United States or Germany. For the external balance regressions, we use only the home tax rate, but the results are not affected much if we compare external balances against a partner country and use the ratio of

7. OECD Annual National Accounts and Revenue Statistics databases.

8. The dataset is available at www.imf.org/external/pubs/ft/wp/2006/data/update/wp0669.zip.

9. Despite no tax increase, upward trends in the effective consumption tax rate and the goods and services trade balance have been strong in Luxembourg since 1992. Financial services provided to other EU countries pay VAT on inputs but do not receive a rebate. In addition, exports of electronic services, telecommunications, and broadcasting services are subject to VAT in Luxembourg (OECD 2014a).

tax rates. For the case studies, we focus on behavior in the country implementing a pronounced change and measure the exchange rate as the trade-weighted RER.¹⁰ The primary measure of the trade balance (BAL) is the current account balance (CAB). However, we also examine the goods and services trade balance (GSB) and the difference between the CAB and the GSB, which is the balance on income and transfers (INC). All balance measures are expressed as percents of nominal GDP.

Goods and services tax revenue (GSREV) are taxes on goods and services transactions, including VAT, sales taxes, excise taxes, and tariffs.¹¹ All of these taxes are border adjusted, so that imports incur the tax and exports do not.¹² Household consumption (CONS) is in nominal terms.

WHAT HAPPENS AFTER A VAT IS ADOPTED?

Analyzing the effect of introducing a VAT with border adjustment depends on what taxes are being replaced and whether the total tax burden is rising or falling. If other types of sales taxes that are also border adjusted are replaced, the effect on the RER will be minimal. In contrast, if corporate or income taxes are replaced, one would expect the effects to show up in the exchange rate.

Table 2 lists the OECD countries and the year VAT was adopted, the VAT rate, and the taxes that were replaced. In most cases, VATs were introduced to replace other more distortionary turnover taxes. The problem with a sales tax that applies to all goods is that it taxes intermediates twice—once when they are sold and again when the final good in which they are an input is sold. Like VATs, they are largely border adjusted, because imports face the tax but exports do not. However, the border adjustment is incomplete, because rebates are not provided on sales taxes paid on intermediates of exported goods.

After VATs were introduced, most countries recorded an increase in the share of tax revenue from goods and services taxes—in part because VATs require fewer exceptions and can be charged more broadly and at a higher rate, without the distortions a sales tax creates.

Figure 1 shows the movement of exchange rates, prices, and trade balances in countries around the time VATs were imposed. Panel A shows results for the maximum number of countries that have data for four years before and after implementation in each series. Panel B shows results for 10 countries that have data in all series. The upper left charts in panels A and B show the change in the tax rate—measured using OECD data on goods and services taxes as a share of consumption. On average, the share of goods and services taxes in consumption increased by 1.5 percentage points when the VAT was implemented. In New Zealand, Poland, Portugal, and Spain, which also reduced income taxes, the increase was above 3 percentage points. To the extent that some of the taxes in the measure may not have been border adjusted—for example, turn-

10. Data on trade-weighted exchange rates are from the World Bank's *World Development Indicators*.

11. In these countries tariff rates are low and stable, and taxes on exports are uniformly zero.

12. It is possible that some of the non-VAT taxes are not rebated on exports, but we believe such nonadjusted taxes are a tiny share of revenues.

over taxes charged on intermediates to exports—one would still expect to see some evidence of exchange rate appreciation around the time the VAT was implemented if the border adjustment works.

The remaining charts in panels A and B show average movements in the inflation rate, the trade-weighted real exchange rate, the dollar real exchange rate, the current account relative to GDP, and the goods and services trade balance relative to GDP, for a balanced sample of countries.¹³ There is strong evidence that inflation increased and the RER appreciated following VAT implementation.

While the current account generally improved throughout the period, it does not appear to have been associated with VAT implementation, as the upward trend precedes the introduction of VAT. Importantly, the goods and services trade balance to GDP stabilized at the time of VAT implementation.

REGRESSION ANALYSIS

We next use the full panel dataset to estimate the effect of changes in the effective consumption tax rate (GSREV/CONS) on RERs and external balances. We ran panel unit root tests on all measures of RER, BAL/GDP, and GSREV/CONS. We reject that these series are nonstationary in every country. However, we also reject that these series are stationary in every country. Plots of these data display trending behavior of GSREV/CONS in some countries and RER and BAL/GDP in a few countries.

Given the apparent mixture of stationary and nonstationary data, we analyze the data using both cointegration and conventional frameworks. The results are rarely sensitive to the choice of framework. The estimated equations are shown below, where Y denotes either the real exchange rate (RER) or the external balance (BAL/GDP).

Cointegration framework:

$$\Delta Y_{it} = \beta \{Y_{it-1} - \alpha (\text{GSREV/CONS})_{it-1} - \Lambda \text{Controls}_{it-1}\} + \text{country effects} + \text{year effects} \quad (1)$$

$$+ \Gamma (\Delta Y_{it-1}, \Delta(\text{GSREV/CONS})_{it-1}, \Delta(\text{GSREV/CONS})_{it}, \Delta(\text{GSREV/CONS})_{it-1}, \Delta \text{Controls}_{it})$$

Conventional framework:

$$Y_{it} = \alpha (\text{GSREV/CONS})_{it} + \Lambda \text{Controls}_{it} + \beta Y_{it-1} + \Gamma (\Delta Y_{it-1}, \Delta(\text{GSREV/CONS})_{it}, \Delta \text{Controls}_{it}) + \text{country effects} + \text{year effects} \quad (2)$$

Equation (1) is estimated by a dynamic fixed effects algorithm. The coefficient α represents the long-run effect of the consumption tax rate and β represents the speed of adjustment to the long-run relationship. Equation (2) is estimated by ordinary least squares (OLS). The long-run effect is given by $\alpha/(1-\beta)$.

A notable difference between the two frameworks is the inclusion of additional dynamic terms on the tax rate variable in equation (1). In particular, the lead difference term controls for possible short-run endo-

13. Countries with average inflation rates above 10 percent in the four years before the VAT was implemented were excluded from the inflation graph.

generosity of the consumption tax rate to either the real exchange rate or the external balance. For example, a cyclical boom may push up RER and push down BAL/GDP at the same time that it increases GSREV/CONS because tax rates may be higher on cyclically sensitive goods. We want to exclude such a transitory correlation and focus on the long-run changes in GSREV/CONS, which we assume are driven by policy choices and not economic shocks.

We view the cointegration results as more conservative than the conventional results because the conventional framework may find spuriously significant results when the data are truly nonstationary. There are strong economic grounds for arguing that these data should be stationary, but if a series is not long enough, it may behave like a nonstationary series.

In the simple theoretical model discussed above, the RER should rise in proportion to any increase in the border-adjusted tax rate on consumption (GSREV/CONS), implying that $\alpha = 1$ in equation (1) and $\alpha/(1-\beta) = 1$ in equation (2). The same model implies that GSREV/CONS should have no effect on the external balance, so that $\alpha = 0$ in equation (1) and $\alpha/(1-\beta) = 0$ in equation (2).

Control variables include general government revenues (percent of GDP); general government fiscal balance (percent of GDP); purchasing power parity (PPP)-adjusted per capita income (log ratio to US per capita income); and net international investment position (percent of GDP).

Real Exchange Rates

Table 3 presents our basic results for the effect of consumption taxes on RERs using the cointegration framework. The top half displays results using the RER against the United States and the bottom half displays results using the RER against Germany. Because the RER responds to factors both at home and abroad, the explanatory variables are expressed as differences between the home country value of the variable and the partner country value.¹⁴ The partner country, either the United States or Germany, is excluded from the regressions. All regressions include a full set of country fixed effects to control for differences across countries that are stable over time.¹⁵

The table displays long-run coefficients on all variables that were included in the cointegrating vector. We do not display the short-run coefficients or the estimated country and year fixed effects. The bottom row displays the error correction coefficients, which capture the speed of adjustment to long-run equilibrium, about 20 percent per year. These coefficients are always highly significant, suggesting that the data are either cointegrated or stationary.

14. In principle, we could have specified the regressions using each country's trade-weighted real exchange rate, but doing so would have required us to construct country-specific trade-weighted measures of the foreign explanatory variables.

15. Country fixed effects are required in these regressions because the real exchange rates are indexes set to 100 in 2010 and thus contain no information on absolute price differences across countries.

Column 1 displays results with a full set of control variables and year effects. Column 2 shows results with all control variables but no year effects. Columns 3 and 4 show results dropping the fiscal balance, the variable with the largest number of missing observations. The change in the estimated consumption tax effect (the first row) reflects the additional observations and not the omission of the fiscal variable.¹⁶ Finally, columns 5 and 6 display results using only the consumption tax rate and country and year effects.

The first row of each half of the table displays the estimated effect of the consumption tax rate on the real exchange rate. With the United States as partner country, the average value is 1.7. With Germany as partner country, the average value is 0.7. The overall average is 1.2.

The large differences in the estimates across specifications probably reflect the fact that real exchange rates are far more volatile than consumption tax rates. For the typical country and year, the real exchange rate against the United States appreciates or depreciates by 11 percent, whereas the consumption tax rate (relative to the United States) rises or falls only 1 percent.¹⁷ We have a slight preference for the results shown in column 3 because this specification uses a large number of control variables while retaining most of the available observations. However, the other specifications also provide a useful sense of the considerable uncertainty surrounding any one estimate.

Statistical significance is conventionally measured as a two-tailed test of deviations from 0 in either direction. The asterisks next to the coefficient estimates denote this conventional measure of significance at the traditional 1, 5, and 10 percent levels. However, we are particularly concerned about the hypothesis of full exchange rate offset of consumption taxes, $\alpha = 1$. Thus, two rows at the end each half of the table display one-tailed tests of the hypotheses that $\alpha = 0$ and $\alpha = 1$. We reject $\alpha = 0$ in favor of $\alpha > 0$ in four of six regressions against the United States and one of six regressions against Germany. We never reject $\alpha = 1$ in favor of $\alpha < 1$. In other words, the results are consistent with a one-for-one real exchange rate adjustment in response to changes in the VAT in the long run.

One measure of the short-run response of RER to GSREV/CONS is the sum of the estimated coefficients on the lead, contemporaneous, and lagged changes in GSREV/CONS. The average value of this sum for the regressions in table 3 is 0.44, implying that the real exchange rate moves by 44 percent of any change in relative consumption tax rates by the year after the tax rate changes.

Table 4 displays results based on the conventional framework. The results are broadly similar to those of table 3. The average long-run effect of the consumption tax rate on the real exchange rate is 1.3 and the average short-run effect (the sum of the coefficients on the contemporaneous level and change in GSREV/

16. The coefficient on the consumption tax rate is virtually unchanged by dropping the fiscal variable in column 1 and restricting the regression to the same 892 observations. This is also true in the bottom half of the table.

17. We define "typical" as one standard deviation in the annual change of a variable. Typical RER movements against Germany are smaller (7 percent) because many countries in the sample are either in a currency union with Germany or target their exchange rates with Germany.

CONS) is 0.40. The one-tailed tests of $\alpha/(1-\beta) = 0$ are significant (in favor of $\alpha/(1-\beta) > 0$) at the 10 percent level in 10 of 12 regressions and the tests of $\alpha/(1-\beta) = 1$ are never significant.

The results broadly support the hypothesis of full exchange rate offset of changes in consumption tax rates. However, the results depend greatly on which country (the United States or Germany) is the partner country. The existence of fixed exchange rates between some countries may imply a different pattern of dynamic adjustment relative to floating exchange rates. For this reason, we also ran equation (2) separately on (a) euro area countries plus Denmark starting in 1999 and (b) non-euro-area countries excluding Denmark.¹⁸ For the former countries (about one-quarter of the full sample), we use Germany as the partner country and for the latter countries (about one-half of the full sample) we use the United States. About one-quarter of the sample is lost owing to pre-1999 years for euro members and late joiners to the euro area.

For the non-euro-area countries, the results are similar to the full sample results, with average long-run tax rate coefficients that are never significantly different from those of the top half of table 4 and that have an average value of 1.3. For the euro area countries, the coefficients vary considerably across specifications with large standard errors, raising the likelihood of too small of a sample for the number of parameters being estimated. The coefficients are never significantly different from those of the bottom half of table 4 but the average value of the coefficients is somewhat lower, at 0.5.

Trade Balances

Table 5 displays our basic results for external balances in the cointegration framework. The top displays results for the current account balance; the middle displays results for the goods and services trade balance; and the bottom displays results for the difference between the first two: the balance on income and transfers. In each case, a country's external balance refers to its trade with the rest of the world and we therefore do not need to specify the explanatory variables as differences between values in the home and partner countries.

The estimated effects of the consumption tax rate on the current account are all close to 0 and only one is significantly different from 0. The goods and services trade balance coefficients are uniformly higher and three out of six are significantly positive. The income and transfers coefficients are all negative and four out of six are statistically significant. The short-run effects, measured as the sum of coefficients on the changes in consumption tax rates, are about two-thirds of the long-run effects for goods and services trade and half of the long-run effects for income and transfers. Thus, most of any long-run change in the external balance happens by the year after the tax rate changes. The error correction coefficients are a bit larger than the

18. Denmark has maintained a tightly fixed exchange rate against the euro since 1999. We include Greece, which joined at the beginning of 2001 but exclude countries that joined the euro area after 2001.

coefficients for the RER, with a long-run adjustment speed of about 20 to 25 percent per year; they are always highly significant.

Table 6 displays analogous results using the conventional framework. Although the overall pattern is similar to that of table 5, the coefficient values are uniformly lower for the current account and the goods and services trade balance. None of the current account coefficients is significantly different from zero. Two of the goods and services coefficients are significantly positive. The results for income and transfers are nearly identical to those of table 5, with four of six significantly negative. Put simply, the results are consistent with changes in the VAT having no significant effect on the current account in the long run.

Overall, the results in tables 5 and 6 suggest that consumption taxes have little effect on the current account balance, but they tend to lower net income and transfer payments and to raise net goods and services exports. We conjecture that by raising the real exchange rate, consumption taxes reduce the value of income received from foreign investments and transfers relative to the value of payments to foreigners on their investments and to outgoing transfers from domestic residents. The higher RER also reduces the net international investment position of domestic residents and thus reduces their real wealth. This reduced wealth may increase saving and thus spur an increase in net exports. Based on a typical coefficient of 0.2 for the trade balance and -0.2 for the income and transfers balance, a 10 percentage point increase in the consumption tax rate—which is an order of magnitude larger than the typical yearly movement and larger than any yearly change in our sample—would be expected to raise the trade balance by 2 percent of GDP and reduce the income and transfers balance by an equal amount, leaving the current account unchanged.

FOUR CASE STUDIES

The results presented above are broadly consistent with full exchange rate offset, but there are potential concerns with both methodologies. The event study suffers from confounding effects from the type of tax reform. The regression analysis allows us to control for other factors, but the coefficients are not precisely estimated. As a final attempt to understand the effect of border adjustment, we examine the consequences of a VAT introduction or increases in four countries where one would most expect to see adjustment and that are relevant for the United States.

New Zealand

New Zealand is the cleanest example in our sample. It implemented a 10 percent value added tax in October 1986, which was raised to 12.5 percent in 1989 and 15 percent in 2010 (Benge, Pallot, and Slack 2013). The tax is uniquely broad-based: It applies to government transactions and excludes only residential rents and financial services, reflected in the VAT revenue ratio of nearly 1 (table 1). As the VAT largely

replaced corporate and income taxes, there was a notable adjustment in the share of goods and services taxes in consumption. The border adjustment, therefore, was new.

Much of the initial adjustment happened via inflation. Inflation (measured relative to the same quarter the previous year) averaged 11 percent during the first three quarters of 1986, then jumped to 18 percent in the four quarters after the tax was introduced (table 7). Put differently, the 10 percent tax was accommodated by a one-time increase in the rate of inflation of 7 percent. The jump in prices mirrors the expansion in the share of goods and services taxes in consumption, which rose from 12 percent in 1985 (the year before the VAT was implemented) to 20 percent in 1987 (the first full year of the tax). These results are consistent with evidence reported in Zodrow et al. (2010) that rising VAT rates contribute to a one-time increase in prices. The price increase fed into the RER, which appreciated by 15 percent between 1986 and 1987 (figure 2).

The case of New Zealand offers evidence that the broad-based VAT was associated with a one-time real appreciation that offset the tax. The evidence suggests that the initial mechanism for the adjustment was via prices. Indeed, the real exchange rate jumped by more than the consumption tax rate, although the effect likely reflected the financial market's positive assessment of the entire package of reforms, which improved the fiscal outlook and relaxed many domestic regulations.

Figure 2 also shows the current account balance in New Zealand around the time of implementing the VAT. Overall, there was some increase in the current account balance over the period, but it started doing so before the change occurred. The shift from income to consumption taxes would be expected to increase saving, which would improve the current account over time.

Australia

In July 2000 Australia introduced a 10 percent VAT, which largely replaced other indirect sales taxes. Despite flat or decreasing total revenue in GDP, the share of goods and services taxes in consumption increased by nearly 2 percent.

The overall impact should have been lower than in New Zealand, since the shift to border-adjusted taxes was smaller. The period was associated with rising inflation in the short run. The jump in the inflation rate of 3 percentage points (table 7) closely matched the increase in the consumption tax rate. The real exchange rate, however, did not appreciate at the time VAT was adopted. In addition, the current account to GDP ratio temporarily increased, suggesting that the border adjustment may have temporarily fed into the trade balance. Over the next two years it reversed, with no medium run change in the current account (figure 2).

Canada

Canada introduced a 7 percent VAT in 1991, which was later reduced to 5 percent in the mid-2000s. The tax largely replaced a sales tax on manufacturers that had been in place since 1924. The manufacturer's tax cascaded through the value chain and was regressive, subjecting it to complaints and a series of reports suggesting reform from as early as the 1930s (Bird and Gendron 2009).

The new VAT was combined with provincial sales taxes, which were turned into VATs, some immediately. The share of goods and services taxes in consumption was flat, but including provincial taxes, which were added on top, the overall increase was larger. In addition, the tax was applied to a much broader base than the previous manufacturer's tax and was border adjusted to a greater extent than the manufacturer's tax. Still, given the conversion of sales taxes, we expect only a small change in prices and the exchange rate.

The tax had a small and immediate effect on prices and the real exchange rate (figure 2). The current account balance as a share of GDP remained unchanged.

The price change is apparent immediately in quarterly data (table 7). Although the increase was relatively modest, the conservative government that enacted the tax lost the next election. Sullivan (2011) writes, "The Canadian experience confirms every politician's instinct that supporting a VAT is career suicide." But, he also calls the case for the VAT "compelling," as it solved Canada's budget problems without increasing the size of government. Despite the next government campaigning to remove the tax and sweeping the election, the VAT remains in place to this day.

China

In 1994, China implemented a 17 percent VAT on goods, with a reduced rate of 13 percent on staples. The VAT applied only to goods, with a separate business tax covering services. It deviated from a broad-based VAT in several other respects as well: For example, some capital expenditures were not deductible, and input rebates for exports varied by sector (Yan 2011).

The tax replaced a cascading turnover tax and allowed for lower corporate income taxes. The turnover tax did not allow deduction of taxes paid on intermediates, which meant that taxes cascaded up the value chain. The VAT raised significant revenue, accounting for over 40 percent of total tax revenue when it was implemented.

China also began pegging the yuan to the dollar in 1994. As a result, the nominal exchange rate could not adjust to the VAT. The VAT was implemented during a period of high inflation. Nevertheless, a sharp one-time increase in prices after VAT implementation is visible. The rate of inflation jumped from 17 to 22 percent in the first quarter VAT was applied (table 7). The price change facilitated a real exchange rate appreciation. In contrast, the current account remained relatively stable in the years after the VAT was

implemented. The experience of China is also consistent with the real exchange rate adjusting to offset the border adjustment in the tax.

CONCLUSIONS

This paper largely supports the theoretical assertion that a country's real exchange rate rises in proportion to any increase in its border-adjusted consumption taxes, with little effect on the current account balance. However, the border-adjusted cash flow tax being considered in the United States differs in important ways from the consumption taxes we examine, raising the possibility of a slower and more complicated adjustment.

Real Exchange Rates

The event study and case studies generally find evidence of a positive effect of border-adjusted consumption taxes on the real exchange rate. Much of the adjustment comes through consumer prices. In some cases, the nominal exchange rate also appreciated and the RER appreciated by even more than the increased tax rate. This excess adjustment probably reflects other reforms that accompanied VAT increases that financial markets viewed positively.

The regressions support the hypothesis of full exchange rate offset ($\alpha = 1$) significantly more than the hypothesis of no exchange rate offset ($\alpha = 0$). One-tailed tests that the offset is greater than 0 are significant in five of 12 cases at the 10 percent level in the cointegration framework and 10 of 12 cases in the conventional framework. One-tailed tests that the offset is less than 1 are never significant.

The degree of offset is not precisely estimated. Point estimates range from 0.5 to 3.1. This imprecision almost certainly reflects the dominant role of factors other than consumption taxes, including factors not readily observable, in exchange rate behavior. Exchange rates are highly volatile, and economists have had scant success in explaining them.

External Balances

The event study and case studies find no evidence of any strong effect of border-adjusted consumption taxes on the current account balance. In some cases, the current account increased moderately around the time of a VAT increase, but many VAT increases were associated with increases in the fiscal balance, which would restrain demand for imports.

The regressions find some evidence for a moderate effect of consumption tax rates on the components of the current account balance: the goods and services trade balance and the income and transfers balance. Median point estimates are around 0.2 for trade and -0.2 for income and transfers. One possible explanation is that the consumption tax has a small positive effect on the goods and services balance that is offset

by a small negative effect on the investment income balance, reflecting the decline in profits on foreign investment caused by the real exchange rate appreciation. Goods and services and investment income are typically the two largest components of the current account.

Implications for the Destination-Based Cash Flow Tax

In the long run, changes in policy are accommodated by changes in the real exchange rate, exactly as theory predicts. The event study and the case study analysis reveal that adjustment to the new equilibrium is complete within about two years, with much of the adjustment happening immediately through prices. The regression analysis finds somewhat slower adjustment, although more than half of adjustment seems to occur within three years. To the extent that bold tax reform is a rare event that takes place every 30 years or so, a three-year adjustment is not too worrisome.

Three important caveats are worth noting. First, the United States is a large country that controls the world's reserve currency. While movement in the nominal exchange rate could immediately offset the border adjustment of the cash flow tax, the extent to which dollar movements reflect trade relative to financial flows may be quite small in practice. In addition, the dollar's special role in global trade and finance, and the fact that a number of countries' exchange rates are tied to the dollar, could mute this channel.

Second, the proposed border-adjusted CFT is different from a VAT or sales tax, for which prices do most of the adjustment. In the absence of rapid exchange rate appreciation, adjustment requires increases in both prices and wages, which would likely take longer and be more complex. If wages are slow to adjust, there would likely be real effects on employment and trade in the short run. There is also a question of the extent to which the Federal Reserve would accommodate the change.

Third, the size of the proposed CFT is larger than other taxes. Most other countries have raised border-adjusted consumption taxes in small steps, requiring only small price increases or exchange rate appreciations. The shift to the destination-based CFT, as proposed in the House blueprint, would require a 25 percent appreciation or a 25 percent increase in wages and prices. The magnitude of the change is far outside our sample and could create additional concerns for the global financial system and for consumer price and wage inflation.

If the exchange rate does not immediately adjust, or adjusts only partially, real trade effects are likely. During the adjustment period, exporting and import-competing firms would benefit, while retailers and firms using imported inputs would suffer.

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Table 1 VAT rates and VAT revenue ratios

Country	Standard VAT		VAT revenue ratio, 2012
	rate, 2012 (percent)	VAT revenue ratio, 2000	
Australia	10	n.a.	0.47
Austria	20	0.61	0.59
Belgium	21	0.5	0.48
Canada	5	0.5	0.48
Chile	19	0.64	0.64
Czech Republic	20	0.42	0.57
Denmark	25	0.6	0.59
Estonia	20	0.72	0.7
Finland	23	0.61	0.56
France	19.6	0.5	0.48
Germany	19	0.6	0.55
Greece	23	0.49	0.37
Hungary	27	0.52	0.52
Iceland	25.5	0.59	0.45
Ireland	23	0.62	0.45
Israel	16	0.62	0.64
Italy	21	0.43	0.38
Japan	5	0.68	0.69
Korea	10	0.59	0.69
Luxembourg	15	0.76	1.13
Mexico	16	0.28	0.31
Netherlands	19	0.57	0.53
New Zealand	15	0.99	0.96
Norway	25	0.67	0.57
Poland	23	0.42	0.42
Portugal	23	0.6	0.47
Slovak Republic	20	0.44	0.43
Slovenia	20	0.67	0.58
Spain	18	0.52	0.41
Sweden	25	0.52	0.56
Switzerland	8	0.74	0.71
Turkey	18	0.45	0.4
United Kingdom	20	0.47	0.44
<i>Average</i>	18.7	0.57	0.55

n.a. = not available

Note: VAT revenue ratio is actual VAT revenue divided by revenue that would be collected if all consumption were taxed at VAT rate.
Source: OECD (2014b).

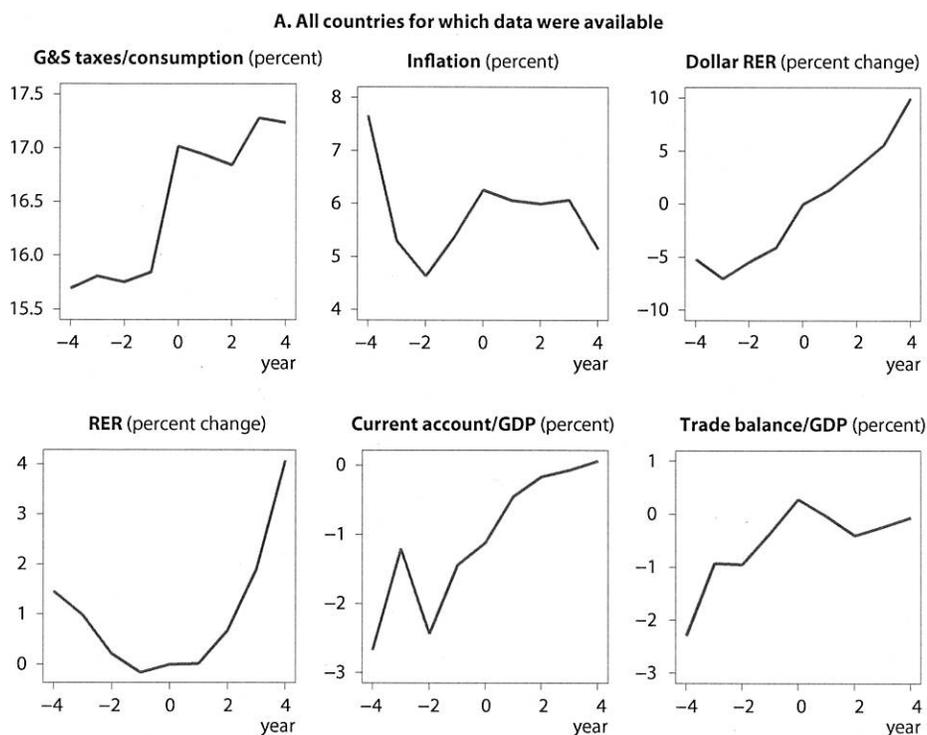
Table 2 VAT implementation dates and rates

Country	Year implemented	VAT rate	Taxes replaced
Australia	2000	10% goods and services tax (VAT)	State indirect taxes and income taxes
Austria	1973	16% VAT, reduced rate 8%	Cascade turnover tax
Belgium	1971	Four-rate VAT: standard 18%, 6%, 14%, 25%	Cascade turnover tax
Canada	1991	7% goods and services tax (VAT)	Manufacturers' sales tax (MST)
Switzerland	1995	6.5% VAT	Sales tax on goods
Chile	1975	20% VAT	Cascade sales tax, other indirect taxes
Czech Republic	1993	23% VAT, reduced rate 5%	Turnover tax
Germany	1968	10% VAT, reduced rate 5%	Cascade turnover tax
Denmark	1967	10% VAT	Wholesale tax
Spain	1986	Three-rate VAT: standard 12%, 6%, 33%	Cascade sales tax, other indirect taxes
Estonia	1992	10% VAT	Turnover tax
Finland	1994	22% VAT	Turnover tax
France	1968	16.66% VAT	Earlier VAT
United Kingdom	1974	10% VAT	Purchase tax and selective employment tax
Greece	1987	Four-rate VAT: standard 16%, 3%, 6%, 36%	Stamp duties, business turnover tax
Hungary	1988	Multiple-rate VAT: top rate 25%	Turnover tax
Ireland	1972	Four-rate VAT: 5.26%, 11.11%, 16.37%, 30.26%	Wholesale and turnover tax
Iceland	1990	24.5% VAT	—
Israel	1976	8% VAT	None
Italy	1973	12% VAT	—
Japan	1989	3% Consumption tax (VAT)	Other indirect and excise taxes
Korea	1977	10% VAT	Cascade turnover tax, other indirect taxes
Latvia	1995	18% VAT	Turnover tax
Luxembourg	1971	8% VAT, reduced rate 4%	—
Mexico	1980	10% VAT	—
Netherlands	1969	12% VAT, reduced rate 4%	Cascade turnover tax
Norway	1969	20% VAT	General sales tax
New Zealand	1986	10% VAT	Income tax
Poland	1993	22% VAT, reduced rate 7%	Turnover tax
Portugal	1986	Three-rate VAT: standard 16%, 8%, 30%	Tax on transactions and other indirect taxes
Slovak Republic	1993	23% VAT, reduced rate 5%	Turnover taxes
Slovenia	1999	20% VAT, reduced rate 8.5%	—
Sweden	1969	10% VAT	Retail sales tax
Turkey	1985	10% VAT	Other indirect taxes

— = no information available

Sources: National sources and OECD reports.

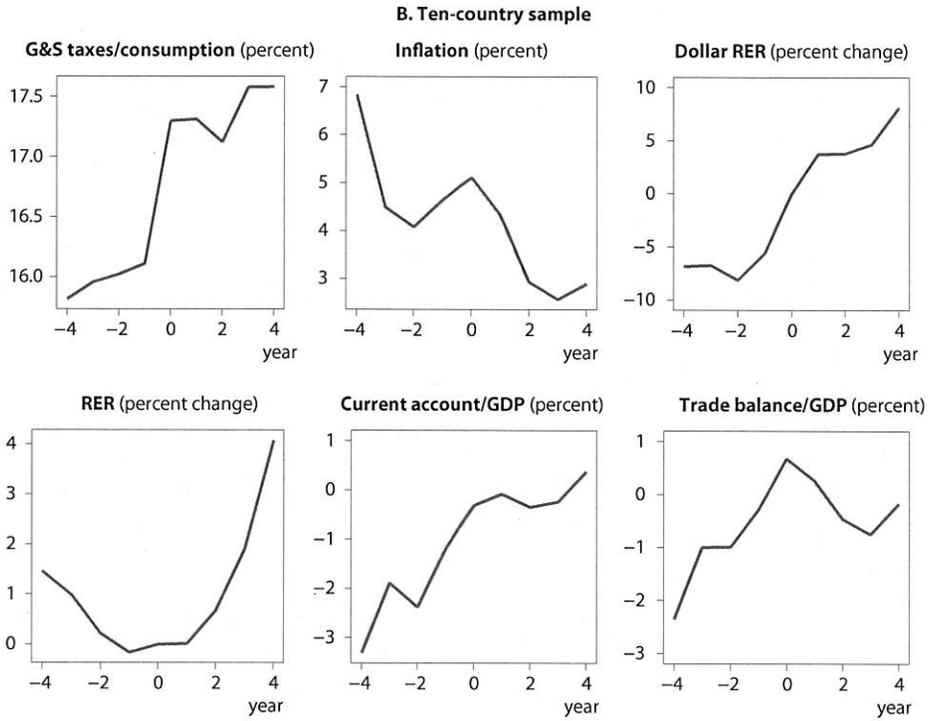
Figure 1 Changes in exchange rates, prices, and trade balances following implementation of VAT



Notes: Graphs are based on all countries for which data were available: 12 for goods and services (G&S) tax revenue as a share of consumption, 14 for inflation, 14 for the real dollar exchange rate, 10 for the trade-weighted real exchange rate (RER), 14 for the current account as a share of GDP, and 12 for the trade balance as a share of GDP.

(figure continues)

Figure 1 Changes in exchange rates, prices, and trade balances following implementation of VAT (continued)



Note: The sample consists of Australia, Canada, Finland, Greece, Iceland, Japan, New Zealand, Portugal, Switzerland, and Spain. The inflation graph excludes countries with average inflation above 10 percent during the four years before tax reform.

Source: Authors' calculations using data described in text.

Table 3 Cointegrating regression of real exchange rate on consumption tax rate, 1970–2015 annual, equation (1), long-run cointegration coefficients

Partner: United States	1	2	3	4	5	6
Goods & services tax rate	3.11*** (1.07)	2.17* (1.26)	1.16 (0.79)	0.70 (0.90)	0.75 (0.74)	2.04** (0.81)
Fiscal balance	1.10** (0.50)	2.58*** (0.51)				
Government revenue	-1.05 (0.69)	0.58 (0.82)	0.11 (0.55)	1.76*** (0.62)		
Relative per capita income	0.41*** (0.10)	0.51*** (0.12)	0.30*** (0.09)	0.57*** (0.11)		
Net investment position	-0.06* (0.03)	-0.08** (0.04)	-0.03 (0.03)	-0.03 (0.04)		
Error correction	-0.19*** (0.02)	-0.22*** (0.02)	-0.17*** (0.02)	-0.20*** (0.02)	-0.17*** (0.02)	-0.17*** (0.01)
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.69	0.28	0.67	0.24	0.61	0.16
Observations	892	892	1120	1120	1164	1164
$\alpha > 0$	***	**	*			***
$\alpha < 1$						
Partner: Germany	1	2	3	4	5	6
Goods & services tax rate	0.83 (1.15)	0.73 (1.00)	1.04 (0.64)	0.48 (0.57)	0.61 (0.61)	0.61 (0.61)
Fiscal balance	0.94** (0.43)	0.15 (0.32)				
Government revenue	-1.76*** (0.67)	-1.72*** (0.55)	-0.02 (0.42)	-0.09 (0.33)		
Relative per capita income	0.54*** (0.11)	0.57*** (0.06)	0.22*** (0.07)	0.32*** (0.04)		
Net investment position	-0.03 (0.02)	-0.02 (0.02)	-0.01 (0.02)	-0.05** (0.02)		
Error correction	-0.21*** (0.02)	-0.24*** (0.02)	-0.18*** (0.02)	-0.21*** (0.02)	-0.17*** (0.02)	-0.18*** (0.02)
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.45	0.33	0.45	0.25	0.37	0.13
Observations	689	689	1120	1120	1164	1164
$\alpha > 0$			*			
$\alpha < 1$						

* p<.10, ** p<.05, *** p<.01

Source: Authors' calculations using data described in text.

Table 4 Ordinary least squares (OLS) regression of real exchange rate on consumption tax rate, 1970-2015 annual, equation (2), estimated long-run effects

Partner: United States	1	2	3	4	5	6
Goods & services tax rate	3.14*** (1.08)	2.29* (1.25)	1.59** (0.74)	1.15 (0.81)	0.87 (0.66)	1.37* (0.76)
Fiscal balance	1.19* (0.71)	2.75*** (0.73)				
Government revenue	-1.19 (1.18)	0.40 (1.12)	0.15 (0.72)	1.59*** (0.50)		
Relative per capita income	0.44*** (0.12)	0.48** (0.21)	0.33** (0.14)	0.57*** (0.21)		
Net investment position	-0.06 (0.06)	-0.09 (0.07)	-0.02 (0.05)	-0.04 (0.05)		
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.92	0.82	0.92	0.82	0.90	0.77
Observations	905	905	1134	1134	1208	1208
$\alpha/(1-\beta) > 0$	***	**	**	*	*	**
$\alpha/(1-\beta) < 1$						
Partner: Germany	1	2	3	4	5	6
Goods & services tax rate	0.94 (1.39)	0.70 (1.09)	1.47** (0.65)	0.87 (0.54)	0.80 (0.62)	0.84 (0.59)
Fiscal balance	1.07 (0.68)	0.23 (0.48)				
Government revenue	-1.88* (1.11)	-1.72* (1.00)	-0.01 (0.54)	-0.15 (0.50)		
Relative per capita income	0.52*** (0.12)	0.57*** (0.08)	0.24** (0.10)	0.33*** (0.07)		
Net investment position	-0.02 (0.04)	-0.02 (0.03)	-0.01 (0.04)	-0.04 (0.04)		
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.87	0.85	0.85	0.8	0.82	0.76
Observations	700	700	1134	1134	1208	1208
$\alpha/(1-\beta) > 0$			**	*	*	*
$\alpha/(1-\beta) < 1$						

* p<.10, ** p<.05, *** p<.01

Source: Authors' calculations using data described in text.

Table 5 Cointegrating regression of external balances on consumption tax rate, 1970–2015 annual, equation (1), long-run cointegration coefficients

Current account	1	2	3	4	5	6
Goods & services tax rate	0.19 (0.22)	0.2 (0.23)	0.21 (0.16)	0.33** (0.16)	-0.10 (0.14)	0.19 (0.13)
Fiscal balance	0.00 (0.11)	-0.07 (0.11)				
Government revenue	-0.35** (0.15)	-0.22 (0.15)	-0.25** (0.12)	-0.07 (0.10)		
Relative per capita income	0.06*** (0.02)	0.08*** (0.02)	0.05** (0.02)	0.07*** (0.02)		
Net investment position	-0.01 (0.01)	-0.02** (0.01)	-0.01* (0.01)	-0.02** (0.01)		
Error correction	-0.26*** (0.03)	-0.25*** (0.02)	-0.25*** (0.02)	-0.24*** (0.02)	-0.23*** (0.02)	-0.23*** (0.02)
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.30	0.22	0.29	0.23	0.23	0.13
Observations	944	944	1162	1162	1205	1205
Goods & services trade balance	1	2	3	4	5	6
Goods & services tax rate	0.31 (0.19)	0.26 (0.19)	0.54*** (0.17)	0.63*** (0.18)	0.15 (0.16)	0.46*** (0.16)
Fiscal balance	-0.02 (0.10)	-0.07 (0.09)				
Government revenue	-0.17 (0.13)	-0.11 (0.12)	-0.32** (0.13)	-0.09 (0.11)		
Relative per capita income	0.07*** (0.02)	0.09*** (0.02)	0.10*** (0.02)	0.13*** (0.02)		
Net investment position	-0.02*** (0.01)	-0.03*** (0.01)	-0.04*** (0.01)	-0.04*** (0.01)		
Error correction	-0.25*** (0.02)	-0.25*** (0.02)	-0.20*** (0.02)	-0.19*** (0.02)	-0.18*** (0.02)	-0.17*** (0.02)
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.31	0.25	0.29	0.23	0.21	0.11
Observations	946	946	1179	1179	1242	1242

(table continues)

Table 5 Cointegrating regression of external balances on consumption tax rate, 1970–2015 annual, equation (1), long-run cointegration coefficients (continued)

Income and transfers	1	2	3	4	5	6
Goods & services tax rate	-0.12 (0.11)	-0.06 (0.11)	-0.35** (0.14)	-0.29** (0.13)	-0.27* (0.14)	-0.23* (0.12)
Fiscal balance	0.03 (0.05)	0.01 (0.05)				
Government revenue	-0.15** (0.07)	-0.09 (0.07)	0.06 (0.11)	0.01 (0.09)		
Relative per capita income	-0.02 (0.01)	-0.01 (0.01)	-0.05*** (0.02)	-0.04*** (0.02)		
Net investment position	0.02*** 0.00	0.02*** 0.00	0.01 (0.01)	0.01 (0.01)		
Error correction	-0.29*** (0.03)	-0.29*** (0.03)	-0.15*** (0.02)	-0.16*** (0.02)	-0.13*** (0.02)	-0.14*** (0.02)
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.35	0.30	0.28	0.23	0.12	0.08
Observations	944	944	1162	1162	1205	1205

* p<.10, ** p<.05, *** p<.01

Source: Authors' calculations using data described in text.

Table 6 Ordinary least squares regression of external balances on consumption tax rate, 1970-2015 annual, equation (2), estimated long-run effects

Current account	1	2	3	4	5	6
Goods & services tax rate	-0.01 (0.26)	-0.16 (0.28)	0.06 (0.16)	0.08 (0.17)	-0.20 (0.19)	0.04 (0.18)
Fiscal balance	0.00 (0.10)	-0.07 (0.13)				
Government revenue	-0.44** (0.17)	-0.32* (0.17)	-0.30** (0.13)	-0.07 (0.13)		
Relative per capita income	0.06*** (0.02)	0.09*** (0.02)	0.04* (0.02)	0.08*** (0.02)		
Net investment position	-0.01 (0.01)	-0.02 (0.01)	-0.01* (0.01)	-0.02** (0.01)		
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.68	0.65	0.7	0.66	0.67	0.62
Observations	958	958	1177	1177	1251	1251
Goods & services trade balance	1	2	3	4	5	6
Goods & services tax rate	0.01 (0.24)	-0.11 (0.25)	0.31* (0.16)	0.32* (0.18)	-0.04 (0.23)	0.24 (0.21)
Fiscal balance	-0.02 (0.12)	-0.06 (0.12)				
Government revenue	-0.29 (0.18)	-0.22 (0.17)	-0.40** (0.16)	-0.10 (0.13)		
Relative per capita income	0.08*** (0.02)	0.10*** (0.02)	0.10** (0.04)	0.13*** (0.02)		
Net investment position	-0.03*** (0.01)	-0.03*** (0.01)	-0.04*** (0.01)	-0.05*** (0.01)		
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.72	0.69	0.79	0.77	0.77	0.73
Observations	959	959	1193	1193	1291	1291

(table continues)

Table 6 Ordinary least squares regression of external balances on consumption tax rate, 1970-2015 annual, equation (2), estimated long-run effects (continued)

Income and transfers	1	2	3	4	5	6
Goods & services tax rate	-0.02 (0.10)	-0.05 (0.12)	-0.27** (0.12)	-0.23** (0.10)	-0.23** (0.10)	-0.23* (0.11)
Fiscal balance	0.04 (0.06)	0.01 (0.06)				
Government revenue	-0.13 (0.09)	-0.07 (0.07)	0.06 (0.12)	0.01 (0.07)		
Relative per capita income	-0.02 (0.01)	-0.01 (0.01)	-0.05 (0.03)	-0.04 (0.03)		
Net investment position	0.02*** 0.00	0.02*** (0.01)	0.01 (0.01)	0.01 (0.01)		
Year effects	Yes	No	Yes	No	Yes	No
R-squared	0.71	0.69	0.81	0.8	0.77	0.76
Observations	957	957	1176	1176	1250	1250

* p<.10, ** p<.05, *** p<.01

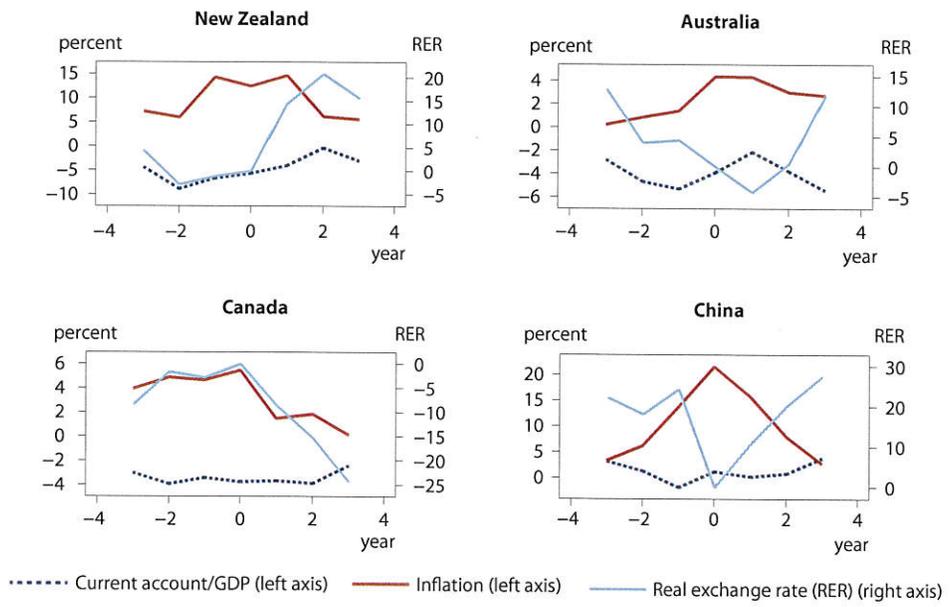
Source: Authors' calculations using data described in text.

Table 7 Inflation around VAT change, four-quarter price change (percent)

Quarter	New Zealand	Australia	China	Canada	Average
Q3	12.96	1.92	13.90	4.61	8.35
Q2	10.42	2.80	16.10	4.15	8.37
Q1	11.03	3.08	17.13	4.95	9.05
Q0	18.24	6.11	22.23	6.44	13.26
Q1	18.29	5.79	21.87	6.21	13.04
Q2	18.94	6.03	25.70	5.81	14.12
Q3	16.95	6.13	26.90	4.09	13.52
Q4	9.59	2.47	22.60	1.58	9.06
Q5	8.98	3.15	19.97	1.37	8.37
Q6	6.35	2.98	14.80	1.20	6.33

Sources: Data for Australia, New Zealand, and China are from OECD. Data for Canada are from Statistics Canada via Haver Analytics.

Figure 2 Implementation of VAT, by country



Source: Authors' calculations using data described in text.

MEMBER QUESTIONS FOR THE RECORD

HEARING ON HOW TAX REFORM WILL GROW OUR ECONOMY AND CREATE JOBS

Questions for the Record

Question from Rep. Smith (MO)

Question for Mr. Stephens

Lead in:

Mr. Stephens, big companies like AT&T can go to capital markets to finance investment. However, farmers and small businesses in the Missouri don't have that ability, they need to borrow money to get the capital they need to buy land, equipment, and run a farm, and they need to finance these expenses through debt.

Question:

What kind proposals would you have for us, so we can help our farmers and small businesses to grow?

Mr. Stephens:

We want and need small business to succeed. If they succeed, we all succeed. They are our partners, our suppliers and our customers. AT&T is proud of our commitment to small and minority owned businesses. I think it is important to recognize that smaller businesses do not have the same access to capital that a larger company like AT&T does. The House Better Way plan proposes ending the deduction for net interest expense to help finance a lower rate. Recognizing that base broadening is necessary, there should be some type of exemption to help small businesses that rely on debt financing. I believe the Committee should pay special attention to industries that heavily rely on debt related capital, industries like agriculture and farming which are critical to our overall economy.

Additionally, this issue highlights the importance of having transition rules that do not harm businesses for decisions made under prior law. If the committee ends the deduction for net interest expensing, they should include a grandfather to allow the expensing of existing debt. Failing to do so may shift businesses' focus away from investment and toward debt repayment. It would also penalize businesses for decisions made under prior tax laws.

Questions from Rep. Holding

Questions for Mr. Peterson and Mr. Stephens

Lead in:

In putting together a tax reform package, one of the key goals is to ensure that American companies have a tax system in place that allows them to remain competitive on the global stage – and moving to a territorial tax system is an important step in achieving this goal.

Similarly, if we are moving to a territorial system for businesses, it makes sense to me that we also ensure the tax code supports the competitiveness of American citizens globally by moving

away from the current citizenship-based taxation system and to a form of residence-based taxation.

Question 1:

Do you see a benefit from having Americans in positions in your overseas operations?

Mr. Peterson:

At S&P Global, we benefit from a variety of backgrounds in our employee base. As such, we do see a benefit in having Americans in some of our overseas positions and value the diversity of opinions they provide in those operations. We're an international company and invest in our employees both in the U.S. and abroad. But permanent, comprehensive tax reform allows companies like ours to make additional, long-term investments in the U.S. and in our workers.

Question 2:

How does the current tax code, with citizenship-based taxation, impact your ability to hire and retain Americans in operations outside of the U.S.?

Mr. Peterson:

Hiring Americans in other markets has a higher cost due to the current system. Taxation is not the only factor in making these hiring decisions, but the cost is something the company must consider.

Question 3:

In your opinion, do you think a change in our tax laws to move to a residence-based taxation system could allow or encourage companies to hire more Americans for jobs in their overseas operations?

Mr. Peterson:

In any tax reform effort, we would expect companies to evaluate changes to the tax code and change their behavior appropriately. From a purely employee perspective, the American candidate will be able to compete with similarly skilled employees of other nationalities.

Question 4:

And if so, what impact do you think this would have on the overall job market for Americans?

Mr. Peterson:

Combined with a lower rate and more competitive international system, comprehensive tax reform with residence-based taxation would increase economic opportunities for Americans.

Question 1:

Do you see a benefit from having Americans in positions in your overseas operations?

Mr. Stephens:

Yes – clearly there is a benefit.

Question 2:

How does the current tax code, with citizenship-based taxation, impact your ability to hire and retain Americans in operations outside of the U.S.?

Mr. Stephens:

Americans working in foreign jurisdictions are taxed on their worldwide income and are nearly always much more expensive than employees from other countries who are only taxed on “in country” income. Additionally, the U.S. taxes benefits such as housing and transportation while other countries do not. This also makes employing Americans much more expensive.

Question 3:

In your opinion, do you think a change in our tax laws to move to a residence-based taxation system could allow or encourage companies to hire more Americans for jobs in their overseas operations?

Mr. Stephens:

It will make more economic sense for global companies to hire Americans for jobs overseas and increase employment opportunities for the U.S. worker.

Question 4:

And if so, what impact do you think this would have on the overall job market for Americans?

Mr. Stephens:

It would increase the demand for American workers and thereby increase employment opportunities and wages.

PUBLIC SUBMISSIONS FOR THE RECORD



Statement of the A Call To Invest in Our Neighborhoods (ACTION) Campaign

In Response to the Ways and Means Committee Hearing on “How Tax Reform Will Grow Our Economy and Create Jobs”

May 18, 2017

The A Call To Invest in Our Neighborhoods (ACTION) Campaign, representing over 2,000 national, state, and local organizations and businesses, urges the Ways and Means Committee to expand and strengthen the Low Income Housing Tax Credit (Housing Credit), and to protect multifamily Housing Bonds, as part of any tax reform effort to grow our economy and create jobs.

A 30 Year History of Success

The Housing Credit is our most successful tool for encouraging private investment in the production and preservation of affordable rental housing, with a proven track record of creating jobs and stimulating local economies. For 30 years, it has been a model public-private partnership program, bringing to bear private sector resources, market forces, and state-level administration to finance more than 3 million affordable apartments – nearly one-third of the entire U.S. inventory – giving more than 6.7 million households, including low-income families, seniors, veterans, and people with disabilities, access to homes they can afford. Roughly 40 percent of these homes were financed in conjunction with multifamily Housing Bonds, which are an essential component of the program’s success.

The Housing Credit Creates Jobs

Housing Credit development creates jobs – roughly 1,130 for every 1,000 Housing Credit apartments developed, according to the National Association of Home Builders (NAHB). This amounts to roughly 96,000 jobs per year, and more than 3.25 million since the program was created in 1986. NAHB estimates that about half of the jobs created from new housing development are in construction. Additional job creation occurs across a diverse range of industries, including the manufacturing of lumber, concrete, lighting and heating equipment, and other products, as well as jobs in transportation, engineering, law, and real estate.

The Housing Credit Stimulates Local Economies and Improves Communities

The Housing Credit stimulates local economies. NAHB estimates the Housing Credit adds \$9.1 billion in income to the economy and generates approximately \$3.5 billion in federal, state, and local taxes each year.

Conversely, a lack of affordable housing negatively impacts economies. Research shows that high rent burdens have priced out many workers from the most productive cities, resulting in 13.5 percent foregone GDP growth, a loss of roughly \$1.95 trillion, between 1964 and 2009.

Housing Credit development positively impacts communities. About one-third of Housing Credit properties revitalize distressed communities. Stanford University research shows these investments improve property values and reduce poverty, crime, and racial and economic isolation.

The Housing Credit is a Model Public-Private Partnership

The Housing Credit is structured so that private sector investors provide upfront equity capital in

AFFORDABLE RENTAL HOUSING A.C.T.I.O.N. A Call To Invest in Our Neighborhoods

exchange for a credit against their tax liability over ten years that only vests once the property is constructed and occupied by eligible households paying restricted rents. This unique, market-based design transfers the real estate risk from the taxpayer to the private sector investor. In the rare event that a property falls out of compliance anytime during the first 15 years after it is placed in service, the Internal Revenue Service can recapture tax credits from the investor. Therefore it is in the interest of the private sector investors to ensure that properties adhere to all program rules, including affordability restrictions and high quality standards.

The Housing Credit is State Administered with Limited Federal Bureaucracy

The Housing Credit requires only limited federal bureaucracy because Congress wisely delegated its administration and decision-making authority to state government as part of its design. State Housing Finance Agencies, which administer the Housing Credit in nearly every state, have statewide perspective; a deep understanding of the needs of their local markets; and sophisticated finance, underwriting, and compliance capacity.

The Housing Credit Addresses a Serious and Growing National Need

More than one in four renter households in the U.S. – over 11 million – spend more than half of their monthly income on rent, leaving too little for other necessities like food, medical care, and transportation. This crisis is continuing to grow. HUD reports that as of 2015, the number of households with “worst case housing needs” had increased by 38.7 percent over 2007 levels, when the recession began, and by 63.4 percent since 2001. A recent study by Harvard University’s Joint Center for Housing Studies and Enterprise Community Partners estimates that the number of renter households who pay more than half of their income towards rent could grow to nearly 15 million by 2025.

Affordable Housing Improves Low-Income Households’ Financial Stability

Affordable housing promotes financial stability and economic mobility. It leads to better health outcomes, improves children’s school performance, and helps low-income individuals gain employment and keep their jobs. Affordable housing located near transportation and areas with employment opportunities provides low-income households with better access to work, which increases their financial stability and provides employers in those areas with needed labor.

Families living in affordable homes have more discretionary income than low-income families who are unable to access affordable housing. This allows them to allocate more money to other needs, such as health care and food, and gives them the ability to pay down debt, access childcare, and save for education, a home down payment, retirement, or unexpected needs.

The Housing Credit is Critical to Preserving Our Nation’s Existing Housing Investments

The Housing Credit is also our primary tool to preserve and redevelop our nation’s current supply of affordable housing. Without the Housing Credit, our ability to revitalize and rehabilitate our nation’s public housing and Section 8 housing inventory, decades in the making, would be significantly diminished. In addition to putting the residents of these properties at risk of displacement, we would lose these investments that taxpayers have already made.

In rural areas, where direct funding for rural housing programs has been cut significantly, the Housing Credit is the backbone for preservation and capital improvements to the existing housing stock. Low-income rural residents’ incomes average just \$12,960, and they are often living in areas with extremely limited housing options, making preservation of the existing housing stock crucial.



Congress Should Strengthen and Expand the Housing Credit

Congress should support investment in the Housing Credit as part of any effort to grow the economy and create jobs. The Affordable Housing Credit Improvement Act (H.R. 1661), sponsored by Representative Pat Tiberi (R-OH-12) and Ways and Means Committee Ranking Member Richard Neal (D-MA-1), has strong bipartisan support in the House and among the Ways and Means Committee members. This legislation would enact roughly two dozen changes to strengthen the Housing Credit by streamlining program rules, improving flexibility, and making the program better able to serve a wider array of local needs.

ACTION also calls on Congress to expand the Housing Credit. Viable and sorely needed Housing Credit developments are turned down each year because the cap on Housing Credit authority is far too low to support the demand. In 2014 – the most recent year for which data is available – state Housing Credit allocating agencies received applications requesting more than twice their available Housing Credit authority. Many more potential applications for worthy developments are not submitted in light of the intense competition, constrained only by the lack of resources.

The scarcity of Housing Credit resources forces state allocating agencies to make difficult trade-offs between directing their extremely limited Housing Credit resources to preservation or new construction, to rural or urban areas, to neighborhood revitalization or developments in high opportunity areas, or to housing for the homeless, the elderly, or veterans. There simply is not enough Housing Credit authority to fund all of the properties needed, but with a substantial increase in resources, many more of these priorities would be addressed – and the benefits for communities would be even greater.

Though the need for Housing Credit-financed housing has long vastly exceeded its supply, Congress has not increased Housing Credit authority in 16 years. To meaningfully increase affordable housing development, we urge Congress to increase the cap on Housing Credit authority by at least 50 percent. Such an expansion would support the preservation and construction of up to 400,000 additional affordable apartments over a ten-year period.

We also call on Congress to retain the tax exemption on multifamily Housing Bonds, which provide critical financing to roughly 40 percent of Housing Credit developments and are essential to sustaining the Housing Credit's production potential.

Investing in the Housing Credit is an investment in economic growth. It transforms the lives of millions of Americans who for the first time are able to afford their homes – and it transforms their communities and local economies as well.

ACTION Co-Chairs

National Council of State Housing Agencies
Enterprise Community Partners

ACTION Steering Committee Members

Affordable Housing Tax Credit Coalition
Council for Affordable and Rural Housing
Council of Large Public Housing Authorities

AFFORDABLE RENTAL HOUSING A.C.T.I.O.N. A Call To Invest in Our Neighborhoods

CSH
Housing Advisory Group
Housing Partnership Network
LeadingAge
Local Initiatives Support Corporation/National Equity Fund
Make Room
National Association of Affordable Housing Lenders
National Association of Home Builders
National Association of Housing and Redevelopment Officials
National Association of REALTORS®
National Association of State and Local Equity Funds
National Housing and Rehabilitation Association
National Housing Conference
National Housing Trust
National Low Income Housing Coalition
National Multifamily Housing Council
Stewards of Affordable Housing for the Future
Volunteers of America

For a full list of ACTION Campaign members, visit www.rentalhousingaction.org.

May 30, 2017

Tax Reform Should Include Incentives for Investment in Knowledge-Based Pre-Revenue Start-Up Companies

Introduction to AdvaMed Accel

The Advanced Medical Technology Association (AdvaMed) is the leading trade association representing medical technology manufacturers and suppliers that operate in the United States. AdvaMed's member companies produce the medical devices, diagnostic products, and digital health technologies that are transforming health care through earlier disease detection, less invasive procedures, and more effective treatments. Our members range from the largest to the smallest medical technology innovators and companies. Collectively, we are committed to ensuring patient access to life-saving and life-enhancing devices and other advanced medical technologies.

AdvaMed Accel is the division within AdvaMed dedicated to the needs of smaller medical technology manufacturers. AdvaMed Accel is the only organization of its kind focusing specifically on the needs of the medtech industry's emerging growth companies. AdvaMed Accel focuses on promoting policies conducive to capital formation and innovation, and advocating for domestic and international regulatory and reimbursement policies that recognize the unique needs of emerging companies.

Importance of start-ups to U.S. job growth

While there has been a significant amount of discussion about tax reforms that might benefit small businesses with taxable income, there has been little focus on startup pre-profit businesses that will not benefit directly from reductions in the corporate tax rate. Yet start-up companies are crucial sources of job creation and of economy-side innovation. If comprehensive tax reform is to achieve its goal of stimulating long-term economic growth and job creation and developing a more competitive U.S. economy, the needs of pre-profit start-up firms must be addressed.



Research shows that all the net job creation in the economy consistently comes from the start-up sector.¹ Moreover, start-ups that continue to grow after their first few years are disproportionate engines of job creation. Fast-growing small firms, comprising less than 1 percent of all companies, generate roughly 10 percent of new jobs in any given year.^{2,3} As the 2016 *Economic Report of the President* stated, “A healthy environment for start-ups sets the stage for current and future job growth.”⁴ It also points out that “Entrepreneurial success ultimately translates into improvements in quality of life and in productivity growth.”⁵

This job effect is especially pronounced for knowledge-based start-ups. In the innovative high-tech sector—defined as firms with high shares of employees in science and the life sciences, technology, engineering and math—new firm formation was 28 percent higher than in the private sector as a whole for the period 1990-2011. Among high tech firms one to five years old, net job creation totaled 3 percent per year. By contrast, the high failure rate among all young firms resulted in a net job loss of around 3.5 percent for these firms. If businesses that failed during their first five years are excluded, young high-tech firms generated an average employment growth of more than 9 percent per year, while the comparable figure for the economy as a whole was closer to 5 percent.⁶

Knowledge-based start-ups are especially important in sustaining and improving U.S. international competitiveness. U.S. competitiveness, especially in manufacturing, depends on maintaining a comparative advantage in producing new and transformative products and in innovation in manufacturing methods. Indeed, since the U.S. cannot hope to compete—and would not want to compete—on low wages, it is only by innovation in products and methods that we can maintain or regain world leadership. It is typical of many knowledge-based industries that the most innovative and transformative new products originate with start-up companies.

The deterioration of the U.S. start-up economy

While a healthy start-up sector is critical to America’s long-term economic future, the U.S. has been experiencing a decline in start-up activity at least since the late 1970s. While start-ups accounted for approximately 16 percent of all firms in 1977, that proportion had declined to

¹ Tim Kane, “The Importance of Startups in Job Creation and Job Destruction,” The Kauffman Foundation Research Series: Firm Formation and Economic growth, July 2010. Start-ups are defined as firms one year old or less. Of course, not all job-creation comes from start-up firms, but the jobs created by older firms are roughly balanced out by job losses in other older firms.

² Diane Stangler, “High Growth Firms and the Future of the American Economy,” The Kauffman Foundation Research Series: Firm Formation and Economic growth, March 2010.

³ Ian Hathaway, “Tech Starts: High-Technology Business Formation and Job Creation in the United States,” August 2013.

⁴ 2016 Economic Report of the President, p. 213.

⁵ Id., p. 212.

⁶ Ian Hathaway, “Tech Starts: High-Technology Business Formation and Job Creation in the United States,” August 2013.

less than 9 percent by 2013.⁷ A sustained decline of this magnitude is a clear warning sign that reform is needed.

Typically, funding from venture capital or angel investment is a key source of financing for start-up companies in the knowledge-based sector. The lack of stability in availability of financing can be a powerful force stifling start-ups and choking off a whole generation of potential innovation. The medical technology sector is a prime example. The innovations provided by small start-up firms have been a disproportionate source of new products and job growth. Such firms are critical to the industry's innovation ecosystem. Yet innovation in medtech is critically threatened by regulatory burdens and reimbursement uncertainties that create lengthy and expensive development and commercialization cycles, witnessed by the following statistics:

- The number of new medtech firms created each year has fallen by almost two-thirds, from 1,500 annually in the late 1970s and early 1980s to around 600 in 2012.
- More than 30 percent of medtech firms are at least a quarter century old and more than half are more than 16 years old – markedly older than other high tech industries.
- Medtech's share of total venture capital has fallen from 13 percent in 1992 to 4 percent in 2014, and its share of early-stage venture investment has fallen from 10 percent in 1993 to 3 percent in 2014.⁸

Overall, the latest statistics for 2014 and 2015 indicate that the number of the earliest-stage start-up companies receiving funding is the lowest at any time since 1995.⁹ A 2013 survey of investors found that almost half planned to reduce investment in medical technology over the next three years, while only one-quarter expected to increase it.¹⁰

While the U.S. provides few special incentives for investment in start-up firms, this is not true of major competitor nations. Other countries recognize that knowledge-based, high value added firms are the jewel in the crown of a successful strategy for high-paying jobs and economic growth. They provide a wide variety of tax and non-tax incentives to attract and nurture such firms, including firms that are in the pre-revenue stage.

Tax reform, including lowering of the basic corporate tax rate, is critical to America's long-term growth and competitiveness, in part because it will facilitate capital formation. But pre-profitability start-up firms, already suffering from difficulties in achieving robust investment

⁷ 2016 Economic Report of the President, p. 215.

⁸ Innovation Counsellors LLC, "A Future at Risk: Economic Performance, Entrepreneurship, and Venture Capital in the U.S. Medical Technology Sector," 2016

⁹ Varun Saxena, "Med Tech VC financing tops \$800M, but funding for new companies remains scarce," Fierce Medical Devices, October 16, 2015; PWC and National Venture Capital Association, op. cit.

¹⁰ National Venture Capital Association, "Patient Capital 3.0: Confronting the Crisis and Achieving the Promise of Venture-Backed Medical Innovation," 2013.

and capital formation, will not benefit from reductions in tax rates. The striking decline in the number of such firms being created every year is a danger signal that would be a mistake to ignore.

Tax incentives to support start-up firms and capital investment

If tax reform is to achieve its overriding goal of creating a brighter economic future for America, it must include discrete provisions to stimulate additional investment in start-up, pre-profit firms. Current federal tax law actually discourages investments in pre-revenue start-ups in a number of ways, including very strict limitations on the use of net operating losses and restrictions on tax benefits that might otherwise accrue to passive investors in new ventures. Although these limitations were enacted to prevent abuses that had little, if anything, to do with legitimate innovative start-up ventures, they have had a devastating impact on the ability of American innovators to raise capital.

Medical Device Excise Tax

For the medtech sector, the impact of the current federal tax rules is compounded by additional taxes that have a punitive effect on all companies. The medical device excise tax, imposed as part of the Affordable Care Act, has been a significant drag on medical innovation and resulted in the loss or deferred creation of jobs, reduced R&D and slowed capital expansion. Overall, the U.S. medical technology industry saw its jobs ranks fall by nearly 29,000 while the medical device excise tax was in effect, according to data from the U.S. Department of Commerce.¹¹ While the job loss cannot be attributed with absolute certainty to the medical device tax, the magnitude of the job loss during those years that the tax was in effect certainly indicates a likely nexus between the tax and that employment trend. A new policy brief released by the American Action Forum (AAF) in March further underscores the impact of the device tax on medtech employment. According to AAF, if the tax resumes in 2018, up to 25,000 additional jobs could be lost by 2021. The net impact of permanently repealing the medical device tax could be in excess of 53,000 additional jobs, compared to what would occur if the tax remains in effect.¹²

The effect of the tax on start-up firms is two-fold – it deters company growth, since the tax is imposed on the first dollar of revenue earned; and it restricts the ability of established medical technology companies to invest in or acquire start-up companies by limiting the amount of available funds. Congress wisely saw fit to suspend the device tax in 2015, and we urge the Committee and Congress to finish the job and permanently repeal this tax.

¹¹ AdvaMed Medtech Employment Analysis, https://www.advamed.org/sites/default/files/resource/advamed_medtech_jobs_analysis_2010-15_final_final.pdf, accessed on May 16, 2017.

¹² Dr. Robert Book, “Employment Effects of the Medical Device Tax,” American Action Forum, Mar. 2, 2017, <https://www.americanactionforum.org/research/employment-effects-medical-device-tax/>, accessed on May 22, 2017.

Angel Investor Tax Credit

Investment in pre-revenue companies is the best way to insure that they will eventually become the powerful innovators and job creators that will strengthen the global competitiveness of the US in high-technology and that will add to the U.S. revenue base at home. It is worth noting that the research credit and the ability to deduct research expenditures are important incentives to encourage companies to continue investing in research. However, these credits have done little to strengthen investment in pre-revenue companies.

One approach that has been supported previously is a tax credit specifically offered to angel investors. Already, 24 states have addressed the need to keep innovative small business at home by enacting angel investor credits for technology companies. Eight states, including Kansas, New Jersey, North Carolina, Wisconsin, and Arizona, have adopted angel credits specific to bioscience investors. Similar proposals have been made on the federal level – with the new Administration in Washington committed to boosting U.S. economic growth, a federal angel investor credit would send a clear signal that the United States intends to keep and foster small business innovation at home.

Taking these needs into account and building upon the successes at the state level, AdvaMed Accel has developed an angel investor tax credit legislative proposal. This tax credit is relatively simple in structure and purpose. Equity investors in a small business, defined as a domestic business entity in a pre-revenue position with under 100 employees and headquartered in the U.S., will receive a tax credit equal to 25 percent of their investment. To qualify for the credit, the investment must be also made in a small business engaged in a high-technology field that has been in existence for less than five years.

Because the purpose of the credit is to facilitate the transition of the entity from pre-revenue to profit-making status, it is temporary and capped: over the lifetime of the entity the total amount of credits allowable is limited to \$25 million and to no more than \$5 million in a single year. No single investor will be entitled to more than \$2 million in credit in any single year. Qualifying investors include SEC-accredited individual investors, investor networks, or investor funds. Qualifying investments include any form of equity, such as stock, a general partnership interest, or a limited partnership interest, and any capital interest in a partnership.

We look forward to working with Congress, and in particular, the Ways and Means Committee to advance this legislation as a component of corporate tax reform. Other policy options may also be appropriate, but failure to address the issue of incentivizing investment in start-ups would be a major shortcoming of any comprehensive approach to tax reform. The lack of capital investment incentives for start-ups has resulted in a flight of innovation from the U.S. to foreign jurisdictions in which government policy is more supportive of new ventures. Unfortunately, as these new ventures seek capital overseas, they are likely to remain overseas when they take off and become profit-making employers. Small businesses and innovators are

the engines of economic growth in the U.S., and it is therefore imperative that the U.S. establish a policy that encourages private investment in start-ups in order to keep them at home.

Conclusion

Tax reform, including lowering of the basic corporate tax rate, is critical to America's long-term growth and competitiveness, in part because it will facilitate capital formation. But pre-profitability start-up firms, already suffering from difficulties in achieving robust investment and capital formation, will not benefit from reductions in tax rates. These firms, especially knowledge-based start-ups, are critical to long-term economic growth, job creation and competitiveness. The striking decline in the number of such firms being created every year is a danger signal that would be a mistake to ignore. If tax reform is to achieve its overriding goal of creating a brighter economic future for America, it must include discrete provisions to stimulate additional investment in start-up, pre-profit firms. AdvaMed, AdvaMed Accel, and its associated member companies stand ready to work with Congress to achieve this goal.

Milford Wayne Donaldson, FAIA
Chairman

Leonard A. Forsman
Vice Chairman

John M. Fowler
Executive Director



Preserving America's Heritage

May 31, 2017

The Honorable Kevin P. Brady
Chairman
Committee on Ways and Means
U.S. House of Representatives
Longworth House Office Building, 1102
Washington, DC 20515

The Honorable Richard E. Neal
Ranking Member
Committee on Ways and Means
U.S. House of Representatives
Longworth House Office Building, 1102
Washington, DC 20515

REF: Letter for the Record: Hearing on How Tax Reform Will Grow Our Economy and Create Jobs,
May 18, 2017

Dear Chairman Brady and Ranking Member Neal:

The Advisory Council on Historic Preservation (ACHP) welcomes the opportunity to provide the Committee on Ways and Means with a letter for the record following the May 18 hearing on how tax reform will grow our economy and create jobs. Established by the National Historic Preservation Act (NHPA), the ACHP is the independent federal agency charged with advising the President and Congress on matters relating to historic preservation. Among its duties, the NHPA specifically tasks the ACHP with promoting studies regarding the effects of tax policies at all levels of government on historic preservation.

The written testimony of the hearing witnesses tended to focus on reducing corporate tax rates, modernizing international tax rules, and simplifying the tax code. Tax credits were not central to the testimony, but the ACHP would like to take this opportunity to commend to you an important tax incentive that has an outstanding record of past success and great future potential to create jobs, grow the economy, and support community vitality – the federal historic rehabilitation tax credit, also known as the historic tax credit.

Administered by the Department of the Interior and the Internal Revenue Service, the current 20 percent credit supports projects that rehabilitate income-producing historic buildings – commercial and industrial buildings, hotels, apartment buildings, residential rentals, etc. – while maintaining their historic character. The incentive it offers is often essential to the financing for rehabilitation projects that are helping revitalize both urban cores and small towns. The ACHP wishes to express its full support for maintaining the historic tax credit as a component of a reformed tax code. The ACHP consistently has encouraged measures to ensure the continued use of the historic tax credit as a valuable tool for integrating historic preservation and development investment, and for improving the economic vitality of America's communities.

Since the inception of tax incentives for historic preservation in 1976, more than 42,000 projects have been approved in all 50 states, the District of Columbia, the Virgin Islands, and Puerto Rico. As of FY 2016, these projects have generated \$84.15 billion dollars in rehabilitation investment and created 2.44 million jobs.¹ These jobs have benefited several key sectors of the economy, notably the construction, manufacturing, services, and financial/real estate sectors. Sectors not immediately associated with historic rehabilitation, such as agriculture, mining, transportation, and public utilities, have benefited as well. (For more information

ADVISORY COUNCIL ON HISTORIC PRESERVATION

401 F Street NW, Suite 308 Washington, DC 20001-2637

Phone: 202-517-0200 Fax: 202-517-6381 achp@achp.gov www.achp.gov

on the impacts of the historic tax credit by sector, see the attached chart.) As of FY 2015, the cumulative positive impacts on the national economy included \$271.7 billion in output, \$134.7 billion in GDP, \$99.1 billion in income, and \$39.0 billion in taxes, including \$28.1 billion in federal tax receipts.²

It also is important to note that the historic tax credit pays for itself. Through FY 2015, the \$23.1 billion cumulative cost of the program was more than offset by the \$28.1 billion in federal tax receipts generated by the rehabilitation projects receiving the credit.³

The success of the historic tax credit is reflected in legislation introduced in this session that would build upon the credit and further enhance it. The Historic Tax Credit Improvement Act (S. 425/H.R. 1158) has bipartisan support, with nearly equal numbers of Republican and Democratic cosponsors. (There are a total of 54 cosponsors in the House and 10 in the Senate.) The bill would refine the credit to encourage its use in small, midsize, and rural communities, and to make community-oriented projects – such as the rehabilitation of theaters, libraries, and schools – easier. Using the historic tax credit to encourage rehabilitation of historic schools also is addressed in the School Infrastructure Modernization Act (S. 1156), which would modify the credit to apply to school buildings that continue to operate as schools.

The historic tax credit has a critically important role to play in retaining and restoring key historic landmark buildings and complexes and bringing renewed economic vitality to America's city centers and Main Street corridors. We respectfully request that you carefully consider the effectiveness, value, and reach of the credit, and its impact on American communities as you proceed with your assessment of tax code reform priorities. We are confident that your examination will conclude that the historic tax credit is a cost-effective way to encourage essential private sector investment in our nation's cities and towns, and that the credit makes an important contribution to growing the economy and creating jobs.

Please feel free to contact us if you have any questions on our position or if the ACHP can be of any assistance. Our Executive Director, John Fowler, can be reached at (202) 517-0200.

Sincerely,



Milford Wayne Donaldson, FAIA
Chairman

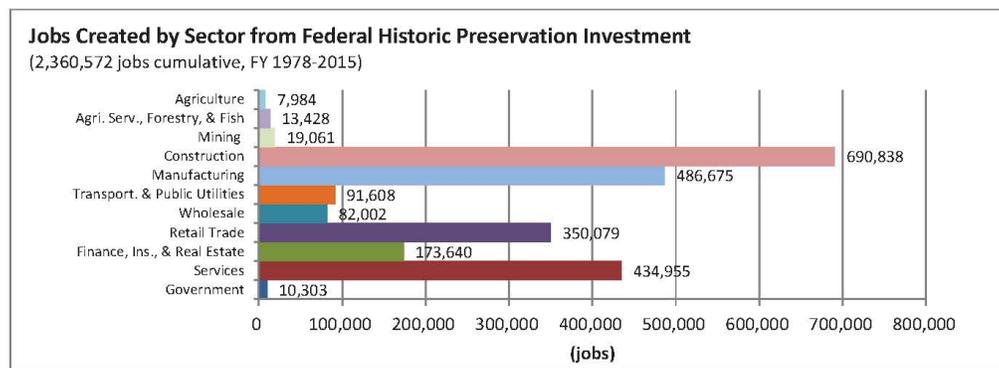
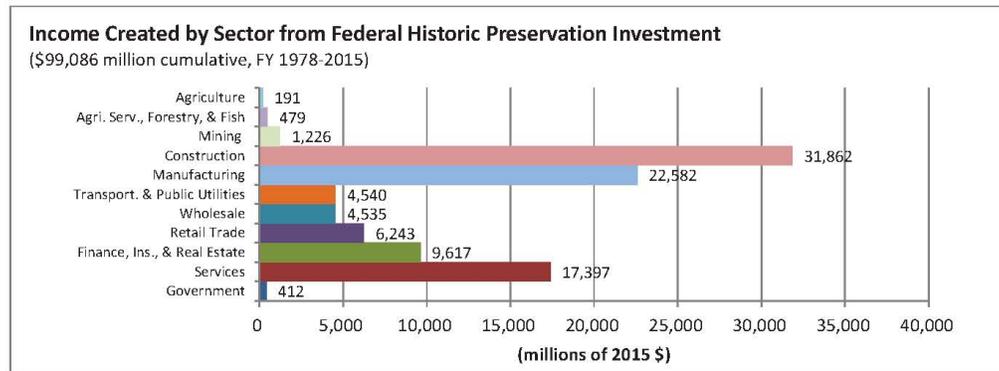
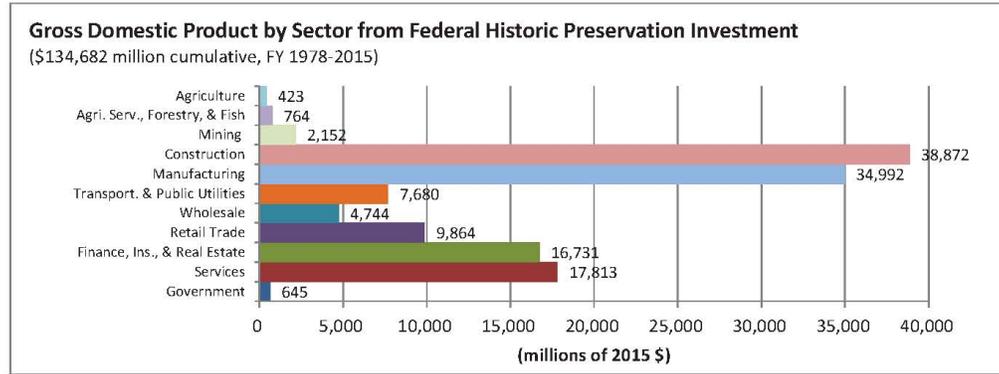
Attachment

¹National Park Service, *Federal Tax Incentives for Rehabilitating Historic Buildings: Statistical Report and Analysis for Fiscal Year 2016* (March 2017).

²Rutgers University and the National Park Service, *Annual Report on the Economic Impact of the Federal Historic Tax Credit for FY 2015* (August 2016).

³Ibid.

SUMMARY EXHIBIT 1
National Economic and Tax Impacts of Federal HTC-related Activity
FY 1978 through FY 2015 (HTC Investment: \$120.8 billion)





**Alliance for Competitive Taxation¹
Statement for the Record**

Submitted to U.S. House of Representatives, Committee on Ways and Means
May 18, 2017

Member Companies

3M
Abbott Laboratories
Alcoa Corporation
Bank of America Corp.
Boston Scientific Corp.
Caterpillar Inc.
The Coca-Cola Company
Danaher Corporation
The Dow Chemical Company
DuPont
Eli Lilly and Company
Emerson Electric Co.
Exxon Mobil Corporation
General Electric Company
General Mills Inc.
Google, Inc.
Honeywell International Inc.
IBM Corporation
International Paper Company
Johnson & Johnson
Johnson Controls, Inc.
JPMorgan Chase & Co.
Kellogg Company
Kimberly-Clark Corp.
MasterCard Inc.
McCormick & Company, Inc.
Morgan Stanley
Oracle Corporation
PepsiCo, Inc.
Pfizer Inc.
Procter & Gamble Co.
Prudential Financial Inc.
S&P Global Inc.
State Street Corporation
Texas Instruments, Inc.
United Technologies Corporation
United Parcel Service, Inc.
Verizon Communications Inc.
The Walt Disney Company

The Alliance for Competitive Taxation (ACT) submits the following statement for the record of the May 18, 2017 hearing held by U.S. House of Representatives, Committee on Ways and Means on “How Tax Reform Will Grow Our Economy and Create Jobs.”

ACT is comprised of leading American businesses that employ millions of American workers from a diverse range of industries, including technology, manufacturing and services. We believe pro-growth business tax reform can be fiscally responsible, create U.S. jobs, increase wages for American workers and strengthen small and large American businesses by setting a competitive corporate tax rate and modernizing our international tax system.

For years, ACT has called for tax reform that lowers the corporate tax rate and provides a competitive international tax system that allows American businesses to compete in the global economy.

ACT applauds today’s hearing for underscoring the need for comprehensive tax reform that will grow our economy and create American jobs.

As policymakers debate the merits of corporate tax reform, the benefits for American workers must be a priority. In recent years, leading economists and experts on both sides of the aisle have weighed in, and their analysis is clear: America’s complex and outdated tax code is hurting American workers in the global economy and tax reform would create new opportunities and growth for workers here at home.

Having the highest corporate tax rate in the developed world is not only a hindrance to U.S. businesses, it also hurts American workers. A report from the Congressional [Joint Committee on Taxation](#) highlighted this issue and offered two points of consensus from existing research:

“One is that the burden of the corporate income tax falls largely on domestic individuals, and therefore the corporate income tax does impact the well-being of these individuals. The second is that the burden of corporate income taxes is not borne entirely by capital owners, and is

¹ Alliance for Competitive Taxation, P.O. Box #34346, Washington DC 20043, 202-464-9522



instead shared between capital owners and labor with the share borne by each being the subject of ongoing debate.”

Member Companies

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The Coca-Cola Company
Danaher Corporation
The Dow Chemical Company
DuPont
Eli Lilly and Company
Emerson Electric Co.
Exxon Mobil Corporation
General Electric Company
General Mills Inc.
Google, Inc.
Honeywell International Inc.
IBM Corporation
International Paper Company
Johnson & Johnson
Johnson Controls, Inc.
JPMorgan Chase & Co.
Kellogg Company
Kimberly-Clark Corp.
MasterCard Inc.
McCormick & Company, Inc.
Morgan Stanley
Oracle Corporation
PepsiCo, Inc.
Pfizer Inc.
Procter & Gamble Co.
Prudential Financial Inc.
S&P Global Inc.
State Street Corporation
Texas Instruments, Inc.
United Technologies Corporation
United Parcel Service, Inc.
Verizon Communications Inc.
The Walt Disney Company

The [burden of a high corporate tax](#) rate is borne by American workers (through lower wages), consumers (through higher prices), and savers (through a lower return on their savings) – not by corporations.

American multinational companies are some of our nation’s leading employers and contribute significantly to U.S. economic growth. It is clear that there is much to be gained by modernizing the U.S. international tax system. A study for the [Business Roundtable found](#) that in 2013 U.S. companies with global operations directly employed 23.3 million American workers and supported a total of 76.6 million U.S. jobs, \$4.7 trillion in U.S. labor income and \$8.3 trillion in U.S. GDP.

Additionally, the Organisation for Economic Co-operation and Development (OECD) studied the effect of tax systems on economic growth and [concluded](#),

“Corporate income taxes are the most harmful for growth as they discourage the activities of firms that are most important for growth: investment in capital and productivity improvements.” Corporate tax increases are the most economically damaging way to raise revenue, as they reduce economic growth, reduce jobs, depress wages and hurt all American families.”

It’s estimated American multinationals have over \$2.6 trillion of accumulated foreign earnings indefinitely reinvested abroad – much of which is trapped overseas by the 35 percent tax rate imposed by the United States on repatriated earnings. What does this mean for American workers? According to ACT economic advisor [Doug Holtz-Eakin](#):

“Currently, American companies have \$2 trillion in earnings that they cannot invest in the United States without incurring a tax penalty; that’s money our economy desperately needs. The benefits are obvious: That \$2 trillion can fund research and development in the U.S. so that the next great product can be American-designed. It can expand domestic production facilities. It can hire American workers. Today, 95 percent of the world’s consumers are outside of the U.S. We should want our businesses to sell American workers’ products to them. And when they do, we should want the profits to come back home.”



Member Companies

3M
Abbott Laboratories
Alcoa Corporation
Bank of America Corp.
Boston Scientific Corp.
Caterpillar Inc.
The Coca-Cola Company
Danaher Corporation
The Dow Chemical Company
DuPont
Eli Lilly and Company
Emerson Electric Co.
Exxon Mobil Corporation
General Electric Company
General Mills Inc.
Google, Inc.
Honeywell International Inc.
IBM Corporation
International Paper Company
Johnson & Johnson
Johnson Controls, Inc.
JPMorgan Chase & Co.
Kellogg Company
Kimberly-Clark Corp.
MasterCard Inc.
McCormick & Company, Inc.
Morgan Stanley
Oracle Corporation
PepsiCo, Inc.
Pfizer Inc.
Procter & Gamble Co.
Prudential Financial Inc.
S&P Global Inc.
State Street Corporation
Texas Instruments, Inc.
United Technologies Corporation
United Parcel Service, Inc.
Verizon Communications Inc.
The Walt Disney Company

Along with a competitive corporate tax rate, it's time for the United States to establish a competitive international territorial tax system that encourages economic growth, spurs job creation and lets American businesses compete in the modern global economy on a level tax playing field.

We hope you will keep these facts in mind as you consider the impacts of corporate tax reform on American workers and the U.S. economy.

We applaud the House Ways and Means Committee for its continued leadership on this issue. ACT stands ready to work with Congress and the Administration to enact a 21st century tax code that will create American jobs and make the U.S. an attractive place for both small and large businesses to innovate, invest, and thrive.

Sincerely,

The Alliance for Competitive Taxation



STATEMENT FOR THE RECORD

**Submitted to the
House Ways and Means Committee**

How Tax Reform Will Grow Our Economy and Create Jobs Across America

May 18, 2017

America's Health Insurance Plans
601 Pennsylvania Avenue, NW
Suite 500, South Building
Washington, D.C. 20004

America's Health Insurance Plans (AHIP) is the national association whose members provide coverage for health care and related services to millions of Americans every day. Through these offerings, we improve and protect the health and financial security of consumers, families, businesses, communities and the nation. We are committed to market-based solutions and public-private partnerships that improve affordability, value, access and well-being for consumers.

The debate over how to reform the federal tax code to help grow jobs and expand prosperity is an important one for our country. It is critical in this debate to reinforce the elements of the tax code that currently work. Included among those are a cornerstone of both the American health care system and the employer-employee relationship: employer-sponsored health benefits. One out of every two Americans with health insurance receives that coverage through an employer – be it their own or that of a spouse or parent. This amounts to at least 150 million Americans who are covered by an employer.¹ After the federal government, private businesses are the largest payor of health care in the United States. For most employers, offering health insurance coverage to their employees is an important priority to attract and retain the best qualified workforce while investing in the long-term health and financial stability of those in their employ. Across the country, business owners and leaders take pride in offering quality health coverage to their teams of employees and hope to continue those offerings.

Central to the stability of employer-sponsored health benefits and the continued offering of benefits is the treatment of employee health benefits under the tax code. Section 106 of the Internal Revenue Code recognizes that health coverage is distinct from income and an important component of an individual's compensation. This recognition is essential to promoting the availability of good jobs that include robust, earned benefits that make our economy competitive in a global market.

Employers are constantly reminded of the rising cost of health care, realized in the form of high premiums borne by employer and employee alike. With these high costs, it is important to recognize the substantial variation in plan costs based on a variety of factors, including geography, family size, drug costs, and market forces. A one-size-fits-all approach or attempt to tax benefits above an arbitrary threshold would cause middle class Americans to lose coverage and an unsustainably large number of businesses to be penalized with taxation that would hinder growth and increase the uninsured rate. The Affordable Care Act's (ACA) excise tax on high

¹ 2016 Employer Health Benefits Survey, Kaiser Family Foundation, September 14, 2016. <http://kff.org/health-costs/report/2016-employer-health-benefits-survey/>

cost employer-sponsored health coverage (section 4980I of the Internal Revenue Code) is currently an obstacle to economic growth and hinders the ability of businesses of all sizes to engage in long-term planning.

The rising cost of health insurance is fueled in part by taxes that increase premiums and limit the ability of businesses, especially small business, to expand and create new jobs. Relief from these taxes, namely the Health Insurance Tax (HIT) established by the ACA, is a clear way to encourage economic growth by lowering premiums. According to an analysis by Oliver Wyman, repealing the HIT would have as much as a three-percent impact on premiums for 2018 – reducing premiums by an average of \$220 for consumers who buy coverage in the individual market, \$280 for small business employees, and \$270 for employees of large businesses.² Together, the HIT and the excise tax on high-cost coverage increase the cost of doing business and limit the ability of employers to hire new people and create new jobs. Repealing these taxes would be an important step toward reducing health insurance premiums, promoting affordability, and helping more employers offer quality health benefits.

A system that encourages employers to offer health benefits to employees is one that supports American competitiveness and allows for American workers to keep more of their hard-earned money. Further, as more Americans enter the workforce, the strength of employer health coverage in this system increases the number of Americans with health insurance without requiring government expenditures.

The employer-sponsored benefit system also helps fuel the growth of the fastest growing economic sector in the United States: health care. The Bureau of Labor Statistics estimates that health occupations and industries will add the most jobs to the U.S. economy in the decade spanning 2014 to 2024.³ This growth is supported by the innovation and cost-efficiencies generated by employer-sponsored health plans. Employer health plans have been leaders in value-based insurance design, workplace wellness, and accountable care that allows for job growth by reducing costs and promoting a healthier workforce.

Employee health benefits are worth protecting and enhancing because they are succeeding. Given the amount of time most Americans spend at work and the vested interest employers have

² Estimated Impact of Suspending the Health Insurance Tax from 2017-2020, Oliver Wyman, December 16, 2015. <https://ahip.org/wp-content/uploads/2015/12/Oliver-Wyman-report-HIT-December-2015.pdf>

³ Employment Projections: 2014-24 Summary, Bureau of Labor Statistics, December 8, 2015. <https://www.bls.gov/news.release/ecopro.nr0.htm>

in protecting the health of their employees, this system makes practical sense and is worth protecting. The close relationship between an employer plan and the patient-employee also allows for data-driven decisions and efforts to improve health outcomes in ways that other systems are not as well suited to do. The treatment of employee health benefits under the tax code helps preserve this relationship and gives employer-sponsored plans the opportunity to innovate in areas such as patient-centered medical homes, accountable care organizations, and active engagement in employee wellness.

Beyond their role in innovation, the employer-sponsored benefit system serves as a bedrock of stability particularly in contrast to the ongoing policy uncertainty and market instability that is roiling the individual health insurance marketplace. Eighty-two percent of American workers report that they are satisfied with their employer-sponsored insurance.⁴ According to the same survey, if their employer health insurance relationship were to end, nearly one in three American workers say they would leave their job within a year.

Preserving the existing system of employee health benefits also helps Americans at all income levels, but particularly middle class Americans, keep more of their paychecks. It encourages employers to offer robust health plans with low deductibles and allows workers the freedom to invest more money in their families and communities. Any tax reform efforts to encourage job growth should include the goal of increasing jobs that are both high-paying and include health benefits that add to the value of work and enhance American competitiveness. Protecting the employer-sponsored benefit arrangement does just that.

Thank you for considering our views on the importance of maintaining the current treatment of employee health benefits under the tax code and repealing the ACA's health insurance tax and excise tax on high-cost employer-sponsored health coverage. We look forward to working with the committee as you consider these and other health-related issues in the tax reform debate.

⁴ Employer Beware: Workers Demand Health Coverage, Accenture Private Health Insurance Exchange Consumer Research 2015. <https://www.accenture.com/us-en/insight-employer-beware-workers-demand-health-coverage>

AMERICAN CHEMISTRY COUNCIL

**WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

**HEARING ON “HOW TAX REFORM WILL GROW OUR ECONOMY AND CREATE
JOBS”**

DATE OF HEARING: MAY 18, 2017

The American Chemistry Council (ACC) thanks the Committee for continuing to examine comprehensive tax reform and for examining the effects of tax reform on the U.S. manufacturing sector. Because of the importance of manufacturing to the U.S. economy and the effect of tax rules on manufacturers, we are particularly interested in the Committee’s consideration of a reformed business tax system.

ACC and its place in U.S. manufacturing:

ACC represents the leading companies engaged in the business of chemistry. ACC member companies apply the science of chemistry to create and manufacture innovative products that make people’s lives better, healthier and safer. The business of chemistry is a \$768 billion enterprise and a key element of the nation's economy. Over 26% of U.S. GDP is generated from industries that rely on chemistry, ranging from agriculture to oil and gas production, from semiconductors and electronics to textiles and vehicles, and from pharmaceuticals to residential and commercial energy efficiency products. Our industry directly employs over 810,000 Americans in high-paying, quality jobs and each of those jobs supports an additional 6.3 American jobs in other manufacturing industries, meaning that nearly 6 million Americans are working in the industries that rely on chemistry to drive economic growth, innovation, and American competitiveness. Importantly, our industry is one of the nation's largest exporting sectors, with over \$173 billion in exports in 2016, or more than ten cents out of every export dollar. The U.S. chemical industry is a leader in the amount of R&D performed, innovation delivered, and exports shipped, contributing enormously to the nation’s economy. Further, given the recent surge in the development and availability of domestic natural gas, which is an important feedstock and energy source for the production of chemical products, the U.S. chemical industry has reacted by announcing plans for over \$181 billion of new U.S. based investment. These investments will spur the U.S. economy, increase employment and increase the U.S. standard of living.

As a major U.S. advanced manufacturing industry, we are keenly interested in how tax reform can, and will, affect our industry and manufacturers generally. To ensure the U.S. regains its competitive edge, our tax code should be reformed to drive U.S. investment, innovation and productivity to create U.S. jobs. The focus of your hearing was timely, and the decisions you make can be critical to the health of the manufacturing sector in general, and to the American chemical industry in particular. In considering the outlook for tax reform, the ACC Board adopted the following “Guiding Principles for Corporate Tax Reform”:

- *Tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America.*
- *Tax reform should recognize and reflect the important role of American manufacturing and the jobs it creates.*
 - *Manufacturing is a capital intensive activity, and therefore, tax treatment of capital cost recovery is of key importance.*
 - *Advanced manufacturing techniques and products rely on research, and therefore, incentives for research and development expenses also should be supported.*
- *ACC supports adoption of a competitive territorial system for the taxation of income earned outside the United States.*
- *ACC supports a substantial income tax rate reduction to reflect rates at least comparable to Organization for Economic Development and Cooperation (OECD) averages.*
- *Tax reform must produce a “level playing field concept” such that American companies investing abroad can compete equally with foreign investors, and American and foreign companies investing in the United States are treated equally.*
- *Tax reform should be enacted comprehensively, not piecemeal, and should include transitional rules that allow taxpayers to adjust to a new tax regime without financial dislocation, contraction, or reduction in employment.*

ACC regards the principles not as a menu of alternatives, but as a template for a reformed corporate tax system that would achieve the overriding goal of economic growth. Our comments below reflect these principles.

Proposals for business tax reform:

As our principles state, ACC believes that business tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America. The measure of each decision and trade off made in the process of tax reform should be whether it advances these goals. We also support the adoption of a competitive territorial system where foreign earnings are not subject to significant additional U.S. tax.

We note that business tax reform is generally proposed within a framework of revenue neutrality, under which the reformed system of business income taxes would produce the same amount of tax revenue as the current system, but at a lower tax rate—requiring repeal of a broad range of so-called “tax expenditures.” In assessing whether such reforms would need to be revenue neutral, we respectfully suggest that the Committee take into account the impact on revenues that would result from a reformed globally competitive system that is more supportive of economic growth. We fear that embarking on a complex and difficult tax reform process that simply achieves revenue neutrality on a “static basis” would

be less effective in promoting economic growth since, by definition, it would create winners and losers in a zero sum game.

We are also concerned that a base broadening effort to repeal a number of so-called tax expenditures could disproportionately and adversely affect U.S. manufacturing. For example, accelerated depreciation is highly significant in encouraging and supporting investments and job creation by the manufacturing sector. Without careful balancing of the impact of changes in current law on the manufacturing sector, solid, middle class jobs could be impacted.

A poorly designed system could reduce the chemical industry's ability to compete in U.S. and global markets could cause the industry to experience reduced growth or contraction, resulting in a corresponding reduction of the manufacturing workforce. Likewise, spill-over consequences would adversely affect suppliers and service-providers that depend upon manufacturing customers.

Our concerns arise from recent economic analyses of certain tax expenditures and the consequent effect of repeal of such provisions on economic growth.¹ Specifically, unless the statutory tax rate under a reformed business tax system is low enough to compensate industry for the loss of tax provisions for investment, reductions in capital investment and economic growth are likely to result.

Finally, any comprehensive changes to the tax code must include transition rules in order to ensure that taxpayers have time to adjust to a new tax regime without economic contraction and consequent reduction in employment.

Rate reduction –

The U.S. has the highest marginal corporate tax rate of any major industrial nation in the world. This high tax rate acts as an impediment to U.S. investments and expansions for both U.S. and foreign owned firms. The U.S. needs to enact comprehensive tax reform that *significantly* reduces the tax rate. Doing so can provide powerful incentives for U.S. investment, particularly when not neutralized by other changes that directionally increase the cost of capital. ACC realizes that coupled with the tax rate, a wide number of tax expenditures may be eliminated or reduced to fund the lower tax rate. But if the rate reduction is not sufficiently large and if the loss of tax expenditures disproportionately affects the manufacturing sector, the result may be less, not more, growth.

¹ See, e.g., Joint Committee on Taxation Report, "Background and Present Law Relating to Manufacturing Activities Within the United States", July 2012, p. 87.

Accelerated Cost Recovery --

The accelerated depreciation of capital assets, known as “accelerated cost recovery” or “ACR,” has been allowable under the tax code for decades. ACR is a central element in the business plans of most chemical manufacturers. It allows recovery of the cost of capital investment more quickly for tax purposes than under financial accounting rules that amortize asset value over a longer period of time, but slower than under expensing or recent “bonus depreciation” rules.

ACR encourages new investment in manufacturing by providing cost-recovery rules that compensate companies in part for the risk of investing large amounts of capital in relatively low-profit enterprises. For the chemical industry, this typically means longer start-up periods for bringing new assets on line and longer pay-out times in order to achieve returns commensurate with the investment.

Because ACR is extremely significant to manufacturing, repeal would have an obvious and disproportionate adverse effect on the industry. ACR *leverages* the value of capital investment in productive assets. Accordingly, greater investment means more growth and more U.S. jobs, all of which could be at risk if tax reform removed the provision. Rather, if ACR is to be repealed, it must be supplanted by an even more aggressive provision, such as immediate expensing, so that capital intensive industries are able to expand and reach their full economic and job-creating potential.

We respectfully question whether “reform” and the progress the term implies would occur if changes in the tax law meant a significant economic discouragement from making new capital investments, with less growth, and erosion of the national economic ballast that the manufacturing sector currently represents.

Incentives for research and development –

The chemical industry is among the largest creators and users of technology. Accordingly, current federal tax incentives for research and development represent key factors in retaining a domestic chemical industry that can compete with chemical manufacturers globally that typically enjoy more favorable home-country tax regimes. The tax reform debate should consider the continuing and important role of competitive incentives for creation of U.S. technology, including expensing and an effective R&D credit, while addressing the mobile nature of capital and intellectual property. As a goal, the tax system should encourage investment in the U.S. in R&D activities, the ownership of resulting intellectual property (IP) in the U.S. and exploitation of the IP from the U.S.

A territorial system for taxation of foreign earnings –

ACC endorses adoption of a competitive territorial taxation system in replacement of the obsolete and overburdened world-wide system for taxation of foreign earnings from active business operations. The U.S. is the only major industrial nation with a worldwide tax system. The incremental U.S. tax imposed upon ACC member companies’ foreign operations causes such companies to be less competitive than their foreign competitors. This is not just a matter of abstract theory since 95% of the world’s

population is outside the U.S. To serve this large and growing market, we encourage the Committee to continue to search for ways to promote exports of property manufactured in the U.S. to meet these global needs. But in addition to serving such markets by exports, as explained below, ACC member companies must also expand overseas to grow and prosper. It is important to note that as these companies expand throughout the world, new high value jobs in R&D, engineering and administration are created in the U.S.

The manufacture of chemical products is a global and highly competitive industry. Freight is a significant cost for ACC member companies; to compete effectively they cannot produce all products in the U.S., ship them across an ocean and truck them to a customer in the interior of a continent. We must be local to compete effectively and the current U.S. tax code acts as an impediment to our competitiveness.

Finally, movement to a territorial taxation system would eliminate the current “lock out” effect of existing tax law and allow substantial amounts of cash, (particularly from industries outside the chemical sector,) to be repatriated to the U.S. This result, when coupled with pro-growth domestic tax changes, would drive additional capital investment and employment in the U.S.

Repatriated earnings–

Outside of comprehensive tax reform and absent recognition of the unique circumstances of the chemical manufacturing sector’s operations abroad, ACC strongly opposes proposals to tax historical foreign earnings.

In previous years, proposals under consideration for raising tax revenue to pay for highway and infrastructure projects included a device referred to as “deemed repatriation” or “mandatory repatriation” to U.S. parent corporations of foreign earnings accumulated by foreign subsidiary corporations and permanently reinvested abroad. Use of the term “repatriation” in these contexts is inaccurate and misleading because the proposals do not require nor anticipate any actual return of cash. The proposals mandate U.S. tax on foreign earnings as though the earnings *were* distributed to U.S. parent corporations as dividends. In the case of the chemical industry and other manufacturers, the distinction between actual and deemed dividends is very real and has very serious consequences.

With the exception of relatively small amounts of working capital to pay receivables and meet other current expenses, foreign subsidiaries of U.S. parent chemical companies typically keep only incidental cash funds offshore. Earnings from manufacturing operations of the foreign subsidiaries are reinvested in plant and equipment in order to serve foreign markets and compete internationally. As a consequence, only a relatively small amount of earnings is represented as cash and cash equivalents and available for actual repatriation, and therefore parent companies would need to borrow money in order to pay the U.S. tax with respect to deemed transfers of deemed cash.

Absent comprehensive tax reform that includes significant corporate rate reductions, adoption of a territorial tax system, and sufficiently lengthy transition periods, the tax on reinvested earnings would reduce amounts and availability of capital in the U.S. This would also lead to weakened balance sheets, lowered share prices, limited investment in new plant and equipment, stifled growth, and eroded payroll and job creation. As noted above, the chemical industry is among the largest U.S. exporters, with an

outsized share of export dollars, with many jobs in the industry supporting exports as well as foreign operations.

LIFO—

Congress enacted the LIFO tax accounting method in 1939, concluding that for some taxpayers, LIFO is a more accurate means of calculating taxable income. A business cannot thrive and maintain operations, unless it generates enough after-tax cash flow to produce and purchase replacement goods at current—not historical prices. By matching current revenues against current inventory costs, LIFO can provide a better measure of the true economic performance of a business.

Without LIFO, a business could not deduct current prices from taxable income and its ability to produce or purchase new, replacement inventory and to maintain and grow investment would be impaired. Purely inflationary gains would be masked and taxed as “profit.”

Like ACR, inventory accounting methods have been designed to appropriately reflect taxable income and to serve as prime instruments for encouraging reinvestment of earnings. Far from a “loophole,” LIFO is an essential element in the structure of a tax on business net income. Elimination of LIFO absent a correlating offset elsewhere and a significant transition period would represent a tax increase to manufacturers, a significant cash cost, and would hinder growth.

Interest deductions—

The chemical industry has tentatively budgeted approximately \$181 billion for investment in plants to utilize ethane from domestic shale gas as the feedstock in manufacture of chemical products. This new source of lower-cost feedstock can mean a significant cost advantage for U.S. manufacturers and a manufacturing renaissance. But exploitation of the shale gas resource requires capital investment commensurate with the enormous growth potential for the U.S. economy. A significant concern for those considering investment in new plants is the ability to use both debt and equity capital to finance the ventures. Full deductibility of interest expense is vital to all industries in this regard, but of key importance to manufacturers and other capital intensive industries.

In the case of a long-term project that requires large up front outlays, like the building of a new plant, investment dollars are tied up for a period of years before completion of construction and onset of production at a profit. During this period, the interest on company debt compounds. Accordingly, long-term, capital intensive projects are especially sensitive to changes in the cost of capital. Limiting or eliminating the deductibility of interest, once again absent other reforms that act to offset the effects of such policy, would directly increase the cost of capital and would have a dramatic effect on investment decisions that of necessity rely upon analysis of the time-value of money.

Interest paid on debt is recognized as a cost of doing business and virtually every business relies on debt at some level to finance its operations. Investing activity targeted for growth is based upon achieving certain rates of return over and above their cost of capital. Reducing or eliminating the interest

deduction would immediately increase the cost of capital, thereby increasing hurdle rates companies use to evaluate investment opportunities. This will lead to reduced investment and capital spending activity with the potential for companies to reevaluate capital decisions that have already been made or are under consideration.

Companies need flexibility in raising capital for their operations, whether through debt or equity. They use a range of factors in striking the right balance: cash flow, capital costs, types of projects to be financed, risk profile, and desired financial profitability. We appreciate the concern with companies that are too heavily in debt and are over-leveraged, but the market is a very efficient mechanism for sorting this out. Companies with too much debt will see their cost of capital increase in the market, which would probably move them toward a more balanced mix of debt and equity that will keep their capital costs more in line with their competition. There is no need to legislate what the market already manages efficiently and effectively.

Moreover, imposing a limit or reducing interest expense deductibility would have an immediate and sustained impact on capital costs. The resulting decrease in corporate investment activities would threaten the already low economic growth experienced in the U.S. over the last several years. Accordingly, as with changes to the ACR rules and mandatory repatriation tax, absent comprehensive tax reform that includes significant corporate rate reductions, adoption of a competitive territorial tax system, and sufficiently lengthy transition periods, the disallowance of deductions on interest expenses would reduce amounts and availability of capital in the U.S.

Summary: “Level playing fields”

As reflected in the attached Guiding Principles for Corporate Tax Reform and as an overall principle to guide policymakers, ACC believes that U.S. tax reform must provide for a “level playing field” where U.S. companies investing abroad can compete equally with foreign investors, and where U.S. subsidiaries of foreign investors which invest in the U.S. and U.S. parented companies are treated equally. Further, we believe that tax reform should not create winners and losers among industries or among types of businesses, but should attract investment and enhance job creation throughout U.S. business enterprises and foreign enterprises investing in the United States. In summary:

- The U.S. should adopt U.S. tax rules that will enable, rather than impede, U.S. companies to compete on a level playing field with regard to their foreign business operations. ACC supports the adoption of a territorial system (which is comparable to those of our major trading partners) for the taxation of foreign business income, that would permit competitive treatment for U.S. companies.
- U.S. companies operating in the U.S.—whether U.S. owned or foreign owned-- should be subject to comparable rules, and thus taxed on a level playing field with regard to U.S. business operations. ACC supports U.S. tax rules which would provide parity between U.S.-owned companies and foreign-owned companies.
- Changes that would place the burden of U.S. tax reform on one or more particular industries would not result in a level playing field. For example, when looking at potential base broadeners,

the manufacturing industry (including the chemical industry) should not be disproportionately impacted, unfairly so, vis-à-vis other industries. Otherwise, this would have a significant negative impact on U.S. manufacturing, economic growth, new investment and jobs.

Comments of the American Council for an Energy-Efficient Economy on Tax Reform and Energy Efficiency

Steven Nadel, Executive Director

June 1, 2017

We commend the House Ways and Means Committee for beginning consideration of tax reform. The American Council for an Energy-Efficient Economy is a research, education and policy organization founded in 1980 that focuses on technologies, programs and policies that improve energy efficiency in the U.S. For the past several years we have researched ways the current tax code impedes cost effective investments in energy efficiency and ways to improve the tax code so it instead encourages energy efficiency investments that create jobs, improve competitiveness and strengthen our economy, with only a limited cost to the Federal Treasury and without favoring specific technologies. Here we briefly summarize three recommendations.

- 1. Refine depreciation periods to more accurately reflect the average service lives of equipment.** Inaccurate depreciation periods distort market forces. Under current law, depreciation periods for many types of equipment are written into the law, and some of these depreciation periods bear little relationship to typical service lives in the field. Particularly egregious are the depreciation periods for equipment in commercial buildings, including heating and cooling systems, lighting fixtures and controls, and roofing systems. Currently, this equipment is depreciated over 39 years, the same depreciation period as is used for a new commercial building. However, lighting, cooling and heating equipment and roof systems typically have lives of 15-20 years, not 39 years. The 39-year depreciation period acts as a barrier to new investment as many businesses will choose to repair equipment when it fails in order to avoid having to write off the un-depreciated value. We call this situation “penalty depreciation,” just the opposite of the accelerated depreciation that is sometimes employed to encourage investments. Since equipment has been steadily increasing in efficiency, encouraging equipment replacement will save energy as well as creating sales for equipment manufacturers and installers.

We recognize that the Republican “Better Way” plan includes immediate expensing for investments and hence eliminates depreciation. But if this aspect of Better Way is not included in legislation, we recommend that Congress establish a depreciation period of about 15 years for energy-related equipment in commercial buildings. Along with partners in industry, we have developed a draft definition which we can share if you are interested. Furthermore, new tax legislation should authorize the IRS to modify depreciation periods in response to market changes with the guidance that depreciation periods should approximate average service lives in the field. As equipment evolves and changes, the IRS should be able to adjust depreciation periods as service lives change.

Likewise, in the case of combined heat and power (CHP) systems (systems that generate both heat and power, achieving high efficiencies), the depreciation period varies as a function of who owns the equipment and how it is used, even though often the same equipment is used by a variety of owners and for a variety of applications. We recommend that a single service life be selected for all owners, perhaps 15 years.

Improving depreciation periods will reduce distortions and allow market forces to operate more freely.

2. **Refine existing energy efficiency tax incentives in order to promote advanced energy-saving techniques in a way that is technology neutral, allows manufacturers and installers to plan for the mid-term and phases out when market share targets are reached.** Tax policy should promote energy-saving technologies and practices that have a limited market share today due to market barriers, but where temporary federal assistance can advance these technologies and practices to the point where they can prosper without federal assistance. Federal incentives can open both a domestic market and an export market for advanced energy-saving techniques. Specifically, we have reviewed experience with energy efficiency tax incentives provided in the 1980s and over the 2005-2011 period, and based on this review we recommend that the following principles apply:

- Set product performance standards primarily in terms of whole building energy efficiency savings, letting all technologies compete.
- Target efficiency improvement levels that currently have a very small market share, which keeps the cost of tax incentives down and minimizes the number of “free riders” (consumers who take the tax incentives but would have made the same purchase decisions, even if the tax incentives were not offered).
- Provide a substantial incentive to motivate significant additional sales.
- Monitor market share of eligible products and when the market share starts to become significant, the tax incentives should either be phased out or eligibility levels increased, starting the process to “transform markets” again.
- Keep the incentives in place for long enough so manufacturers and other market players find it worth making investments to develop and market eligible products.

Many of the tax incentives first enacted in the Energy Policy Act of 2005 have been successful, and provide useful lessons for energy efficiency tax reform. For example, high-efficiency appliances, heating and cooling equipment, and new homes now have much higher market shares due in significant part to these tax incentives. In the case of appliances, the original qualification levels are now standard practice, and qualification levels were tightened several times. On the other hand, tax incentives for Energy Star windows largely subsidize purchases that would have happened anyway since qualification levels were set too low. Going forward, limited federal funds for energy efficiency tax incentives should be provided in four areas:

- a. Efficient new homes
- b. Efficient new commercial buildings
- c. Comprehensive retrofits of existing homes
- d. Comprehensive retrofits of existing commercial buildings

For each of these four areas we recommend that legislation establish a three-tier incentive for “good”, “better” and “best” performance, with the highest incentives for “best” performance. Market share for each tier should be monitored by the Department of Energy, and when the market share for a tier reaches 10%, the eligibility threshold should be increased or the tier phased out. And when the market share of the highest tier reaches 20%, tax incentives in that

area should be sunset. Performance should be measured using metrics in widespread current use for each area (e.g. for new construction, percent savings relative to national model building codes). We have been working with industry groups to develop this proposal and can provide additional details on this approach if you are interested. If eligibility levels are set higher than typical current practice, costs can be kept to modest levels (on the order of \$1 billion per year for all four areas combined according to our preliminary analysis).

By setting broad performance criteria that ensure public benefits and advances beyond normal market practice, combined with phasing out incentives once technologies and practices that achieve the performance become established, Congress can advance US competitiveness at a modest cost to the Treasury.

3. **Consider “clean tax cuts”.** The Grace Richardson Fund, R Street Institute, ConservAmerica, ACEEE and others have been working to develop the concept of “clean tax cuts” – the application of supply-side tax rate cuts to “clean” investments that reduce emissions of various pollutants. The idea is that by cutting taxes on income from clean investments (where “clean” is specifically defined), investors will be more interested in making such investments, and large amounts of private capital can be leveraged. Clean tax cut proposals are now being prepared to promote clean investments in oil and gas production, energy efficiency, renewable energy production and more. In terms of energy efficiency, examples of “clean” investments could include investments that allow a building to meet the criteria for an Energy Star certified building or that reduce the energy use of a commercial building or an industrial process by at least 30% as determined using approved software.

Three leading mechanisms are being developed to promote investments that meet a definition of clean:

- i. Applying the capital gains tax rate to income from clean investments that is passed through to individual tax-payers and covered by individual tax returns;
- ii. Expensing of investment amounts in lieu of depreciation (similar to item #1 above); and/or
- iii. Allowing tax-free bonds to be used to finance clean investments.

Details of these proposals are being developed by the Clean Tax Cut Working Group (see <http://cleantaxcuts.org/>).

Addressing Energy Efficiency in Tax Reform Will Create Jobs

In a 2013 report¹ ACEEE examined the approximate impacts of earlier variants of two of these provisions (depreciation and energy efficiency incentives) on the US economy. To estimate the impact of the energy efficiency tax incentives on the overall economy, we used ACEEE’s DEEPER input-output model of the U.S. economy. The DEEPER model looks at cash flow in different sectors of the economy and estimates the impact of efficiency investments relative to spending on conventional energy supplies that are displaced. DEEPER looks both at the investments and the impact of energy savings that are available to be re-spent. Overall, we found that these two energy efficiency tax provisions would result in a significant increase in employment – an average of about 160,000 jobs over the 2014-2030 period. The job gains would start at about 52,000 in the first year of the new tax policy and steadily increase to about 300,000 jobs in the final years. These job gains are

¹ <http://aceee.org/research-report/e132>

driven by both increasing investments in energy-efficient products and services as well as reinvestment of the energy bill savings. We have not conducted an input-output analysis of our revised recommendations, but the results of our 2013 study provide a likely order-of-magnitude estimate of job gains from inclusion of the energy efficiency provisions we recommend.

Conclusion

If enacted, these reforms would reduce barriers to cost-effective energy efficiency investments and contribute toward increased investments in efficiency. Such investments would reduce energy waste, create jobs, and foster economic growth.

We would be happy to provide further details on these proposals if they would be of use. We would also be happy to discuss these ideas with Members or staff.



Hearing Statement of Maurice A. Perkins
Senior Vice President
The American Council of Life Insurers
Before the
U.S. House Committee on Ways and Means
“How Tax Reform Will Grow Our Economy and Create Jobs”

May 18, 2017

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the record for the May 18, 2017 hearing, titled “how tax reform will grow our economy and create jobs.” We thank Chairman Kevin Brady and Ranking Member Richard Neal for holding this hearing. ACLI would like to take this opportunity to respectfully comment on tax reform.

On behalf of the U.S. life insurance industry, we share the Committee’s goal for tax reform of encouraging economic growth. ACLI is a Washington, D.C.-based trade association with approximately 290 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers’ products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing 94 percent of industry assets, 93 percent of life insurer premiums, and 97 percent of annuity considerations in the United States.

Understanding the financial and company tax implications of the life insurance business model is key to safeguarding the financial security protections and guarantees our products provide for consumers. These protections and guarantees are not available from any other financial services companies.

The nature of the life insurance business is very different from that of a manufacturer or retailer in that it involves the satisfaction of long-duration promises. Life insurers receive premiums in exchange for a contractual promise to pay insurance or annuity benefits. Those premiums are invested in assets that match our expected liability obligations and duration. Life insurers utilize those premiums as well as investment returns on the premiums to pay policyholder benefits as they arise, often many decades in the future. Because of the nature of our business, financial regulation supports our ability to deliver on our long-duration promises.

Life insurers help to grow the economy through long-term investments. The industry is the largest investor in U.S. corporate bonds and also holds significant investments in the mortgage, real estate and equity markets.

It is important that tax reform support the policy of protecting personal financial security through use of financial protection and retirement savings products. The ACLI appreciates the opportunity to comment and point out the unique features of our products that make them so critical to the financial security of all Americans. ACLI and its member companies look forward to continuing to work with the Committee to address the industry's concerns on these very important issues.

Thank you.

A handwritten signature in black ink, appearing to read 'M. Perkins', with a large loop at the end.

Maurice A. Perkins



Statement of the American Farm Bureau Federation

**SUBMITTED FOR THE HEARING RECORD
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS**

**“HOW TAX REFORM WILL GROW OUR ECONOMY AND CREATE
JOBS”**

MAY 18, 2017

**Submitted By:
The American Farm Bureau Federation**

The American Farm Bureau Federation is the country's largest general farm organization, with nearly 6 million member families and representing nearly every type of crop and livestock production across all 50 states and Puerto Rico. Our members grow and produce the food, fiber and fuel that propel our nation's economy as well as putting food on our tables. According to USDA, 11 percent of U.S. employment comes from the agriculture and food industry, accounting for 21 million jobs of which about 18 million are off-the-farm positions.

Federal tax policy affects the economic behavior and well-being of farm households as well as the management and profitability of farm and ranch businesses. Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We appreciate the opportunity to file this statement explaining the importance of tax reform and highlighting tax code provisions important to the long-term financial success of farm and ranch businesses.

Farms and ranches operate in a world of uncertainty. From unpredictable commodity and product markets to fluctuating input prices, from uncertain weather to insect or disease outbreaks, running a farm or ranch business is challenging under the best of circumstances. Farmers and ranchers need a tax code that recognizes the financial challenges that impact agricultural producers. They want a simpler more transparent tax code that doesn't make the challenging task of running a farm or ranch business more difficult than it already is.

Farm Bureau supports tax laws that help the family farms and ranches that grow America's food and fiber, often for rates of return that are modest compared to other business opportunities. What is needed is tax reform that supports high-risk, high-input, capital-intensive businesses like farms and ranches that predominantly operate as sole proprietors and pass-through entities. We believe that tax reform should be equitable and designed to encourage private initiative and domestic economic growth.

Farm Bureau commends the Committee on Ways and Means for moving forward with comprehensive tax reform designed to spur growth of our nation's economy. Many of the provisions of the tax reform blueprint will be beneficial to farmers, including reduced income tax rates, reduced capital gains taxes, immediate expensing for all business inputs except land, and the elimination of the estate tax. The proposed loss of the deduction for business interest expense and the deduction for state and local taxes, however, is a cause for concern. The blueprint can be improved by guaranteeing the continuation of stepped-up basis, preserving cash accounting and maintaining like-kind exchanges.

The statement that follows focuses on and provides additional commentary on the tax reform issues most important to farmers and ranchers.

COMPRHENSIVE TAX REFORM WILL BOOST FARM AND RANCH BUSINESSES

Any tax reform proposal considered by Congress must be comprehensive and include individual as well as corporate reform and rate reduction. By far, the most common form of farm ownership is as a sole-proprietor. In total, farms and ranches operated as individuals, partners and S corporation shareholders constitute about 97 percent of our nation's 2 million farms and ranches

and about 85 percent of total agricultural production. Because many business deductions and credits are used by both corporate and pass-through businesses, their elimination without substantial rate reduction for all business entities could result in a tax increase for the vast majority of farmers and ranchers.

LOWER EFFECTIVE TAX RATES WILL BENEFIT FARM AND RANCH BUSINESSES

Farm Bureau supports reducing tax rates and views this as the most important goal of tax reform. While lower tax rates are important, the critical feature for farmers and ranchers is the effective tax rate paid by farm and ranch businesses. Tax reform that lowers rates by expanding the base should not increase the overall tax burden (combined income and self-employment taxes) of farm and ranch businesses. Because profit margins in farming and ranching are tight, farm and ranch businesses are more likely to fall into lower tax brackets. Tax reform plans that fail to factor in the impact of lost deductions for all business entities and for all rate brackets could result in a tax increase for agriculture.

Farming and ranching is a cyclical business. A period of prosperity can be followed by one or more years of low prices, poor yields or even a weather disaster. Without the opportunity to even out income over time, farmers and ranchers will pay more than comparable non-cyclical businesses. Tax code provisions like income averaging allow farmers and ranchers to pay taxes at an effective rate equivalent to a business with the same aggregate but steady revenue stream. Farm savings accounts would accomplish the same object plus allow a farmer or rancher to reserve income in a dedicated savings account for withdrawal during a poor financial year. Installment sales of land benefits both buyers and sellers by providing sellers with an even income flow and buyers with the ability to make payments over time.

ACCELERATED COST RECOVERY HELPS FARMERS REMAIN EFFICIENT

Farmers and ranchers need to be able to match income with expenses in order to manage their businesses through challenging financial times. Expensing allows farm and ranch business to recover the cost of business investments in the year a purchase is made. In addition to Sect. 179 small business expensing, the tax code also provides immediate cost recovery through bonus depreciation and through long-standing provisions that allow for the expensing of soil and water conservation expenditures, expensing of the costs of raising dairy and breeding cattle and for the cost of fertilizer and soil conditioners such as lime. Farm Bureau supports the expansion of immediate expensing.

Because production agriculture has high input costs, Farm Bureau places a high value on the immediate write-off of all equipment, production supplies and pre-productive costs. While Sect. 179 does provide full expensing for most small and mid-size farms, USDA reports that almost a quarter of the large farms that account for nearly half of all agricultural production made investments exceeding the expensing limit in 2015. Thus, an expansion of immediate expensing has the potential to change the investment behavior of farms responsible for a significant amount of agriculture production.

When farmers are not allowed immediate expensing they must capitalize purchases and deduct the expense over the life of the property. Accelerated deductions reduce taxes in the purchase year, providing readily available funds for upgrading equipment, to replace livestock, to buy production supplies for the next season and for farmers to expand their businesses. This is not only a benefit to production agriculture; a journal Agricultural Finance Review study found that for every \$1,000 increase to the Section 179 expensing amount, farms that had been previously limited by the expensing amount made an incremental capital investment of between \$320 and \$1,110.

CASH ACCOUNTING HELPS FARM AND RANCH BUSINESSES TO CASH FLOW

Cash accounting is the preferred method of accounting for farmers and ranchers because it allows them to match income with expenses and aids in tax planning. Farm Bureau supports the continuation of cash accounting.

Cash accounting allows farmers and ranchers to improve cash flow by recognizing income when it is received and recording expenses when they are paid. This provides the flexibility farmers need to plan for major business investments and in many cases provides guaranteed availability of some agricultural inputs.

Under a progressive tax rate system, farmers and ranchers, whose incomes can fluctuate widely from year to year, will pay more total taxes over a period of time than taxpayers with more stable incomes. The flexibility of cash accounting also allows farmers to manage their tax burden on an annual basis by controlling the timing of revenue to balance against expenses and target an optimum level of income for tax purposes.

Loss of cash accounting would create a situation where a farmer or rancher might have to pay taxes on income before receiving payment for sold commodities. Not only would this create cash flow problems, but it also could necessitate a loan to cover ongoing expenses until payment is received. The use of cash accounting helps to mitigate this challenge by allowing farm business owners to make tax payments after they receive payment for their commodities.

DEDUCTING INTEREST EXPENSE IS IMPORTANT FOR FINANCING

Debt service is an ongoing and significant cost of doing business for farmers and ranchers who must rely on borrowed money to buy production inputs, vehicles and equipment, and land and buildings. Interest paid on these loans should be deductible because interest is a legitimate business expense. According to USDA Economic Research Service, the interest expense accounts for 17.9 percent of fixed expenses for farms and ranches. Immediate expensing will not offset the loss of this deduction, especially for the bulk of farmers and ranchers currently covered under Sect. 179 small business expensing.

Farm and ranch businesses are almost completely debt financed with little to no access to investment capital to finance the purchase of land and production supplies. In 2015, all but

5 percent of farm sector debt was held by banks, life insurance companies and government agencies. Without a deduction for interest, it would be harder to borrow money to purchase land and production inputs and the agriculture sector could stagnate.

Land has always been farmers' greatest asset, with real estate accounting for 79 percent of total farm assets in 2015. Since almost all land purchases require debt financing, the loss of the deduction for mortgage interest would make it more difficult to cash flow loan payments and could even make it impossible for some to secure financing at all. The need for debt financing is especially critical for new and beginning farmers who need to borrow funds to start their businesses.

REPEALING ESTATE TAXES WILL AID IN FARM TRANSITIONS

Estate taxes disrupt the transition of farm and ranch businesses from one generation to the next. Farm Bureau supports estate tax repeal, opposes the collection of capital gains taxes at death and supports the continuation of unlimited stepped-up basis.

Farming and ranching is both a way of life and a way of making a living for the millions of individuals, family partnerships and family corporations that own more than 99 percent of our nation's more than 2 million farms and ranches. Many farms and ranches are multi-generation businesses, with some having been in the family since the founding of our nation.

Many farmers and ranchers have benefited greatly from congressional action that increased the estate tax exemption to \$5 million indexed for inflation, provided portability between spouses, and continued the stepped-up basis. Instead of spending money on life insurance and estate planning, farmers are able to upgrade buildings and purchase equipment and livestock. And more importantly, they have been able to continue farming when a family member dies without having to sell land, livestock or equipment to pay the tax.

In spite of this much-appreciated relief, estate taxes are still a pressing problem for some agricultural producers. One reason is that the indexed estate tax exemption, now \$5.49 million, is still catching up with recent increases in farmland values. While increases in cropland values have moderated over the last three years, cropland values remain high. On average cropland values are 62 percent higher than they were a decade ago. As a result, more farms and ranches now top the estate tax exemption. With 91 percent of farm and ranch assets illiquid, producers have few options when it comes to generating cash to pay the estate tax.

REDUCED TAXATION OF CAPITAL GAINS ENCOURAGES INVESTMENT

The impact of capital gains taxes on farming and ranching is significant. Production agriculture requires large investments in land and buildings that are held for long periods of time during which land values can more than triple. USDA survey data suggests about 40 percent of all family farms and ranches report some gain or loss, more than three times the average individual taxpayer. Farm Bureau supports reducing capital gains tax rates and wants an exclusion for farm land that remains in production.

Capital gains taxes are owed when farm or ranch land, buildings, breeding livestock and some timber are sold. While long-term capital gains are taxed at a lower rate than ordinary income to encourage investment and in recognition that long-term investments involve risk, the tax can still discourage property transfers or alternatively lead to a higher asking price.

Land and buildings typically account for 79 percent of farm or ranch assets. The current top capital gains tax is 20 percent. Because the capital gains tax applies to transfers, it provides an incentive to hold rather than sell land. This makes it harder for new farmers and producers who want to expand their business, say to include a child, to acquire property. It also reduces the flexibility farms and ranches need to adjust their business structures to maximize use of their capital.

STEPPED-UP BASIS REDUCES TAXES FOR THE NEXT GENERATION OF PRODUCERS

There is also interplay between estate taxes and capital gains taxes: stepped-up basis. Step-up sets the starting basis (value) of land and buildings at what the property is worth when it is inherited. Farm Bureau supports continuation of stepped-up basis.

Capital gains taxes on inherited assets are owed only when sold and only on gains over the stepped-up value. If capital gains taxes were imposed at death or if stepped-up basis were repealed, a new capital gains tax would be created and the implications of capital gains taxes as described above would be magnified. This is especially true for the vast majority of farmers and ranchers who are both under the estate tax exemption and have the benefit of stepped-up basis.

Stepped-up basis is also important to the financial management of farms and ranches that continue after the death of a family member. Not only are land and buildings eligible for stepped-up basis at death but so is equipment, livestock, stored grains, and stored feed. The new basis assigned to these assets resets depreciation schedules, providing farmers and ranchers with an expanded depreciation deduction.

LIKE-KIND EXCHANGES HELP AG PRODUCERS STAY COMPETITIVE

Like-kind exchanges help farmers and ranchers operate more efficient businesses by allowing them to defer taxes when they sell assets and purchase replacement property of a like-kind. Farm Bureau supports the continuation of Sect. 1031 like-kind exchanges.

Like-kind exchanges have existed since 1921 and are used by farmers and ranchers to exchange land and buildings, equipment, and breeding and production livestock. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to continue their farm or ranch businesses or, worse yet, delay mandatory improvements to maintain the financial viability of their farm or ranch.

FARMERS AND RANCHERS PAY SIGNIFICANT STATE AND LOCAL TAXES

Farm Bureau supports continuation of the deduction for state and local taxes. Loss of the deduction for state and local taxes paid would have a significant impact on farm and ranch

businesses. According to USDA Economic Research Service, state and local property taxes account for 16 percent of fixed expenses for all farms. An additional, important contributing factor is that taxes are often built into the price of rent and lease payments, which are substantial for farms. Therefore, losing the state and local tax deduction would likely cause higher rent and lease payments. It should be noted that the figures for taxes mentioned above are only for real estate and property taxes and do not include any state income taxes if those exist. Therefore, the overall local and state tax burden is likely higher than stated above.

SUMMARY

Farm Bureau supports replacing the current federal income tax with a fair and equitable tax system that encourages success, savings, investment and entrepreneurship. We believe that the new code should be simple, transparent, revenue-neutral and fair to farmers and ranchers. Tax reform should embrace the following overarching principles:

- Comprehensive: Tax reform should help all farm and ranch businesses, including sole-proprietors, partnerships and sub-S and C corporations.
- Effective Tax Rate: Tax reform should reduce combined income and self-employment tax rates low enough to account for any deductions/credits lost due to base broadening.
- Cost Recovery: Tax reform should allow businesses to deduct expenses when incurred, including business interest expense. Cash accounting should continue. Sect. 1031 like-kind exchanges should continue. There should be a deduction for state and local taxes.
- Estate Taxes: Tax reform should repeal estate taxes. Stepped-up basis should continue.
- Capital Gains Taxes: Tax reform should lower taxes on capital investments. Capital gains taxes should not be levied on transfers at death.



**American
Forest & Paper
Association**

**American Forest & Paper Association
Statement for the Record**

**Committee on Ways and Means
U.S. House of Representatives**

**Hearing on How Tax Reform Will Grow Our Economy and Create Jobs
May 18, 2017**

The American Forest & Paper Association (AF&PA) is the national trade association of the forest products industry, representing pulp, paper, packaging, tissue and wood products manufacturers, and forest landowners. Our companies make products essential for everyday life from renewable and recyclable resources that sustain the environment.

U.S. manufacturers of paper and wood products appreciate the opportunity to provide input to the Ways and Means Committee as it considers how tax reform will grow our economy and create jobs across America. AF&PA supports comprehensive tax reform that encourages economic growth, job creation, and the competitiveness of all U.S. businesses. Central to this is a tax system with a low corporate tax rate, support for investment in U.S. manufacturing and its global supply chain, and an international tax system that reflects a globally competitive territorial tax system.

The U.S. forest products industry — made up of both C-corporations and pass-through entities— is a significant contributor to the U.S. economy, employing nearly 900,000 men and women in above-average wage jobs, investing heavily in equipment and improvements, and exporting products throughout the world. The U.S. forest products industry also supports jobs in other sectors of the U.S. economy. A recent study conducted by the Economic Policy Institute found that each paper industry job supports 3.25 jobs in supplier industries and in local communities as the result of re-spending and tax receipts.

The U.S. forest products industry provides excellent employee payroll, retirement, and health benefits to its workers. Meeting a payroll of approximately \$50 billion, the forest products industry employs about the same number of people as the automotive industry and more people than the chemical and plastics industries. The industry has a generous compensation and benefits structure -- earnings of pulp and paper mill workers exceed the average for all U.S. private sector workers by about 23 percent.

The industry produces more than \$200 billion in paper and wood products annually, accounting for approximately 4.0 percent of the total U.S. manufacturing GDP, and ranks among the top 10 manufacturing sector employers in 45 states. In a typical year, the forest products industry transforms approximately 13 billion cubic feet of wood - the majority of which is purchased from privately-owned forest land – into value-added paper, packaging, lumber and other wood products.

We are highly capital-intensive, in some cases more so than the average manufacturing industry. Data from the U.S. Census Bureau's fourth quarter 2016 Quarterly Financial Report (QFR) indicate that depreciation, depletion and amortization amounted to 5.0 percent of paper industry sales, versus 3.2 percent for all manufacturing. And the industry has made significant investments and facility upgrades in recent years. According to the Annual Survey of Manufacturers, in 2015 the paper and wood products industry invested \$12 billion in plant and equipment. Items such as recovery boilers, turbine generators, paper machines, and environmental controls are critical to maintaining technologically advanced manufacturing facilities that compete in an extremely competitive global marketplace.

The industry's supply chain and customer base is globally integrated and includes many cross-border transactions. Exports of U.S. paper and wood products account for more than 15 percent of the industry's annual total sales. In 2016, the industry's global exports totaled \$29.4 billion, of which \$9 billion were exports of wood products and \$20.4 billion were exports of pulp, paper and packaging. We estimate that our industry's exports support approximately 135,000 jobs at pulp, paper and wood products mills and related logging operations in the U.S., as well as many more jobs in communities where these facilities are located. As a capital-intensive industry, many of the industry's vital large capital purchases come from abroad because there is no U.S. manufacturer of like items.

AF&PA's member companies recognize that comprehensive tax reform will not be easy. However, the opportunity to increase U.S. economic growth through tax reform is enormous. Our key goals include lowering the corporate tax rate and a reformed competitive international tax system to help attract and retain business operations and good paying jobs in the United States. To ensure capital-intensive manufacturers invest and expand with new and more efficient equipment, we support appropriate depreciation, interest expense, and research and experimentation tax policies. Further, capital gains and dividends rates for individuals should be tailored to ensure U.S. equity markets remain a reliable source of capital. AF&PA believes that a reformed tax code should be long-term, prospective, provide for a smooth transition, and not result in negative market bias.

We would be pleased to discuss these priorities with the committee and answer any questions you may have about our industry.

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United States House of Representatives

Committee on Ways and Means

Written Testimony

Jonathan Williams

Chief Economist and Vice President, Center for State Fiscal Reform

American Legislative Exchange Council

May 18, 2017

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee,

Thank you for the opportunity to comment throughout this important policy discussion. By way of background, my name is Jonathan Williams, and I serve as Chief Economist and Vice President of the Center for State Fiscal Reform at the American Legislative Exchange Council (ALEC). As you may know, ALEC is the nation's largest non-partisan individual membership organization of state legislators. Comprised of nearly one-quarter of the country's state legislators and stakeholders from across the policy spectrum, ALEC members represent more than 60 million Americans and provide jobs to more than 30 million people in the United States. We believe all Americans deserve an efficient, effective and accountable government that puts the people in control.

In my role, I work with our members to develop sound tax and fiscal policies based on best practices from the 50 states. ALEC does not support or oppose legislation and I personally submit these comments to bring some observations from our non-partisan research and analysis on state level tax reform efforts.

I commend this committee for taking on the difficult but economically advantageous task of reviewing our federal tax code. As you know, it has been more than 30 years since President Ronald Reagan signed the last comprehensive federal tax reform into law in October of 1986.

As this committee deliberates fundamental changes to our nation's tax policy, states are enacting major changes to their own tax codes. In the past year alone, nine states significantly reduced taxes, according to our Center for State Fiscal Reform research, *State Tax Cut Roundup 2016*. In 2015, 17 states substantially reformed their tax systems in a pro-growth manner. All told, in the past four years, nearly 30 states have significantly reduced their tax burdens. The case studies from these states exemplify how states can indeed be the "laboratories of democracy" as described by United States Supreme Court Justice Louis Brandeis.

Every year, I have the privilege of co-authoring the national economic study, *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*. Together with my co-authors (Reagan economic advisor, Dr. Arthur Laffer and Stephen Moore)-we analyze how economic competitiveness drives income, population and job growth across the states. The new 10th edition of *Rich States, Poor States* offers a roadmap to economic competitiveness based on policy reforms. The report presents rankings of the 50 states based on the relationship between policies and performance, revealing which states are best positioned to grow economic opportunity, and which are not.

Consistent with the sizable majority of the academic research, we also find that taxes matter for economic competitiveness. People and businesses often seek out lower tax burdens across state lines. *Rich States, Poor States* data show states that keep taxes low, avoid job-killing over-regulation and

follow prudent budget practices consistently and significantly outperform their highly taxed, over-regulated counterparts.

Rich States, Poor States adds to a growing body of evidence that taxes matter, and some taxes matter more than others. For many years, our research has warned against an over-reliance on income taxes – on both personal and business income. For instance, we analyzed the nine states without an individual income tax versus the nine states with the highest individual income taxes over the past decade. From 2006 to 2016 (the latest data available from the Census Bureau), the population in states with no income tax grew 111 percent faster than their high tax counterparts (11.9 percent vs. 5.6 percent) on an equally-weighted basis. In aggregate, population grew by 15.2 percent in the no income tax states vs. 6.7 percent in their high tax counterparts. According to the Bureau of Labor Statistics and the St. Louis Fed, over the past ten years (March 2007-March 2017), private sector job growth in the states with no income tax increased 28 percent faster than the states with the highest income taxes (6.9 percent growth vs. 5.4 percent growth) on an equally-weighted basis. In aggregate, private sector jobs increased by 12.2 percent in the no income tax states compared with 7.9 percent growth in the high income tax states. Obviously other factors, including right-to-work status, regulatory environment, and makeup of state economies clearly factors into these statistics; but these general trends are reflected decade after decade for the past 50 years.

The reasons why income-based taxes are economically damaging to states range from the adverse economic effects of the taxes, to purely public finance objections, such as the volatile nature of income tax revenues. Recently, Governor Jerry Brown of California admitted Sacramento’s over-reliance on progressive income taxes has caused some serious budget problems for the Golden State. Meanwhile, Governor Dannel Malloy in Connecticut has acknowledged that numerous tax increases have hurt his state’s competitiveness and economic growth after their loss of General Electric to Massachusetts.

Additionally, an analysis on the impact of various types of taxation, conducted by scholars at the Organization for Economic Cooperation and Development (OECD), found that taxes on productivity, such as personal and corporate income taxes, are particularly harmful to economic growth.

Regardless of the form of taxation policymakers choose to utilize moving forward, the key is having competitive tax rates and eliminating special preferences or carve-outs wherever possible. This avoids the temptation of government picking favorites in the tax code, and essentially driving up tax rates for everyone else.

North Carolina provides us a clear example of the constructive effects of pro-growth tax reform and budget prioritization. Despite being handed a \$3 billion budget gap for the 2011-12 fiscal year, North Carolina’s General Assembly took great strides in repairing the ailing budget and its structural problems, all while providing substantial tax relief.

Next, they repealed the state's "Death Tax," consolidated the individual income tax brackets into a single rate of 5.8 percent, and raised standard deductions for single and joint filers. They also addressed the state's corporate income tax rate, formerly highest in the Southeast, cutting it to 6 percent in 2014, 5 percent in 2015, 4 percent in 2016 and 3 percent in 2017, all contingent upon meeting certain revenue growth targets.

In 2015 lawmakers cut personal income taxes again, raising standard deductions and lowering the rate from 5.75 percent to 5.499 percent beginning in 2017. North Carolina has cut taxes for families and businesses by over \$4.5 billion this decade, and among states that have a corporate tax, North Carolina is now the lowest.

The state led the nation with 13.4 percent growth in its GDP from 2013 to 2015 and preliminary numbers have it continuing this trend in subsequent quarters. Strong domestic in-migration and job growth put North Carolina ahead of every regional competitor and in the top 10 nationwide. Over the last 10 years, North Carolina has attracted more than 500,000 new residents, on net, from the other 49 states, earning the economic vitality, social capital and tax revenue from these new taxpayers.

In spite of, or perhaps because of, all this tax relief and budget prioritization, the state has maintained its AAA bond rating, met every revenue requirement, balanced its budgets every year, and as of February 2017, the state reported a \$552 million budget surplus. Opportunity thrives in North Carolina, and in no small part due to these reforms. What the future holds looks brighter still, with long-run effects of these reforms putting the state on track to provide nearly \$6 billion in total tax relief by 2020. North Carolina serves as a textbook example of what pro-growth tax and budget reform can do for an economy.

Of course, even in the face of all of this positive economic data from the North Carolina tax reforms, some opponents of tax reform might suggest the policy experiences in Kansas since their 2012 tax cuts prove tax reform does not produce growth. In reality, the Kansas tax reform story is far from the abject failure some like to suggest. In fact, recent data suggest there are some very positive trends for hardworking taxpayers in Kansas.

Perhaps the most important complexity to keep in mind is the Kansas tax reform plan was never fully implemented as intended. Many political compromises gave us the fiscal policy patchwork that Kansas taxpayers face. Taxes were lowered, but spending was not. Then taxes were raised in a significant way. Some of the tax increases came in the form of broad-based retail sales taxes, while others were discriminatory taxes on consumers of specific products.

Many critics of the Kansas tax reform experience are quick to point to relatively lackluster economic growth and budget shortfalls in the years following tax reform as proof of the reforms' failure. However, like many other states at the time, the significant downturn in oil prices and agriculture prices hit Kansas especially hard. Controlling for these sectors, the rest of the Kansas economy enjoyed growth.

One of the key reasons Kansas policymakers took up the cause of tax reform in 2012 was to reverse decades of economic stagnation in the state. After the tax reforms of 2012 were enacted, Kansas started to catch up in private sector job growth, shooting up from 40th in the nation for job growth between 1998 and 2012 to 30th in the nation from 2012 to 2015, according to data from the Bureau of Economic Analysis. Pass-through entities have led the way in this jobs boom, accounting for 98 percent of jobs gains since 2012 through 2015—up from 82 percent first two years, according to the U.S. Census Bureau. Furthermore, business startups continue to break records since tax reform was enacted in 2012. The 2012 record was broken in 2013, and again in 2014. New business filings set another record in 2016 with 18,147 new domestic business filings.

Kansas provides a number of important lessons, the most important of which is that broad-based tax relief must be paired with responsible prioritization of spending. After all, taxes and spending are opposite sides of the same fiscal coin. Kansas has increased actual annual general fund spending by more than \$2.94 billion since 1995. This is an 89 percent increase. Adjusted for inflation, this is still an outsized 55 percent increase during a period in which population grew by only approximately 12 percent. Since 2012 alone, general fund spending has increased by more than 4 percent adjusted for inflation. In short, for every 1 percent in population growth from 1995-2017, spending increased by nearly 5 percent in real terms. Based on this spending growth, it is clear why Kansas has faced budget shortfalls as they reduced tax rates.

Much of the criticism about Kansas is based on preconception and myth, rather than empirical data and actual trends. Pro-growth tax relief can be trusted to make states more competitive, but it takes time to develop and must be offset with appropriate spending reforms.

Overall, the economic evidence clearly showcases the success of states that have enacted pro-growth tax reforms. The 50 “laboratories of democracy” give us numerous examples of this every year. In conclusion, I have included the ALEC Principles of Taxation for your review. This document provides some helpful guidelines as you look to create a fairer, pro-growth tax system, which empowers hardworking American taxpayers to enhance their economic opportunity.

I wish you all the best with your important task at hand.

ALEC PRINCIPLES OF TAXATION

The proper function of taxation is to raise money for core functions of government, not to direct the behavior of citizens or close budget gaps created by overspending. This is true regardless of whether government is big or small, and this is true for lawmakers at all levels of government.

Taxation will always impose some level of burden on an economy's performance, but that harm can be minimized if policymakers resist the temptation to use the tax code for social engineering, class warfare and other extraneous purposes. A principled tax system is an ideal way for advancing a state's economic interests and promoting prosperity for its residents.

The goal of American tax policy should be to raise revenue for functions of government in a way that minimizes distortions, so as to grow the overall economy and facilitate commerce.

Guiding principles of taxation

The fundamental principles presented here provide guidance for a neutral and effective tax system; one that raises needed revenue for core functions of government, while minimizing the burden on citizens.

- **Simplicity** – The tax code should be easy for the average citizen to understand, and it should minimize the cost of complying with the tax laws. Tax complexity adds cost to the taxpayer, but does not increase public revenue. For governments, the tax system should be easy to administer, and should help promote efficient, low-cost administration.
- **Transparency** – Tax systems should be accountable to citizens. Taxes and tax policy should be visible and not hidden from taxpayers. Changes in tax policy should be highly publicized and open to public debate.
- **Economic Neutrality** – The purpose of the tax system is to raise needed revenue for core functions of government, not control the lives of citizens or micromanage the economy. The tax system should exert minimal impact on the spending and decisions of individuals and businesses. An effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation through tax pyramiding.
- **Equity and Fairness** – The government should not use the tax system to pick winners and losers in society, or unfairly shift the tax burden onto one class of citizens. The tax system should not be used to punish success or to “soak the rich,” engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers.
Complementary – The tax code should help maintain a healthy relationship between the state and local governments. The state should always be mindful of how its tax decisions affect local governments so they are not working against each other – with the taxpayer caught in the middle.

- **Competitiveness** – A low tax burden can be a tool for a state’s private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.
- **Reliability** – A high-quality tax system should be stable, providing certainty in taxation and in revenue flows. It should provide certainty of financial planning for individuals and businesses.

Benefits of a principled tax system

Since taxes lower the economic welfare of citizens, policymakers should try to minimize the economic and social problems that taxation imposes. Citizens then directly gain the benefits of a low tax burden. These benefits are summarized below:

- **Greater economic growth** – A tax system that allows citizens to keep more of what they earn spurs increased work, saving and investment. A low state tax burden would mean a competitive advantage over states with high-rate, overly progressive tax systems.
- **Greater wealth creation** – Low taxes significantly boost the value of all income-producing assets and help citizens maximize their fullest economic potential, thereby broadening the tax base.
- **Minimize micromanagement and political favoritism** – A complex, high-rate tax system favors interests that are able to exert influence in the state capitol, and who can negotiate narrow exemptions and tax benefits that help only limited taxpayers and not the general economy. “A fair field and no favors” is a good motto for a strong tax system.

The ALEC Principles of Taxation are publicly available at

<https://www.alec.org/model-policy/statement-alec-principles-of-taxation/>

The American Made Coalition (AMC) represents a broad collection of industry leaders from every corner of America's economy, including both small and large businesses. AMC companies collectively employ millions of Americans, either directly or through their suppliers and distributors, and we are proud of our roots here in the United States. We do business all over the world, import to and export from the United States., and witness every day how a badly broken tax code has restrained our country's global competitiveness, limited the growth of the U.S. economy, and reduced the number of jobs available to American workers. Our membership continues to grow, and you can find our latest list on our website: www.americanmadecoalition.org.

The American Made Coalition believes 2017 presents the best opportunity to transform our outdated tax code – to create jobs, increase wages, and save taxpayers money. Thirty years have passed since Congress last overhauled the tax code. In that time, most other developed nations have modernized their tax systems and significantly lowered the rates businesses pay. Many of these countries also stopped taxing business income earned beyond their borders.

In contrast, the United States has the highest business tax rates in the developed world, and its world-wide tax system encourages – and often requires -- American companies to move their operations, assets, and headquarters to other countries in order to remain competitive or, alternatively, leave themselves exposed to acquisition by foreign-domiciled companies. This hurts American workers. The complexity and distortions brought about by the tax code are a familiar, unpleasant reality for U.S. companies who would far prefer to reinvest in the United States while avoiding a foreign takeover. Comprehensive tax reform gives us a chance to correct those systemic flaws and bring our tax code in-to the 21st Century by lowering rates and adopting a competitive territorial system.

By transforming our outdated tax code, Congress and the White House can accelerate economic growth by encouraging more business investment and boosting job growth. The nonpartisan Tax Foundation estimates that, taking the entirety of Chairman Brady's initial proposal, the package would create 1.7 million new jobs, increase wages by 8% and save taxpayers an average of \$4,600 a year. However, the study shows that a rate cut alone will not generate that kind of growth. Businesses need more certainty to make the kind of major, long-term investments that would strengthen the economy. The only way to give businesses that certainty is to make permanent reforms to our broken tax system, within the confines of the congressional budget rules.

Tax reform must be a vehicle to make our economy more competitive. Our global competitors have spent the last 30 years modernizing their tax systems, undeniably surpassing the United States. Our broken system encourages companies to shift earnings, operations, and intellectual property to other countries. In other words, our existing system discourages American companies from investing and creating jobs in the United States. We need to end the incentive for companies with a global footprint to invest and create jobs elsewhere; and instead, encourage them to bring their earnings and critical intellectual property back to their U.S. operations. By adopting a destination-based territorial system that only taxes economic activity in the United States at a low, competitive rate, Congress can bring our tax code in line with other developed countries.

This preference for imports has also helped fuel the flood of foreign-made products into the United States, displacing workers across the American economy, from textile workers in the South to appliance-makers in the Midwest. We might not be able to address all the advantages low wage countries have over American workers, but we can end the tax code's bias for goods and services produced in

other markets, while also building an economy that attracts high-tech manufacturing and information services jobs to the United States.

AMC member companies compete in almost every market in the world. We believe in free trade and open markets. But we also see firsthand how the U.S. tax code disadvantages American companies, both here and abroad. We do not support new barriers to imports; we just want to see Congress modernize our tax code to bring it in line with the rest of the developed world. The global economy is a lot different than it was in 1986, the last time Washington came together to overhaul the tax code, and we are long overdue for major changes that will make our economy more competitive.

In that vein, a simple, temporary rate cut would not go far enough to address these challenges. In order to generate the kind of growth our economy needs, we need an international tax system that makes the U.S. competitive on a global scale. This is why we are so encouraged that Congress and the White House have outlined bold proposals to rework the tax code. Transformational change is long overdue, and we applaud policymakers at both ends of Pennsylvania Avenue for making the most of this moment by pushing for big changes that will reinvigorate our economy and level the playing field for American workers.

The American Made Coalition supports pro-growth tax reform that creates and sustains American jobs, revitalizes American communities and levels the playing field for American businesses and workers. We appreciate the leadership demonstrated by members of the Ways and Means Committee in this debate, encouraging Congress and the White House to embrace game-changing policies. And we applaud the White House for unveiling an outline for comprehensive reform and giving tax reform what it has been missing for years – leadership from the President of the United States. As the process advances, we hope lawmakers continue to think big and enact the kind of change that will propel our economy into the 21st Century.

Submission to the Ways and Means Committee on May 17, 2017

Subject: Hearing on How Tax Reform Will Grow Our Economy and Create Jobs on May 18, 2017

On behalf of:

Americans For Fair Taxation
PO Box 4929
Clearwater, FL 33758
800-FAIRtax
Fax 727-478-3143
info@FAIRtax.org - general information
media@FAIRtax.org - media contacts & news tips

Submission:

America will never be great again with a tax base on production (income, savings and investment). Without production there is nothing to buy and nobody has anything to buy with. Production is what increases the tax base and raises the standard of living for a country. Taxing production is like putting the golden goose on a starvation diet.

The FAIRtax bill HR 24 / S 18 moves the tax base from production to consumption, thus creating a long term jobs and economic stimulus environment. Reference below the FAIRtax Stimulus Model Results with 10 year growth projections. It is from \$22 million of private funds for study, research and focus groups to find and create a solution to our present tax code problems and issues.

Key debate question, “What is wrong with the federal tax code and how to fix it?”

The root of the tax issues is the 16th Amendment (enables direct taxation and without limits) passed in February 1913. Six months later came the first legal income tax, then the IRS, payroll taxes for Social Security and Medicare and tax withholding. The 16th Amendment gave the federal government huge new taxing power and we lost Freedom, Liberty and Civil Rights. The 16th Amendment in our Constitution, the document that protects the people from its government, enables a graduated income tax, the second requirement for communist state per the *Communist Manifesto* by Karl Marx.

Please consider the following problems and note that taxes are a discouragement, a burden, a punishment.

1. We all fear the IRS. This is government tyranny. An IRS investigation does not involve a judge and jury, thus a loss of Civil Rights. The IRS is used for political purposes and needs to be eliminated. The federal tax code has grown to over 74,000 pages. Nobody understands the code, it's too large to administer, full of loop holes and encourages bad practices.
2. Direct taxation discourages work and creativity by taxing production, income, savings and investment. We want more jobs, but have a regressive tax on jobs of 15.3%, shared 50/50 by the employee and the employer. Production is what creates jobs, a vibrant economy, better the standard of living and a larger tax base, but we tax production.

3. The 47% think they are not paying federal taxes, but in fact they are paying over \$0.28 per dollar in embedded business taxes as a hidden regressive sales tax. You see all taxes, fees, etc. to businesses are costs that raise prices and are passed onto the next buyer until finally paid by the final consumer.
4. Border tax adjustment, Untaxing “Made in U.S.A.” and placing imported goods and U.S.A. goods on the same tax system. The U.S.A. has the highest business taxes in the world thus raising the prices for USA goods and services, but imported goods do not carry that same high tax burden.
5. Federal taxes are based on jobs, companies and capital; thus driving them out of our economy and also discouraging them from entering.
6. Federal tax withholding reduces spendable income and take home pay.
7. “United we stand, divided we fall” and our tax code divides us into classes.
8. We spend some \$431 billion per year to just comply with the tax code. That is an expensive “stay out of jail card” that adds nothing to wealth and production.
9. The “underground economy including illegal aliens” is estimated to be over \$2 trillion and is untaxed.
10. Tax evasion is at \$0.6 trillion annually and growing...easily solved with real/true tax reform.
11. There are many who cheat or don't even file a tax return.
12. The tax code hurts most the impoverished and lower incomes while the deductions, loop holes and exemptions are of most help to the wealthy.
13. Let's put the care and feeding of the family before paying federal taxes?
14. The Washington beltway commodity is the federal tax code as it is bought and sold by the lobbyist, special interests and politician. Hence the growth of “Crony capitalism”.

Today the U.S.A. is infected with “tax cancer”, a deadly spreading evil.

Would you like a solution to all of these problems? Flat taxes and rate changes are not the answers as they still tax jobs and creation, need the IRS with annual tax filing and tax withholding. A flat tax may make it easy to file your income tax, but we have been there before and politicians know and agree the tax system will quickly revert back to its old ways. The value added tax (VAT) is another new tax without eliminating any old taxes. It is called a consumption tax but still taxes businesses and opens up a whole new play ground of taxation for the politicians, lobbyists and special interests. Both the flat tax and the VAT still need the 16th Amendment and are not solutions to the real problems.

America's Big Solution is called the FAIRtax ®, a bill of 132 pages (double spaced) in Congress HR 25 / S 18 that does address all of the problems mentioned above. The new Congress has 45 supporting the FAIRtax (40 House and 5 Senate). The FAIRtax is real “replace and repeal” tax reform. It abolishes all federal personal and business income, gift, estate, capital gains, alternative minimum, Social Security, Medicare and self-employment taxes and replaces them with one simple, visible, federal retail sales/consumption tax – collected by existing state sales tax authorities. The FAIRtax is easy to understand, has no tax loopholes and one tax rate. It collects the same tax revenue with a progressive sales/consumption tax on new goods and services of \$0.23 per dollar. The FAIRtax has only one tax break, called a Prebate that is a monthly tax rebate based on family size. The Prebate helps most the impoverished and lower income and decreases in value as income and wealth increase. The Prebate makes the FAIRtax a progressive tax plan and puts you in control of the amount of tax and tax rate you pay. The FAIRtax promises real long term growth for jobs and the economy. The 16th

Amendment would be repealed with companion legislation. Learn more, join the grassroots cause for real/true tax reform and contribute at bigsolution.org, FAIRtax.org and #FAIRTAX.

The FAIRtax Stimulus Model Results with 10 year growth projections is from \$22 million of private funds for study, research and focus groups to create a solution to our present tax code problems and issues.

FairTax simulation model results

In Years



<i>Cumulative growth over current system</i>	1	2	3	4	5	10
Gross Domestic Product	2.4%	5.2%	7.0%	8.2%	9.0%	11.3%
Employment	3.5%	5.7%	7.0%	7.7%	8.2%	9.0%
Domestic investment	33%	35.4%	36.9%	38%	38.8%	41.2%
Income from employment (wages)	27.4%	31.8%	34.5%	36.4%	37.7%	41.2%
Consumption	2.4%	4.1%	5.8%	7.1%	8.1%	11.7%
Disposable personal income (adjusted for changes in the price level)	1.7%	4.5%	6.4%	7.7%	8.7%	11.8%

Units scaled 2004 GDP = 1.00. Capital and labor set to equal constant shares of 0.3 and 0.7, respectively.

End of submission



Thursday, May 18, 2017

Dear Members of the Ways and Means Committee:

On behalf of 3.2 million activists in all 50 states, I write to express broad support for comprehensive tax reform that will lower rates, simplify the code, and encourage opportunity for all Americans. However, as you begin to consider the details of a tax reform package, I encourage you to consider the serious implications the proposed Border Adjustment Tax (B.A.T.) would have for American consumers and businesses and leave it out of the eventual tax reform package

Under a B.A.T., U.S. companies would no longer be allowed to deduct the cost of imported goods from their tax bill. This, in effect, would slap a new tax on imports at the corporate rate—20 percent under the current House proposal. This would equate to a tax hike of more than \$1 trillion over 10 years.

The proposed B.A.T. would directly harm American industries and consumers throughout the country. A recent study from Americans for Prosperity quantifies how much each state stands to lose. In some states, the tax bill on imports under the Border Adjustment Tax could be double, triple, or even quadruple the amount of all federal income taxes businesses in those states currently pay. Our research has also shown that certain U.S. industries—including manufacturing, energy, and agriculture—are particularly vulnerable to the impact of B.A.T., since they rely heavily on imports and international trade.

Supporters of the B.A.T. will attempt to argue that American consumers will not feel the proposed tax's burden because the U.S. dollar would automatically and fully adjust to perfectly offset the increased cost of imports. This argument, however, is based on textbook economic theory that is highly unlikely to play out in reality, since currency markets are inherently difficult to predict. Foreign exchange analysts have gone so far as to call the idea of a perfect adjustment scenario laughable. The risk is simply too high that businesses and consumers will ultimately shoulder the burden of this proposed trillion-dollar tax.

Comprehensive tax reform must involve reducing economic distortions and loopholes while lowering rates for American individuals and businesses. Unfortunately, including of border adjustability in any tax reform plan would create a new, wide-reaching distortion that would impact all sectors of the economy and every consumer. We urge this committee to eliminate the B.A.T. proposal from any forthcoming tax reform package, and to focus on positive, pro-growth reforms that will deliver much needed tax relief and economic growth.

Sincerely,

Brent Gardner
Chief Government Affairs Officer
Americans for Prosperity

Americans for Prosperity (AFP) exists to recruit, educate, and mobilize citizens in support of the policies and goals of a free society at the local, state, and federal level, helping every American live their dream – especially the least fortunate. AFP has more than 3.2 million activists across the nation, a local infrastructure that includes 36 state chapters, and has received financial support from more than 100,000 Americans in all 50 states. For more information, visit

www.AmericansForProsperity.org.

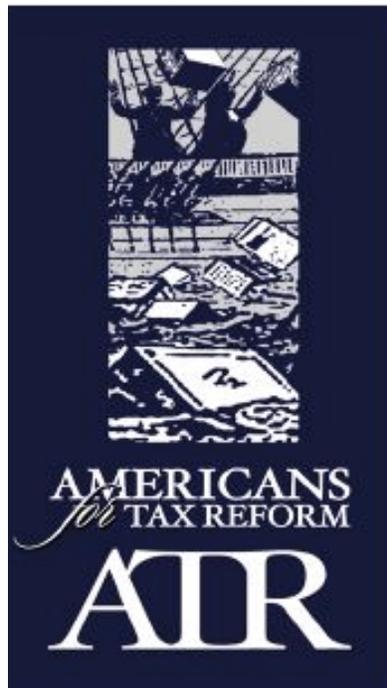
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Statement for the Record –

Ways and Means Committee Hearing: How Tax Reform Will Grow Our Economy and
Create Jobs Across America

Grover Norquist
President, Americans for Tax Reform

May 18, 2017



Over the past decade, the economy has struggled at just two percent GDP growth as the country has experienced the worst recovery in the modern era.¹ While the post-World War II average remains at three percent GDP growth per year, the Congressional Budget Office projects that under current policies, two percent growth will continue into the next decade.² While the unemployment rate has stabilized in recent years, labor force participation has continued to drop, indicating that the economy remains weak.³ Because of this lackluster recovery, families have lost an average of \$8,600 in annual income, according to one estimate.⁴

One reason for the stagnant economy is the fact that the U.S. tax code is outdated, uncompetitive, and complex. The current code restricts the growth of new jobs, increases the cost of capital, and discourages innovation.

It has been more than 30 years since the tax code was reformed, and in that time, the world has changed drastically. Other countries have updated their tax codes and lowered their rates, while the U.S. system has barely changed.

The uncompetitive code means that businesses are unable to compete in the global economy. For instance, our uncompetitive code enables foreign competitors to acquire assets at a far greater pace than American businesses.

Over the past decade, U.S. companies have suffered a net loss of almost \$200 billion in assets. Conversely, if the corporate rate was 25 percent (the average rate in the developed world), one report estimates U.S. businesses would have instead experienced a net gain of \$600 billion in assets over the same period.⁵

Tax reform is the only way to reverse these trends and enact policies that benefit the economy.

Pro-growth reform should reduce taxes on businesses to a globally competitive rate, reduce taxes on capital gains, and eliminate the death tax and gift tax. Tax reform should also allow for full business expensing for new investments, and enact territoriality for individuals and businesses. Changes to the code should be made with an eye toward simplicity and permanency.

Changes to the tax code should not be constrained by concerns over increasing the deficit. Increasing economic productivity by merely one percent over the next decade

¹ [Economic Growth by President](#), Jeffrey H. Anderson, Hudson Institute, August 8th, 2016

² [The Budget and Economic Outlook: 2017 to 2027](#), Congressional Budget Office, January 2017

³ [Labor Force Statistics from the Current Population Survey](#), Bureau of Labor Statistics

⁴ [The 'New Normal'? Part 1: Economic Stagnation](#), Congressional Joint Economic Committee, Oct 05 2016

⁵ [Buying and Selling: Cross-border mergers and acquisitions and the US corporate income tax](#), Business Roundtable, March 15 2015

will strengthen the economy and create \$3.15 trillion in additional federal revenue. Enacting appropriate changes to the code both bolsters the economy and works to reduce the deficit.⁶

Tax Reform Should Reduce Taxes on Businesses: Today, American businesses are taxed at rates far above foreign competitors. The average federal/state corporate tax rate in the U.S. is roughly 39 percent, while the average rate paid by foreign competitors is about 25 percent.⁷ Businesses organized as pass-through entities face rates even higher – above 40 percent, and even 50 percent when state tax rates are accounted for.⁸

While the U.S. rate remains high, other countries have adapted to the global changes by aggressively reducing their rates. Today, only the U.S. and Chile have higher corporate tax rates than they did at the start of the century.⁹

These outdated rates affect the entire economy. People, not businesses, pay taxes, so high business rates are directly absorbed by employees, consumers, and investors through lower wages, fewer jobs, and stagnant economic growth.

For instance, a 2006 CBO report found that roughly 70 percent of the corporate tax cost is borne by labor alone.¹⁰ Similarly, a report by scholars at The American Enterprise Institute found that every dollar increase in corporate taxes decreases wages by two dollars.¹¹

Tax Reform Should Reduce Capital Gains Taxes: The tax on capital gains and dividends is levied on after tax income that has been reinvested in the economy to increase productivity, grow jobs, and increase wages. The U.S. integrated capital gains tax¹² remains one of the highest in the world, which discourages investment, raises the cost of capital, and ultimately suppresses economic growth.

Tax reform should seek to preserve the base of the capital gains tax. Often, the Left argues that the capital gains tax is a “loophole,” and calls for eroding the tax bit by bit through increasing taxes on carried interest capital gains. In truth, carried interest is no different from other types of capital gains income. Increasing taxes on carried interest – or any type of capital gain – would not only hinder economic growth, but would directly

⁶ [The Budget and Economic Outlook: 2017 to 2027](#), Congressional Budget Office, January 2017

⁷ [Corporate income tax rate](#), OECD (Organization for Economic CO-Operation and Development)

⁸ [Pass-Through Businesses: Data and Policy](#), Scott Greenberg, Tax Foundation, January 17, 2017

⁹ [Tax Reform Advancing America in the Global Economy](#), Business Roundtable, October 2015

¹⁰ [International Burdens of the Corporate Income Tax](#), William C. Randolph, Congressional Budget Office, August, 2006

¹¹ [Spatial Tax Competition and Domestic Wages](#), Kevin A. Hassett and Aparna Mathur, American Enterprise Institute, December 1, 2010

¹² [Corporate dividend and capital gains taxation: A comparison of the United States to other developed nations](#), Alliance for Savings and Investment, April 2015

impact pension funds, charities, and colleges that depend on investment partnerships as part of their savings goals.¹³

Tax Reform Should Implement Immediate Full Business Expensing: Under the tax code, business owners cannot immediately expense the cost of purchasing equipment against their taxable income. Instead, they are required to deduct, or “depreciate,” these costs over several years depending on the asset they purchase, as dictated by complex and arbitrary IRS tables. These rules create needless complexity and increase compliance costs.

They also force business owners to make decisions based on tax reasons over business reasons. In contrast, a move toward full expensing of assets will streamline business activity by allowing the efficient purchase of new assets. According to estimates by the Tax Foundation, allowing immediate expensing of assets increases GDP by five percent after a decade and increases wages by 4 percent.¹⁴

Tax reform should also be sure not to change the code in a way that erodes the progress made by moving toward full business expensing. For example, lawmakers should preserve section 1031 “like-kind exchanges,” for land assets as a complimentary provision to expensing.¹⁵ Similarly, the ability to deduct advertising costs as a necessary business expense should be maintained. Going in the other direction by limiting this expense would create new distortions in the tax code.¹⁶

Tax Reform Should Simplify the Code: Tax reform should be made with an eye toward simplifying compliance for taxpayers. Today, the code is more than 75,000 pages long and contains over 2.4 million words. This complexity forces American families and businesses to spend¹⁷ more than 8.9 billion hours and \$400 billion complying with the code every year. In the last 30 years, the code has more than tripled in size.

In addition to implementing policies that increase growth, tax reform should cut taxes for individuals. Rates should be reduced, and credits and deductions should be consolidated and streamlined.

¹³ [Lawmakers Should Oppose Efforts to Increase Taxes on Carried Interest Capital Gains](#), Alexander Hendrie, Americans for Tax Reform, May 10, 2017

¹⁴ [Long Run Growth and Budget Effects of the Expensing Provision in the House Republican Tax Reform Blueprint](#), Stephen J. Entin, Tax Foundation, February 2, 2017

¹⁵ [Like-kind Exchanges Should Be Preserved as Part of Any Tax Reform Plan](#), Alexander Hendrie, Americans for Tax Reform, December 6, 2016

¹⁶ [Tax Reform Must Preserve the Deduction for Advertising Costs](#), Alexander Hendrie, Americans for Tax Reform, February 17, 2017

¹⁷ [Americans Will Spend 8.9 Billion Hours, \\$409 Billion Complying with U.S. Tax Code in 2016](#), John Buhl, Tax Foundation, June 15, 2016

Tax Reform Should Make Permanent Changes to the Code: Where possible, changes to the code should be permanent, not temporary. Permanency should be a goal of tax reform for two reasons.

First, permanency gives certainty for taxpayers who do not need to be concerned that their taxes will rise in a years to come. Certainty means a business owner can plan ahead to invest without concern for their ability to afford the investment and cash flows in the future.

Second, permanent tax policies mean that low-tax advocates do not need to continually devote political capital to ensure tax cuts remain law. Congress already struggles (or fails) to complete its basic annual duties. Relying on federal legislators to renew tax cuts every couple of years is a recipe for disaster.

This does not mean every change in tax reform has to be permanent. However, there is a clear need to make as much of tax reform concrete to ensure stability for Americans.

Tax Reform Should Move to Territoriality for Businesses and Individuals: Today, the U.S. is only one of six modern countries with a worldwide system of taxation. Because of this system, American businesses operating overseas are double taxed on income – once when they earn it in the country they are operating in, and again when they bring this money back into the U.S. economy.

This means that American businesses are faced with a disadvantage relative to their foreign competitors, which endure only one layer of taxation.

The worldwide system has also resulted in an estimated \$2.6 trillion¹⁸ in after tax income being stranded overseas. Moving to territoriality with a reasonable one time repatriation as a phase in will result in this money being brought back into the economy to be reinvested in jobs and wages, and providing higher federal revenues.

One way to end this disadvantage would be moving to a border adjustable tax system. This would guarantee that business activity is taxed only where the product is consumed. Exports that are consumed by individuals outside the country are not taxed, while imports consumed by individuals inside the U.S. are.

Just as American businesses operating overseas are forced to comply with the outdated and burdensome worldwide system of taxation, individuals living overseas are forced to comply with the system of citizenship-based taxation. This means that regardless of

¹⁸ [Thomas A Barthold](#), Letter to Congress from The United States Joint Committee on Taxation, August 31, 2016

where U.S. citizen lives, they must comply with IRS rules and are double taxed on income.

The current citizen-based system effects an estimated 8.7 million Americans that live and work overseas.¹⁹ This system is nearly unique to America – every other country in the world with the exception of Eritrea has residence-based taxation.

Implementing a residence-based taxation system would ensure individuals are taxed based on their location of residence. This would make tax compliance far simpler, and reduce the reach of the IRS. It would also make the extremely burdensome Foreign Account Tax Compliance Act (FATCA) obsolete.

Tax Reform Should Kill the Death Tax and Gift Tax: The death tax is unfair, hurts economic growth, and is extremely unpopular with the American people. It is a tax paid on savings that have already been taxed at least once, and potentially more than once. Furthermore, those who are hit hardest generally are first and second generation small business owners, because the truly wealthy can avoid the tax through an army of accountants, attorneys, and charitable planners.

Repeal of the death tax must also mean repeal of the gift tax. With the death tax gone, the gift tax, which was created as a backstop to the death tax, is no longer necessary. If the gift tax were left in place after repeal of the death tax, it would raise little, if any revenue because a taxpayer would simply wait to transfer their assets until they died. In contrast, repealing the gift tax along with the death tax would serve as a backstop to ensure the death tax is gone for good.

Together, the death tax and gift tax collect very little revenue and suppress economic growth. In 2015, both taxes collectively brought in \$19.2 billion. The federal government brought in a total of \$3.25 trillion, so coupling these taxes together contributes to less than 0.6 percent of all federal revenue.²⁰

Repealing the death tax and gift tax would produce strong growth that would in turn offset this lost revenue. After macroeconomic effects, repeal of both taxes would reduce total revenues by just \$19 billion over the entire first decade.²¹

¹⁹ [8.7 million Americans \(excluding military\) live in 160-plus countries](#), The Association of Americans Resident Overseas

²⁰ [Historical Tables](#), Obama White House Archives, Table 2.5—Composition of "Other Receipts": 1940–2021

²¹ [Modeling the Estate Tax Proposals of 2016](#), Alan Cole, Tax Foundation, June 14, 2016



May 17, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

Dear Chairman Brady, Ranking Member Neal and Members of the Committee:

I write you on behalf of the Association for Corporate Growth (“ACG”) and its 14,500 members, who are all dedicated to advancing policies that enable middle-market businesses grow and succeed. ACG’s members sincerely appreciate your efforts to solicit legislative proposals designed to increase economic growth. Two critical proposals that ACG believes will help consumers, market participants, and financial companies responsibly participate in the economy in a more effective and efficient manner, ultimately leading to overall economic growth, are outlined below.

Background:

I. Middle Market

The middle market is broadly defined to include companies with annual revenues between \$10 million and \$1 billion¹. Overall, these middle market companies are responsible for one-third of private employment in the United States, amounting to nearly 44.5 million jobs. If it were to be a stand-alone economy, the middle-market would rank fifth in the world.² Fewer than 200,000 companies make up the middle-market ecosystem and create over \$10 trillion in combined revenues annually.

II. Association for Corporate Growth

ACG was founded in 1954 and has more than 14,500 members with 45 chapters located within the United States and additional reach in Canada, Europe and China. ACG members are focused on investing, owning, advising or lending to middle-market companies across the United States. This includes professionals from private equity firms, corporations, banks and other lenders to middle market companies, as well as professionals from law firms, accounting firms, investment banks and other advisors to middle-market deal making.

The mission of ACG is to drive middle-market growth. ACG helps to facilitate growth by bringing together middle-market dealmakers and business leaders. ACG accomplishes this by hosting hundreds of events every year, providing online tools for its members, structuring networking opportunities and providing leading-edge market intelligence and thought leadership.

¹ See National Center for the Middle Market (last accessed May 17, 2017), <http://www.middlemarketcenter.org/about-the-middle-market-center> (showing the National Center for the Middle Market’s purpose is to “ensure that the vitality and robustness of Middle Market companies are fully realized and fundamental to our nation’s economic outlook and prosperity”).

² See, <http://www.middlemarketcenter.org/>

III. Middle Market Private Equity

A particular focus of ACG is middle-market private equity (MMPE). ACG's membership includes over 1,000 private equity firms that specialize in the middle-market. Middle-market private equity firms invest in small and midsize businesses. According to Preqin data, private equity deals under \$500 million accounted for 82 percent of all deals in 2016.³

In 2015, ACG updated its ground-breaking research survey using multiple independent databases to better understand the positive impact that private capital investment has on corporate growth and job creation in the United States.⁴ The research found that between 1998 and 2015:

- Private equity-backed companies grew jobs by 70.2 percent, while all other companies in the U.S. economy grew jobs by 23.7 percent;
- Private equity-backed companies grew sales by 83.7 percent, while all other companies in the U.S. economy grew sales by 25.8 percent; and
- Middle-market private equity-backed companies were responsible for well over three-quarters of the job growth created by private equity.⁵

Almost half of all private equity investment comes from pension funds, foundations and university endowments. These investors have realized a 10-year annualized return in excess of 10 percent and superior to all other asset classes⁶, helping enable these organizations to meet their ongoing obligations. MMPE firms provide this rate of return by improving the operational efficiency, governance, and market strength of the companies in which they invest.

These data points are among the reasons that private equity continues to attract the investment and trust of highly demanding, sophisticated investors.

Proposals:

I. Preserve Interest Deductibility on Corporate Debt

The tax deduction of interest paid on corporate debt has been an essential component of the tax code for over 100 years. Corporations use debt financing as a means of accomplishing everything from running day-to-day operations to pursuing growth. The ability to deduct interest on debt has been responsible for making capital affordable, helping to provide much needed liquidity to our capital markets. The removal of this important provision in the tax code would hurt America's status of having the most attractive capital markets in the world.

The preservation of the tax deduction on corporate debt is of utmost importance to small and mid-sized businesses. Large corporations are able to issue equity and bonds as a means to raise capital; small and mid-sized companies have comparably fewer options, making debt financing essential. Many businesses

³ Global Buyout Deals Set for Record Year in 2016 (2017), <https://www.preqin.com/docs/press/Buyout-Deals-2016.pdf>.

⁴ Driving Growth: The Impact of Middle-Market Private Equity on the U.S. Economy, Growth Economy (2016), <http://www.growtheconomy.org>.

⁵ See *Id.*

⁶ Global Buyout Deals Set for Record Year in 2016 (2017), <https://www.preqin.com/docs/press/Buyout-Deals-2016.pdf>.

may take on debt at the beginning of the fiscal year to finance operations, and have that debt fully paid off by the end of the same year.

Nor does the proposed replacement of full and immediate expensing of capital expenditures provide a reasonable replacement for the interest deduction. If a corporation cannot afford a piece of equipment in the first place, the ability to fully expense the piece of equipment will provide no material benefit or incentive to expand one's company. 75 percent of start-ups use some sort of debt financing at inception, and four in five small businesses use some form of debt in their capital structure.⁷

The maintenance of interest deductibility is essential to sustained U.S. economic growth. A 2013 study by Earnest & Young's Quantitative Economic and Statistics group revealed that limiting interest deductibility to finance lower tax rates reduced long-run economic growth by \$33 billion in 2013 dollars. The study shows that all industries and all states will see reductions in economic growth as a result of this crucial element of the tax code being repealed.⁸

II. Lower the Corporate Tax Rate

The statutory corporate tax rate in the United States is 35 percent, with an average combined (federal and state) rate of 39.1 percent. Global competitors, on the other hand, have a combined average rate of 25 percent,⁹ making America's current corporate rate the second-highest in the world – a significant competitive disadvantage. This is of concern to companies in the middle market as they are neither provided with the tax incentives many small businesses are, nor are they able to allocate the resources necessary to have a large team devoted to parsing through the onerous and complex tax code.

ACG recommends a simpler and fairer tax environment for middle market businesses and capital providers and lowering of the corporate tax rate. This will lead to continued job growth, business creation and investment in companies of all sizes.

Conclusion:

ACG appreciates the opportunity to provide recommendations to the House Ways and Means Committee on how to encourage economic growth and welcomes the opportunity to discuss further any of the issues addressed in this letter. If you have any questions, or if we can provide any additional information, please feel free to contact me directly at cmelendes@acg.org or at (312) 957-4277.

Sincerely,



Christine Melendes
Vice President, Events, Partnerships and Public Policy
Association for Corporate Growth

⁷ Why Businesses Use Debt – And How Debt Benefits Businesses (2017), http://buildcoalition.org/wp-content/uploads/2013/06/BUILD_WhyBusinessUseDebt_RebelCole.pdf

⁸ Macroeconomic analysis of a revenue-neutral reduction in the corporate income tax rate financed by an across-the-board limitation on corporate interest expenses (2013), <http://buildcoalition.org/wp-content/uploads/2013/07/EY-Build-Study-July-2013.pdf>

⁹ CBO International Comparisons of Corporate Income Tax Rates (2017), <https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52419-internationaltaxratecomp.pdf>

I, ROBERT D. REIMERS, OFFER COMMENTS ON BEHALF OF BASIN ELECTRIC POWER COOPERATIVE TO THE COMMITTEE ON CERTAIN PROVISIONS IN THE REPUBLICAN HOUSE BLUEPRINT FOR INCOME TAX REFORM ISSUED JUNE 24, 2016 "A BETTER WAY--OUR VISION FOR A CONFIDENT AMERICA"

Beneficial Tax Provisions for Taxable Generation and Transmission Electric Cooperatives

- The Unlimited NOL carry forward proposal is helpful. However, the proposed annual limitation on the use of NOLs to 90% of taxable income should be eliminated. All electric cooperatives operate on a not-for-profit basis in which our patrons supply capital to the cooperative in the form of margins which are returned to the patron over time thereby achieving not-for-profit operation. There is no accession to wealth from patronage income. Under existing tax law, patronage dividends are taxed once at the patron level. This approach must be maintained in order to avoid the potential for double taxation. Creating taxable income from patronage income, which must be returned to the patron over time, is contrary to cooperative tax law as it has existed for many decades. If this limitation were applied it would contradict the longstanding legal principles that exclude patronage allocations from taxation at the cooperative level.
- The proposed reduction in the corporate tax rate to 20% is helpful and should be retained.
- The proposed elimination of the corporate Alternative Minimum Tax is helpful but any AMT Credit carryovers experienced to date should be refunded to the G&T cooperative; otherwise, the government would be effectively receiving a net benefit in the form of the "lost" credit carry-overs.

Provisions Harmful to Taxable Generation and Transmission Electric Cooperatives

- Limiting Interest Expense to Interest Income. While this approach may seem logical, it really only works for a financial entity which leverages investment capital for profit. Consider the implications to entities which are capital intensive with debt financed physical assets such as generation and transmission electric cooperatives. In order for the tax law to properly reflect the economic reality of a taxable generation and transmission cooperative, a full deduction for interest expense incurred to invest in new and expand existing electric infrastructure should be allowed. Additionally, interest income is ancillary and limited, at best, to electric generation and transmission cooperatives. Our patrons depend upon our capital assets and improvements to the electric power infrastructure to keep their rates affordable and their electric service reliable. The American not-for-profit electric cooperative business model is unique, and serves the vast majority of the nation's persistent poverty counties (327 out of 353, or 93%). These counties have deeply entrenched poverty with rates consistently 20% or above for the last three decades. In all, one-in-six of the 42 million Americans served by cooperatives live below the poverty line, many of them in these counties. See, for example, <http://www.ers.usda.gov/topics/rural-economy-population/rural-poverty-well-being/geography-of-poverty.aspx>. It is imperative that we ensure our patron's costs are kept as low as possible and allowing the continued deduction for interest expense would ensure that taxable income is not created which does not reflect the economic income of the taxable generation and transmission cooperative.
- Requiring the write-off of assets in the year purchased or constructed. This provision could only work for taxable generation and transmission cooperatives if there was an unlimited NOL carry forward. Typically, our assets are depreciated over 40-60 years for financial reporting purposes. An unlimited NOL carryover would allow a mechanism to match the financial book depreciation period to the immediate tax write off proposed and also if this provision is dropped would fix the issue that currently exists with a mismatch of the depreciable lives. It is important for intergenerational equity that depreciation over the economic lives of our assets be included in rates so our patrons are charged the appropriate costs for their use of the electric assets of the cooperative during the period in which they take service. An immediate tax write off of capital assets without an unlimited NOL carry over would cause significant economic distortion and create the potential for patrons to be treated differently and their costs to vary greatly depending on which years they are taking service.



5/26/2017

The Honorable Kevin Brady.
Chairman, House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady:

Thank you for the opportunity to submit testimony in support of excise tax reform for the alcohol beverage industry as part of your May 18th, 2017 hearing on how tax reform will grow our economy and create jobs across America. This important hearing was a great way to continue the dialogue about comprehensive tax reform.

Since the Craft Beverage and Modernization and Tax Reform Act was introduced in the 114th Congress, the bill has received favorable comment in public hearings in the House Ways and Means Committee, the Senate Finance Committee, and the House Small Business Subcommittee on Economic Growth, Tax, and Capital Access. This legislation was reintroduced earlier this year as H.R. 747/S. 236 and already enjoys strong bipartisan support from 192 members of the House and 45 members of the Senate.

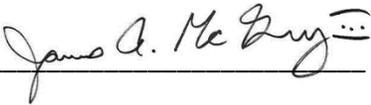
Every congressional district in the United States includes a brewery, winery, distillery, importer, or industry supplier. While these businesses are often cornerstones of their communities, they are laboring under outdated regulations and unreasonably high tax rates that impede their growth.

The alcohol beverage industry remains one of the most regulated and taxed industries in America. Brewers, winemakers, and distillers pay state, local and federal taxes on their production. Federal excises taxes, which are regressive taxes, are simply too high. The compromise agreement to H.R.747 would recalibrate and simplify federal excise taxes for brewers, importers, winemakers, and distillers. It would also update and streamline outdated regulations.

The excise tax relief and regulatory reforms embodied in H.R.747/S.236 have earned support from throughout the U.S. hospitality, manufacturing, and agriculture sectors. This broad, bipartisan, bicameral support signifies how important excise tax relief is to many in Congress. We hope that the House and Senate make will excise tax relief a priority as they consider tax reform in the 115th Congress.

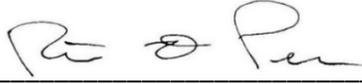


Sincerely,



Jim McGreevy, President & CEO

Beer Institute



Bob Pease, President & CEO

Brewers Association



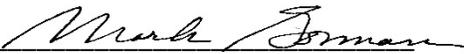
Robert P. "Bobby" Koch, President & CEO

Wine Institute



James Trezise, President

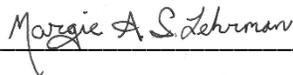
WineAmerica



Mark Gorman, Senior Vice President

Government Relations

Distilled Spirits Council



Margie A.S. Lehrman, Executive Director

American Craft Spirits Association



BIPARTISAN POLICY CENTER

May 16, 2017

The Honorable Kevin Brady
Chairman
U.S. House Committee on Ways and Means

The Honorable Richard Neal
Ranking Member
U.S. House Committee on Ways and Means

Submitted electronically to waysandmeans.submissions@mail.house.gov

Dear Chairman Brady and Ranking Member Neal:

The Bipartisan Policy Center (BPC) requests that following report on *Reforming the Taxation of Pass-Through Businesses*, be entered into the hearing record for the May 18, 2017, hearing on How Tax Reform Will Grow our Economy and Create Jobs.

Sincerely,

G. William Hoagland
Senior Vice President
Bipartisan Policy Center

Executive Summary

The Trump administration and Congress are actively developing tax reform legislative proposals. One key issue policymakers will address is how to reform the tax treatment of pass-through businesses. Pass-through businesses are businesses, large and small (including S Corporations, partnerships, LLCs, and sole proprietorships), where the business itself does not pay tax but instead where taxes are paid directly by the individual owners of the business.

In this type of business structure, income, credits, and deductions realized by the businesses “pass through” to the individual owners, who pay tax on that income according to the tax rates and brackets on the individual side of the tax code, as opposed to the rate for C corporations. Thus, if tax reform eliminates or curtails business-related credits or deductions and does not provide them with a corresponding reduction in the tax rates, these types of businesses could experience a significant tax increase.

In 2013, the latest year for which IRS statistics are available, 3.6 million partnerships and 4.3 million S corporations filed tax returns. This compares with 5.9 million C corporations who filed tax returns that year.ⁱ These pass-through businesses include small start-ups and mom-and-pop businesses that represent the entrepreneurial spirit of the U.S. economy. How pass-through businesses are treated in any tax reform agenda is critical to the future of American business.

This paper provides a menu of options policymakers could consider when reforming the taxation of pass-through businesses. This paper does not assume that the tax rates for pass-through businesses have to be identical to those applied to income earned by individuals unrelated to the pass-through business. These options attempt to balance the desire to avoid tax increases on pass-through businesses while also ensuring that pass-through businesses do not become a means for wealthy individuals to avoid tax on income that should be properly subject to tax at individual tax rates. These options include:

- Limiting what types of businesses or business activity could benefit from lower tax rates on pass-through businesses;
- Creating incentives for the owners of pass-through businesses to reinvest profits into the business; and
- Rules to limit the total amount of income that could qualify for a lower pass-through rate.

Introduction

The Bipartisan Policy Center engaged in a yearlong examination of the issues surrounding corporate- and business-tax reform. BPC’s goal throughout has been to increase and enhance the competitiveness of U.S. companies and workers, increase economic growth, and thereby increase job creation, wage growth, and investment.

This paper, which results from that effort, focuses on one aspect of business-tax reform: pass-through businesses. It is intended to identify the issues that must be confronted by policymakers when integrating corporate-tax reform with pass-through entities. It also provides policymakers with a range of options for addressing this integration as they reform the business aspects of the U.S. tax code.

The project focused on reform of the business-related aspects of the tax code and therefore is not dependent on tax reform that might make changes to the individual code. In addition, when considering the various policy options, it is necessary to be able to consider them in the context of what the current tax rate on C corporations would be after reform. For the purposes of this paper, BPC has assumed a post-reform corporate-tax rate of 25 percent.ⁱⁱ

It is assumed that the revenue loss associated with lowering the corporate rate to the post-reform rate of 25 percent (an estimated reduction in tax revenues of approximately \$1.2 trillion over ten years) would be offset, at least in part, by broadening the tax base.ⁱⁱⁱ This would be accomplished through the elimination or curtailment of credits, deductions, and other policies that businesses currently use to lower their effective tax rates. Because BPC’s work focused on business-tax reform, it does not assume changes in individual tax rates. Therefore, any broadening of the tax base would increase the pass-through businesses’ tax liability, without any offsetting benefit of a reduction in tax rates.^{iv}

This paper describes a series of options for addressing broad policy issues to ensure pass-through businesses are not made less competitive by tax reform that does not simultaneously lower individual rates.

Proposed options for four broad policy questions:

1. What tax rate should be applied to pass-through businesses?
2. What types of business activity should qualify for the pass-through tax rates?
3. What share of qualifying income should benefit from the pass-through tax rates?
4. What policies should be included to prevent abuse and simplify administration of the reformed code?

This paper also concludes with a discussion of other related policy changes that could be incorporated into the integration process.

Question 1: What Tax Rate Should Be Applied to Pass-Through Businesses?

Options for Tax Rates for Pass-Through Businesses

Effective Federal Marginal Tax Rates

BPC's work on business tax reform does not assume the elimination of the existing second layer of tax on corporate income that results from the taxation of dividends. As a result, the effective tax rate on corporate income paid out to shareholders may be higher than the 25 percent assumed in this paper, as this income is still subject to taxes on dividend income received by shareholders. Pass-through entities, which are not subject to corporate tax at the entity level, do not face this double-tax situation. As a result, policymakers may consider that full parity between the corporate rate and the maximum rate on the business income of pass-throughs is not essential.

Analysis by the Treasury Department has found that under current law, C corporations face an effective federal marginal tax rate of approximately 30 percent, while pass-through entities face an effective tax rate of approximately 25 percent.^v (This analysis does not include state corporate tax rates that can increase the effective marginal tax rate.) In a similar analysis, the Congressional Budget Office found that C corporations in 2014 paid an effective rate of 31 percent, while pass-throughs paid an average rate of 27 percent. Thus, because pass-throughs are not burdened by the double tax, currently their marginal rates are effectively between 4 and 5 percentage points lower than those for corporate-rate taxpayers. As a result, pass-throughs could be subjected to a somewhat higher tax rate than C corporations and still be effectively on parity with the effective tax rate for C corporations.

Interaction with Progressive Individual Tax Rates

In addition, under current law, pass-throughs receive the benefit of the lower individual tax rates (relative to the rate for corporations) that apply at lower income levels.^{vi} Thus, some amount of income is taxed at rates much lower than the current C corporation rate of 35 percent. If pass-through entities are provided with a lower rate on qualifying income, policymakers could choose to maintain pass-throughs' access to the lower individual rates.

For example, if the maximum pass-through rate were 28 percent, pass-throughs could be taxed at the lower rates of 10, 15, and 25 percent on income below \$190,151—the threshold for entry into the current 33 percent bracket. Allowing pass-throughs access to these lower rates would reduce the effective rate of taxation.^{vii} Alternatively, pass-throughs could be subjected to one flat rate on all their business income, in a manner analogous to how various tax-reform proposals would treat C corporations.

For purposes of this options paper, as previously stated, BPC assumes that corporations would be subject to one flat rate of 25 percent. Therefore, policymakers should consider whether applying one flat rate could result in some small pass-through entities facing a tax increase. For example, a pass-through owner who had taxable income of \$100,000 would face an effective tax rate of approximately 21 percent if filing as an individual and approximately 19 percent if filing a joint return. Both are below 25 or 28 percent under current law. Thus, the application of one flat rate would result in a tax increase, even before the impact of any base broadening.

“Claw Back” of High-Income Pass-Throughs

If policymakers are concerned about the revenue loss or distributional consequences associated with permitting pass-through entities to maintain access to the lower rates, policymakers could include a “claw-back” option for high-income pass-throughs.^{viii} A claw-back provision would recapture the benefit of the lower rates for pass-throughs with income over a certain threshold. Such a policy could be implemented in a way that protects smaller pass-through entities from tax increases that would result from the loss of access to the lower rates. For example, the phase-out could be implemented in a way that does not increase the effective tax rate for pass-throughs with taxable income below the top pass-through rate. At the same time, this policy would reduce the overall revenue loss from the new top pass-through rate by limiting the benefit of the lower rates for high-income pass-throughs.

Question 2: What Business Activity Should Qualify for The Pass-Through Rate?

Options for Determining What Business Activity Qualifies for Lower Pass-Through Business Rates

When creating a separate tax rate structure for pass-throughs, policymakers must also identify what type of activity is eligible for the separate rate structure. Conceptually, policymakers may wish to permit only certain types of income directly related to the business activity of the pass-through business to benefit from the separate rate structure. In particular, they may want to limit the access to the lower rates to only what policymakers would consider *non-labor income*, which would result in the lower rate applying only to income that is generally analogous to the types of income that would benefit from a reduction in the corporate tax rate.

As noted, policymakers may wish to treat certain types of activity, regardless of whether it’s related to a pass-through or a C corporation business, the same when the individuals engaging in that activity would typically be taxed under the individual side of the tax code. For example, the provision of certain services can be done through both pass-through and C corporation businesses. Policymakers may wish to ensure that the individuals providing such services are taxed in the same manner. These types of activity include, among others, legal and accounting services where individuals provide the same types of service in both pass-through and C corporation businesses, but in the context of the pass-through businesses, the individuals may also be the owners of the business. If these types of activity were eligible for the pass-through tax rates, the income of the pass-through owners would qualify for the same pass-through rates.^{ix}

Policymakers, therefore, could limit access to the separate pass-through regime by excluding certain types of activity from qualifying. For example, they could exclude income arising from the provision of personal services from qualifying for the lower pass-through rates. Such personal services are already defined in the tax code as any activity performed in the fields of health, law, engineering, architecture, accounting, actuarial science, architecture, performing arts, or consulting.^x

Also, policymakers could limit the type of income that qualifies by prohibiting passive income, from investments or other sources, from qualifying for the pass-through tax rates.^{xi} Income from such sources as royalties, rents, dividends, and interest would therefore be excluded from qualifying. Such a limitation would focus the benefits of the pass-through tax rates on active income.

Alternatively, policymakers could specify what types of income qualify, with all other income not qualifying for the pass-through rates. For example, policymakers could determine that only certain manufacturing income would qualify. They could limit the benefits of the pass-through structure to only activity that currently qualifies under the Section 199 deduction for manufacturing.^{xii} There is

considerable precedent as to what types of activity qualify for Section 199, thereby making the administration of the separate rate easier. In contrast, however, there are several different types of business activities that would not qualify for Section 199, such as retail businesses that are generally considered “small businesses.”

Policymakers could develop additional definitions to Section 199, such as for retail establishments. The Census Bureau maintains a definition of what qualifies as retail sales for the purpose of reporting on economic indicators.^{xiii}

Question 3: What Share of Qualifying Income Should Benefit from The Pass-Through Rates?

Options for Determining What Share of Qualifying Income Benefits from the Lower Pass-Through Rates

In addition to determining what types of income can qualify for the separate pass-through rate, policymakers can also make determinations as to the amount of such income that can qualify. Determining how much income can qualify is predicated on policymakers’ goals for how the separate rate would impact taxpayer behavior. For example, if policymakers have a goal of encouraging pass-through owners to invest more in their company, then rules would be designed to encourage that activity. However, if they wish to reduce administrative complexity, they might permit all the qualifying income to benefit from the pass-through tax rate.

In addition, a certain amount of the income earned by the business owner is likely compensation for work performed by the owner, as opposed to a return on the owner’s capital. Therefore, some share of the income may be better qualified as analogous to wages or salary and therefore taxed at the regular individual tax rates. Under current law, notions of “reasonable compensation” apply for S corporations. In this circumstance, the owner is required to receive a reasonable amount of compensation to ensure that income that is more accurately considered labor income is taxed at individual rates and therefore subject to payroll taxes. That same concept can be applied in a separate rate structure for pass-throughs.

From a design standpoint, policymakers can approach this question by distinguishing between income and assets. An income-based approach may be less complicated to administer but also less likely to create incentives to reinvest in the business. An asset-based approach would more directly tie to incentives for the owner to increase their capital investment in the business, but it would also be more complicated to account and administer.

Income-Based Approach

An income-based approach is less complex, and potentially, one structure could be applied to all types of pass-through entities. Under this approach, the pre-tax profit of the entity that is attributable to the owner based on their share of ownership in the entity would be eligible for the pass-through tax rates. Thus, if an S corporation has four owners each with an equal share in the company and the pre-tax income of the entity is \$1 million, then each owner would be able to qualify an amount up to \$250,000 for the pass-through tax rates.

Policymakers could further limit the amount of income that qualifies by limiting the share of qualifying income to a ratio equivalent to income reinvested in the business by the owner or by imposing other explicit ratio limitations to be discussed below.

Policymakers could limit the benefit of the pass-through tax rates in circumstances where the business is in a loss position by prohibiting the owners from applying their share of those losses to other, non-qualifying income. In such a circumstance, the losses could be carried forward as a net operating loss applied against future positive qualifying income.

Asset-Based Approach

Using an asset-based approach to determine the share of income qualifying for the pass-through rate, the income associated with the return on contributions of capital by the owner of the pass-through entity would determine the amount of income that qualifies. Income

associated with the return on labor or services provided by the owner of the pass-through could continue to be taxed at the regular individual rates.

Each of the types of pass-through entities—for example, S-Corp, partnerships, LLC, sole properties—have existing rules and structures that can be used as the basis for measuring the amount of return on capital invested by the owner in the business. One asset-based policy that is common to all forms of pass-throughs requires that any capital—in the form of property, equipment, equity, etc.—contributed to the business by an owner be valued according to fair market value at the time of the contribution. Any built-in gain at the time of the contribution would therefore be included in the valuation.

S Corporations

S corporations present a special case for determining the share of income qualifying for pass-through rates when using an asset-based approach for valuation. In an S corporation structure, the owners receive stock in the company. This stock forms the basis of the owner's share of the corporation. Stock is received in exchange for contributions of capital, including property. The owner's basis (i.e., the value at the time of contribution) in the stock changes over time based on earnings, distributions, and depreciation. One policy option would be to use the value of the owner's stock (i.e., outside basis) in the S corporation as the metric for tracking the amount of, and return on, capital contributed and owned by the individual owner.^{xiv} Such an approach would likely require some businesses that currently do not closely track the value of their stocks to begin doing so. It may also require companies to clearly establish basis value at the time of the new tax structure.

This structure could be applied on a prospective basis only and require the owner to have identified and documented the value of their basis before being able to qualify income for the separate rate structure. Policymakers could also require that the owner's basis in the pass-through be positive before any income could qualify for the pass-through rate. Thus, capital invested to return the owner's basis to a positive basis would not be included in the calculation as to how much of the owner's income is eligible for the pass-through rate.

The net change in basis at the end of a specified period would determine the amount of income received by the owner that qualifies for the pass-through rate. This rate would be applied to the share of the individual's ownership in the S corporation. In order to smooth out volatility, the change could be averaged over more than one year. For example, assume that after year one the owner's basis increased by 20 percent, at the end of year two the owner's basis declined by 10 percent, and at the end of year three the owner's basis increased by 8 percent. Over the three-year period, the owner's basis increased by an average of 6 percent. Thus, the owner could qualify 6 percent of any income for the pass-through rate.^{xv}

The change in basis could be calculated more simply. The owner's initial basis in year one is \$1 million. In year two, the owner contributes \$200,000 in new capital. In year two, the owner's share of the depreciation is \$50,000. The net change in capital (new capital less depreciation) is \$150,000. So, the percentage applicable for that year would be 15 percent ($150,000/1 \text{ million} \times 100 = 15 \text{ percent}$).

This 15 percent would be used to determine the share of the owner's income from the pass-through that would be subject to the pass-through rate. Assuming the pass-through owner keeps access to the lower individual rates (as discussed in the prior section) this ratio would apply only to the share of income above the threshold for the top pass-through rate. For example, assuming the pass-through rate is 28 percent, the 15 percent ratio would be applied to any income received in excess of \$190,151, the entry point of the 33 percent bracket for single filers. In this tax structure, if the owner's basis in the company declines year over year, the owner could not qualify any income for the pass-through rate.

Further, policymakers could limit this tax structure only to owners who have contributed capital to the corporation regardless of the owner's status as an active or inactive participant. Thus, passive owners who do not contribute capital to the business would not be eligible for the pass-through rate. In the case of ownership in an S corporation where the owner's share was a gift, policymakers could apply existing carryover rules under current gift rules. This would effectively reduce or eliminate any basis in the S corporation the recipient of the gift could claim. If policymakers took this approach, it would create a strong incentive for the new owner to invest new capital into the business in order to obtain the basis used to qualify income for the pass-through rate.

Partnerships and LLCs

Unlike S corporations, partnerships already have a formal structure for tracking the partner's ownership interest and capital contributions to the partnership—the partner's capital account. This account tracks the partner's capital contributions to the partnership, profits and losses earned by the partnership, and any distributions paid to the partner. Thus, the partnership capital account can serve as a reasonable measure of the amount of capital invested by the partner and the return to that investment.

The percentage change in the partner's capital account from one tax year to the next or calculated as an average of a set period could serve as the percentage of the partner's distribution that qualifies for the pass-through rate. Any remaining distribution would be taxed at individual rates.

Question 4: What Policies Should Be Included to Prevent Abuse and Simplify Administration of the Reformed Code?

Options for Preventing Abuse and Simplifying Administration

A significant disparity between the top individual rate and the pass-through rate will create strong incentives for owners to try to qualify as much income as possible for the pass-through rate. Therefore, in addition to the options discussed above, policymakers may want to include certain explicit limitations on taxpayers' ability to qualify income for the pass-through rate. They may also wish to adopt these policies as guards against abuse with the understanding that these policies may be stronger protection against abuse than the current rules—such as reasonable compensation rules—that have led to concerns about abuse of pass-through structures. Among other ideas, this can be accomplished by:

- Minimum or safe-harbor ratios of how much income could qualify for the pass-through rate;
- Caps on the annual return to capital for each year; or
- Maximum ratio for how much income could qualify for the pass-through rate.

Safe-Harbor Ratio

A minimum or a safe-harbor ratio could be established to determine how much income could qualify for the pass-through rate. For example, 90 percent of the income received by the owner could be taxed at the individual rate, and 10 percent of the income received by the owner could be taxed at the pass-through rate. The owner could opt instead to perform the calculations described in the previous section if that would provide a more beneficial tax result. By setting a default ratio that would deem at least some percentage of the income as eligible for the pass-through tax rate, the owner is guaranteed at least some recognition of return on "sweat equity" if there is no other capital investment made in the business. In addition, it would ensure that in a situation in which the value of the owner's share in the business declines, the owner can still qualify some income for the pass-through rate. A safe harbor also provides administrative simplicity for businesses, therefore obviating the need for the taxpayer to conduct the calculations.

Cap on Annual Return

Incorporating a cap on the percentage increase as it is calculated and applied in order to determine what share of income qualifies for the pass-through rate would serve as a limitation in situations where large percentage increases result from relatively large gains off a small base. The proposal could rely on existing provisions in the code, such as the long-term applicable federal rate (AFR). Today, the AFR ranges from X percent for short-term to Y percent for long-term investments. A formula to establish AFR plus a percentage (X) could be created.^{xvi} Determining how much income qualifies for the pass-through rate would be the lower of the percentage calculated according to the asset-based approach described above, or AFR plus X.

Maximum Cap

An alternative or complement to the minimum-ratio or safe-harbor concept would be to set a maximum, or cap, on the overall share of income that could qualify for the pass-through rate. For example, the maximum ratio could be set at 50/50, thereby establishing that a maximum of 50 percent of the income received by the owner could be taxed at the pass-through rate. If policymakers apply a maximum cap, they would need to consider whether the cap might be more generous than typical practice for S corporations when satisfying reasonable compensation requirements.

In addition, if policymakers provide more than one approach to the taxation of pass-through entities, they may wish to limit a business's ability to pick and choose what approach to adopt. Companies could be required to elect into one option and have such an election be permanent. Alternatively, policymakers could limit the number of times an entity could switch between options over any specified period of time.

Options for Extending Tax Concepts to Other Income

Finally, decision-makers will confront secondary issues that need to be addressed when deciding how to structure the new pass-through system. Among other items, this would include how to apply payroll taxes, carried interest, standard deductions for small businesses, and a myriad of related issues.

Application of Payroll Taxes

The proposed structures described above could be extended to determine what income is subject to FICA/SECA taxes. The proposal could apply FICA/SECA to all income subject to tax at individual tax rates (subject to the tax maximum for old age, survivor, and disability insurance, or "OASDI"). For S corporations in particular, this would expand the amount of income subject to payroll taxes. However, such a policy would largely address any concerns about abuse of the S corporation structure as a means to avoid SECA taxes. It would also significantly reduce the tax pressure on reasonable-compensation rules.

Application to Carried Interest

The underlying theory behind the asset-based option is that returns to capital should be taxed at business rates, not individual tax rates. The same theory can apply to carried interest. Thus, policymakers could extend the asset-based option and carried-interest profits. Some analysts have suggested that if the carry were subject to individual tax rates, the investors would be able to claim a deduction for the equivalent of wages paid to the service provider.^{xvii}

Standard Deduction

For small pass-through businesses that already pay lower rates because they have low amounts of taxable income, base-broadening could result in a tax increase even if access to the lower rates is maintained. Therefore, policymakers should consider adding a "standard deduction" for pass-through businesses. Such a deduction could be designed to ensure that these pass-throughs do not experience a sharp and unintended tax increase. This deduction could be phased down as the amount of income that qualifies for the pass-through rate increases.

Other Issues

Integrating corporate tax reform with pass-through entities means tackling the various related policy issues that reflect the complexity of the current system and the challenges decision-makers must confront to protect the integrity of the system. As an example, the proposal could incorporate some existing S corporation tax-policy proposals, such as the existing rules that automatically terminate an S corporation when it has excessive passive income. Other changes could include making the time period for electing S corporation status line up with the deadline for filing S corporation taxes for that tax year; there could also be provisions that allow for an easier transition from C corporation to S corporation.

Similarly, the application of a new structure could impact partnerships. Various conforming changes could be made to partnership rules to ensure proper inclusion of capital contributions into the partner's capital account. Among such changes:

- Repeal provisions permitting guaranteed payments and liquidation distributions. Under this structure, such contributions would be included in the partner's capital account and included in the calculation to determine the segregation of income between individual and corporate tax rates.
- Extend current requirements for mandatory basis adjustments upon the transfer of any partnership interests within the partnership or the distribution of property to a partner.
- Ensure proper tracking of any built-in gain in property contributed by a partner to the partnership.
- Ensure that partnership interests provided as a gift to a partner are excluded from the partner's capital account.
- In order to prevent the unintended termination of the partnership when capital in the partnership is transferred, the proposal could repeal the existing rule that would terminate partnerships when 50 percent or more of the capital in the partnership is sold or is exchanged in any 12-month period.

Conclusion

Tax reform is inherently difficult: It is not only intricate, with myriad potential interactions, but it also affects virtually every American. Accordingly, it requires policymakers to weigh an array of potentially competing priorities and goals.

The paramount mission for policymakers should be to develop a business tax code that is seen as fair and equitable in its treatment of businesses both large and small, and to provide the incentives for individuals to become entrepreneurs who will, in turn, create jobs and economic growth. This approach is vital with respect to reforming the tax treatment of pass-through entities. Policymakers must resolve concerns about raising taxes on pass-through businesses while also ensuring that any new rules or structures do not become an avenue of abuse. The options presented in this paper reflect the breadth of issues, challenges, and potential paths forward that policymakers should consider when wrestling with this crucial and complex undertaking.

Endnotes

ⁱ IRS, Statistics of Income, Business Tax Statistics. Available at: <https://www.irs.gov/uac/tax-stats>.

ⁱⁱ This paper assumes a flat corporate rate of 25 percent applied to the first dollar of taxable income.

ⁱⁱⁱ \$1.2 trillion assumes each percentage-point reduction in the corporate rate results in approximately \$120 billion in revenue loss over the ten-year budget window.

^{iv} The increase in taxes on pass-through businesses that would occur if tax reform broadened the tax base on pass-through businesses without any accompanying reduction in tax rates would make pass-through businesses less competitive vis-à-vis C corporations in situations where the pass-through business competes directly with the C corporation.

^v Economic Report of the President, February 2015, 230. Available at: <https://www.gpo.gov/fdsys/pkg/ERP-2015/pdf/ERP-2015.pdf>.

^{vi} For example, an individual filer is subject to a tax rate of 10 percent on the first \$9,275 in income, a tax rate of 15 percent on income over that but not exceeding \$37,650, a rate of 25 percent on income over that but not exceeding \$91,150, and so on with progressively higher income brackets and rates. See: IRS, "IRS Tax Brackets & Deduction Amounts for Tax Year 2016: Federal Tax Rates, Personal Exemptions, and Standard Deductions," 2016. Available at: <https://www.irs.com/articles/2016-federal-tax-rates-personal-exemptions-and-standard-deductions>.

^{vii} For example, assume a pass-through with \$250,000 in qualifying income. The effective tax rate on that income would be approximately 25.2 percent: $(10\% * \$9,275) + (15\% * (\$37,650 - \$9,276)) + (25\% * (\$91,150 - \$37,651)) + (28\% * (\$250,000 - \$91,151))$.

^{viii} A similar concept applies in current law with regard to the corporate rate. Although often glossed over, the current corporate tax rate is progressive with a rate of 15 percent on the first \$50,000 in taxable income, 25 percent on the next \$25,000 in taxable income, and 34 percent on income between \$75,000 and \$10 million. As a corporation's taxable income rises, it loses the benefits of the 15 and 25 percent rates (beginning when a corporation has taxable income over \$100,000) and the 34 percent rate (beginning when a corporation has taxable income over \$15 million). See: Joint Committee on Taxation, Overview of the Federal Tax System as in Effect for 2016, JCX-43_15, May 10, 2016. Available at: <https://www.jct.gov/publications.html?func=startdown&id=4912>.

^{ix} An extreme option would be to require all companies providing such services to be taxed as corporations, such as by subjecting them to taxation as personal service corporations as defined in IRC 269A.

^x Internal Revenue Code 448(d)(2)(A).

^{xi} Policymakers could define such income as income covered by Internal Revenue Code 1362(d)(3).

^{xii} Section 199 (or the domestic-production deduction) provides a deduction against qualified business income that is intended to provide tax relief equivalent to a 3 percent reduction in the taxpayer's effective tax rate.

^{xiii} U.S. Census, Monthly & Annual Retail Trade, March 2017. Available at: <https://www.census.gov/retail/index.html>.

^{xiv} Generally, the inside basis of an S corporation is a measure of the value of the property held by the business entity. The outside basis is a measure of the value of the owner's S corporation stock.

^{xv} Over the first two years in which the pass-through entity participates in this structure, the calculation would be performed only for the years actually recorded. For example, year one the percentage would be measured relative to the owner's starting basis. In year two, the change would be measured averaging years one and two.

^{xvi} The applicable federal rate (AFR) is an interest rate determined by the IRS for income-tax purposes. There are three AFRs: short-term, mid-term, and long-term. See: Internal Revenue Code 1274(d).

^{xvii} Donald Marron, *Goldilocks Meets Private Equity: Taxing Carried Interest Just Right*, Tax Policy Center, Urban Institute and Brookings Institution, October 6, 2016. Available at: <http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000956-Goldilocks-Meets-Private-Equity-Taxing-Carried-Interest-Just-Right.pdf>.



Statement for the
Full Committee Hearing
How Tax Reform Will Grow Our Economy and Create Jobs
Committee on Ways and Means
U.S. House of Representatives
May 18, 2017

The Business Coalition for Fair Competition ([BCFC](http://www.governmentcompetition.org)) is a coalition of private sector firms, large and small, trade associations, think tanks, organizations, and individuals who support the competitive free enterprise system and seek relief from unfair government sponsored competition with private business.

BCFC is deeply concerned that some non-profit organizations operate activities in direct and unfair competition with for-profit, tax-paying private businesses. At a time when small business is struggling and job creation is not being maximized in the private sector, small business cannot afford to compete against non-profits that don't pay their fair share of taxes.

Private enterprise constitutes the strength of the United States economic system and competitive private enterprises remain the most productive, efficient, and effective sources of goods and services.

There are thousands of legitimate non-profits that do exemplary work filling a societal need. The tax treatment of these organizations is not an issue for BCFC. However, when the organizations encroach on private business activities, there are a number of undesirable consequences.

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Entities organized under various provisions in section 501(c) of the Internal Revenue Code are provided special tax "exempt" treatment were clearly intended to perform activities and provide services otherwise considered "governmental" in nature, not those that are commercially available. A 1954 report by this Committee noted:

"The exemption from taxation of money or property devoted to charitable and other purposes is based upon the theory that government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds and by the benefits resulting from promotion of the general welfare."

Source: (Unfair Competition: The Profits of Non-profits, James T. Bennett, Thomas H. DiLorenzo, Hamilton Press, 1989, p. 26)

The problem is, this policy has not been adequately codified by Congress or efficiently implemented by the IRS. The situation has become so pervasive that unfair government-sponsored competition has been a top issue at every White House Conference on Small Business.

In 1980, the first White House Conference on Small Business made unfair competition one of its highest-ranked issues. It said, "The Federal Government shall be required by statute to contract out to small business those supplies and services that the private sector can provide. The government should not compete with the private sector by accomplishing these efforts with its own or non-profit personnel and facilities."

In 1986, the second White House Conference made this one of its top three issues. It said, "Government at all levels has failed to protect small business from damaging levels of unfair competition. At the federal, state and local levels, therefore, laws, regulations and policies should ... prohibit direct, government created competition in which government organizations perform commercial services ... New laws at all levels, particularly at the federal level, should require strict government reliance on the private sector for performance of commercial-type functions. When cost comparisons are necessary to accomplish conversion to private sector performance, laws must include provisions for fair and equal cost comparisons. Funds controlled by a government entity must not be used to establish or conduct a commercial activity on U.S. property."

And the 1995 White House Conference again made this a priority issue when its plank read, "Congress should enact legislation that would prohibit government agencies and tax-exempt and anti-trust exempt organizations from engaging in commercial activities in direct competition with small businesses." That was among the top 15 vote getters at the 1995 Conference and was number one among all the procurement-related issues in the final balloting.

Non-profit organizations unfairly compete with private, for-profit businesses by engaging in commercial activities, but not paying taxes.

Billions of dollars in economic activity occurs each year that is untaxed. This results in lost revenue to Federal, as well as state and local government agencies. And it creates an unlevel playing field for the private sector, particularly small business. When this occurs in universities, it unnecessarily drives up the cost of room, board, tuition and fees.

The 2013 IRS Colleges and Universities Compliance Project studied the unrelated business income tax (UBIT) for which tax-exempt entities, such as most universities, are required to pay on any activities and revenue unrelated to their tax-exempt status. The April 25, 2013 [IRS report](#) "found increases to unrelated business taxable income for 90 percent of the colleges and universities examined, totaling about \$90 million. There were over 180 changes to the amounts of unrelated business taxable income reported by colleges and universities on Form 990-T; and disallowance of more than \$170 million in losses and net operating losses that could amount to more than \$60 million in assessed taxes."

Non-profit organizations are provided special tax status under section 501(c) of the Internal Revenue Code. These groups are required to pay an "unrelated business income tax" or UBIT on its commercial or "non-exempt" activities. The IRS report showed this is not occurring.

The Federal Government first exempted charitable organizations from tax in 1913. In 1950, in response to outrageous examples of unfair competition, Congress changed the tax law by creating the UBIT. Under UBIT, revenues from sources unrelated to the non-profit's tax-exempt purpose are subject to taxation.

Attempts by government to address the problem of unfair competition have been few and far between, and those few measures that have been taken have been largely ineffective. The UBIT which was intended to level the playing field by taxing the revenues of non-profits has, for example, proven difficult if not impossible to enforce. The courts have not been able to give a rigorous and consistent definition of just what constitutes an "unrelated" business activity by a non-profit. And because the UBIT tax was to apply only to "commercial activity which is not significantly related to the purposes for which the non-profit organization was established," enforcement and collection by the IRS has been less than successful. For their part, non-profits have taken an extremely expansive view of what constitutes a related purpose, making the under-reporting or non-reporting of revenues commonplace.

Unfair non-profit competition impedes the development of small business by making it hard for them to enter markets and compete. This is significant because two-thirds of all new jobs are created by businesses with fewer than 20 employees. Because commercial enterprises run by non-profits are exempted from taxes and receive other subsidies, taxpaying businesses must bear an extra burden by paying higher taxes than they would otherwise to make up for exemptions enjoyed by their "non-profit" competitors. Unfair competition ends up crowding out of the market precisely those firms which are the principal source of new jobs—ultimately reducing the rate of economic growth.

Unfair non-profit competition takes many forms. It is YMCAs competing with private health clubs; credit unions competing with community banks; rural electric and telephone cooperatives competing with investor-owned utilities; and universities venturing out of the classroom and into hotels, mapping services, and testing laboratories. A few examples follow:

- Credit unions' tax-exemption currently costs the U.S. Treasury \$2 billion annually. By contrast, the more than 6,000 community banks that are the lifeblood of towns across the country contribute \$4 billion annually in taxes that support our nation and those communities;
- A bicycle rental business in Anchorage, Alaska faced competition from a non-profit entity approved by state gaming regulators- a free bike loan program for downtown Anchorage, known as the Earth Bike Program. The program lasted two years and forced other bike rental businesses out of business, and in one case, leave the state;
- A privately owned inn in Fredericksburg, Virginia hosts functions such as banquets and weddings. The University of Mary Washington's Alumni Center not only competes for similar events and opportunities, but it also is building a hotel less than a mile away that will further compete with the hotels, motels and other lodging destinations that are not tax-exempt. The only reason provided by lost clients for choosing the university was the lower price thanks to the tax differential. University hotels and conference centers are proliferating across the country; and
- A laundry and cleaner in San Antonio, Texas faces competition for its laundry services from a non-profit, Federal tax-exempt Bexar County (government) cooperative entity. The unfair business practice involves, in addition to competing with and eliminating the opportunity for private business services, the co-op going outside its members to provide laundry services to for-profit businesses and hospitals throughout South Texas. It is damaging to a long-time minority owned and operated for-profit business to have to compete in this arena with its taxing entity, Bexar County.

Unfair university competition takes many forms. It is universities venturing out of the classroom and into activities unrelated to their core and exempt education mission, such as hotels, mapping services, bicycle repair, golf courses, gym and fitness centers, cultural resource assessments, testing laboratories and others. A few examples were highlighted in BCFC's [2013](#) and [2014](#) lists of the most egregious examples of unfair government competition as collected by media reports, include:

- The University of Mary Washington's [Alumni Center](#) in Fredericksburg, VA not only competed for similar events and opportunities as provided by a neighboring small business in the wedding, banquet, lodging and catering business, but it also was building a hotel less than a mile away that would further compete with the hotels, motels and other lodging destinations that are not tax-exempt. The only reason provided by lost clients for choosing the university was the lower price thanks to the tax differential. University hotels and conference centers are proliferating across the country;
- George Mason University in Fairfax, Virginia announced in December 2013 it would close its hotel, the Mason Inn, after losing [\\$11 million](#);
- Towson University, a Maryland state University in the Baltimore suburbs, purchased air time on Washington, DC radio stations advertising a [nursery school program](#) for children 2, 3, and 4 years of age and a summer camp programs for pre-teens;
- "Bluffing" to win its first contract, St. Mary's University (MN) [performed](#) commercially available mapping services for the National Park Service and other clients;
- The University of Houston operates the National Center for Airborne Laser Mapping ([NCALM](#)), mapping services utilizing aircraft equipped with Light Detection And Ranging (LIDAR), a technology commercialized by NASA in the 1990s. Towson also runs a [mapping program](#) that has purchased television ads touting a software system that is otherwise commercially available;
- Believing that bicycle repair is inherent to the success of higher education, Virginia Tech University opened its own shop and hired a mechanic to [pedal](#) services to students in Blacksburg, VA in competition with local small business;
- James Madison University in Harrisonburg, VA [operates](#) a variety of charter bus and transit options to not only university students, but also to the general public including local school systems thereby in direct competition and duplication of the local market as would be provided by the small business operators; and
- Elon University in North Carolina started [Live Oak Communications](#), a communications agency that provides public relations, advertising, special event marketing, viral marketing, media relations, website development, video creation and graphic design services for businesses and not-for-profit organizations in the North Carolina region.

The previously referenced 2013 IRS report listed the following activities as within its scope of UBIT research: Fitness, recreation centers and sports camps; advertising; facility rentals; arenas; and golf.

Another form of university competition is in the schools' bookstore. These on-campus, university-owned retail operations go far beyond selling essential textbooks to students, but compete with local, for-profit, tax-paying business in offering office supplies, clothes and apparel, computer equipment and goods under the blanket of the institution's tax exempt status. Finally, universities historically competed with travel and tour companies by offering foreign trips that looked more like vacations rather than instructional endeavors.

Schools of higher education are increasingly venturing away from their core missions of teaching and conducting basic research. Financial pressures, ranging from reduced government funding to pressures to limit tuition increases have led university presidents to transform academicians into entrepreneurs. Universities are generating revenues from commercial activities to supplement their budgets.

University engagement in commercial activities could be called the "Gatorade Syndrome". Ever since professors at the University of Florida invented the popular sports drink to hydrate football players practicing in the heat, academicians have been trying to find the next big discovery. Most simply consume tax dollars, divert scarce resources including tuition, and fail to turn profits. These university-sponsored enterprises have cost their schools millions, exacerbating an unaffordable tuition system that has made a college education a financial burden, if not impossibility, for most students and their parents.

Universities enjoy significant advantages over for-profit companies. They are eligible for billions of dollars in grants from Federal and State governments. They often have the ability to secure non-competitive, sole source contracts with government agencies. They pay no taxes. Their overhead – buildings, electricity, even equipment, is already paid for and is provided for "free". Their student labor force is either unpaid or compensated at well

below prevailing market wages. They carry no professional liability insurance, do not have to pay unemployment compensation and in many cases are exempt from social security contributions. When universities enter into contracts to perform services, they usually insist on “best effort” clauses, which absolve them of ever completely finishing a project. They are also recipients of millions of dollars in free or discounted hardware and software, donated from vendor firms so that students will learn on their systems, be proficient in their use upon graduation and instill a consumer loyalty that will translate into sales once these students move up in the ranks of their private sector employers. The advantages universities bring to the market make it virtually impossible for private firms to compete.

Private sector and for-profit colleges and universities face unfair competition from government institutions. In recent years, such private schools have been singled out for attack from a bevy of regulations proposed by the federal government that create an unfair and unlevel playing field. The latest effort comes in the form of a retooled “gainful employment” regulation by the Department of Education that is impacting private sector schools and largely leaving traditional public and non-profit schools untouched. The “gainful employment” regulation prevents students – often low-income, minorities, and veterans – from having access to thousands of programs at private sector higher education institutions.

In addition, federal actions, including the “90/10 rule”, regulations dealing with state authorization, and the definition of a credit hour all threaten to punish private sector schools to the advantage of traditional public institutions.

For too many years, the unfair government-sponsored competition issue has not been a top priority for Congress or Administrations of either party. The Small Business Administration’s Office conducted a series of hearings and issued a report, “Government Competition: A Threat to Small Business” (March 1980), and “Unfair Competition by Non-profit Organizations With Small Business: An Issue for the 1980s” (June, 1984). The last serious look at non-profits and the UBIT by the Ways and Means Committee was by Congressman J.J. Pickle (D-TX) in 1987-88.

In February 2013, BCFC [testified](#) before this Committee including “unfair university competition” and UBIT within the [hearing](#) entitled, “Tax Reform and Charitable Contributions.”

From April 18 through April 25, 1993, the Philadelphia Inquirer presented an exhaustive investigative exposition of the multibillion-dollar world of America’s so-called non-profit industries, exposing, in several different contexts, the abuses of their unique tax-exempt status. Certainly, this sweeping indictment by the Philadelphia Inquirer encompasses the world of non-profit sometimes run amok. However, as you, Mr. Chairman, contemplate future oversight hearings and legislation to reform this multibillion-dollar, non-tax-paying competition for many of America’s struggling small businesses, you will find valuable factual, albeit dated, information in the Inquirer series.

Source: (Non-profits: America's Growth Industry They're Called Non-profit Businesses, But That Doesn't Mean They Can't Make Money. They Do - Billions Of Dollars. At The Same Time, Their Tax-exemptions Cost Government More Than \$36 Billion A Year,” by Gilbert M. Gaul and Neill A. Borowski, The Philadelphia Inquirer April 18, 1993)

In February 1987, a GAO report found:

- The U.S. Department of Commerce estimates that \$1.2 billion, or 1.3 percent, of the \$91 billion gross national product (GNP) in 1930 could be attributed to non-profit institutions. This share grew to \$131 billion, or 3.3 percent, of the \$3,989 billion GNP by 1985;
- A 1975 IRS Statistics of Income (SOI) study found that for tax-exempt organizations (religious, schools and colleges, cultural and historical, other instructional, health-related services, scientific research, business and professional, farming and related, mutual organizations, employee or membership benefit, sports-athletic-recreational and social, youth, conservation and environmental, housing, inner city or community, civil rights, litigation and legal aid, legislative and political advocacy, other activities directed

to individuals, other activities directed to organizations, other purposes and activities, no activity reported) on average, 39% of their total activity receipts were business receipts; and

- Complete data do not exist to quantify the nature, extent, and impact of competition between non-profits and the private sector. However, the limited data available indicate that taxable businesses and some tax-exempt organizations are increasingly competing to provide similar services.

Source: (GAO Briefing Report to the Joint Committee on Taxation; "Tax Policy: Competition Between Taxable Businesses and Tax-Exempt Organizations", February 27, 1987 – GGD-87-40BR)

In March 1980, a report of the Small Business Administration (SBA) Advocacy Task Force Group on Government Competition with Small Business found:

- The activities of foundations and universities were of particular concern to a number of witnesses;
- In Fiscal Year 1978, the IRS audited approximately 17,000 of the 150,000 required filings by non-profits. Unrelated business income was discovered in 1,800 or 10.6 percent of these 17,000 audited cases. Of the 1,800 audits where unrelated business income was discovered, 46 percent (828 cases) resulted in successful action by IRS to levy additional taxes, and a combined total of \$10 million was recovered. On average, the IRS recovered additional taxes at the rate of \$12,078 per audited case where unrelated business income was discovered and recovery action succeeded; and
- The small business community's perception of the extent of abuse of the tax system by non-profits strongly suggests that a more extensive review of unrelated business income activities is warranted.

Source: ("Government Competition: A Threat to Small Business" Report of the SBA Advocacy Task Force Group on Government Competition with Small Business, March 1980)

This is a problem that is growing, not diminishing. From 1975 to 1990, the non-profit sector grew by 150 percent, while the gross domestic product grew about 50 percent.

University competition is part of a larger problem of unfair government sponsored and tax-subsidized competition with private enterprise including government (including the insourcing of contracts performed by tax-paying private sector firms out of the private sector for performance by Federal employees), non-profits, prison industries, etc. The Federal government and universities can lower costs and increase revenue by applying the "Yellow Pages' Test", a simple test that says if an activity is available from a private sector company found in the Yellow Pages, that activity should not be a responsibility of a college and university and, instead, should actually be performed by a tax-paying private sector firm.

In December 2012, BCFC attempted to bridge the impasse in negotiations on the fiscal cliff and sequestration by providing President Obama and Congressional leaders [budget savings of \\$795 billion](#) by simply utilizing tax-paying private sector firms for commercially available goods and services currently performed by a government or tax-subsidized entity. The federal government can achieve \$795 billion in savings simply by getting out of activities that duplicate or compete with the private sector, which subsidize unfair competition with private, for-profit companies, or by privatizing activities for which there are current or potential private sector providers. This includes:

- Enforce UBIT on commercial activities revenue of non-profits - \$36 Billion.

Institutions of higher education should not be able to use their tax-exempt status to avoid paying income taxes on what are essentially commercial activities. These tax-subsidized entities should not be making the same kind of profits on activities that are virtually identical to those of a for-profit, tax-paying business.

The IRS should more vigorously enforce current rules governing the tax status of universities to assure that academic activities are indeed related to research and education, not commercial production. Here are five very specific recommendations.

1. The Department of the Treasury should be required to provide an annual public estimate of revenues lost through avoidance of UBIT.

2. The Treasury Department should provide an official public estimate of potential new revenues to the Treasury if the UBIT law were expanded to require all commercial operations of universities to pay their fair share of taxes.

3. The law should be modified or new legislation introduced that lets the Treasury Department collect taxes that insures that all commercial activities of universities are taxable. The IRS has only one option today – that is to revoke an organization’s charter to do business. They simply can’t administer the law the way it is.

4. Congress should amend the Higher Education Act to focus universities on their core missions – education and basic research. Legislation should be passed to apply a “commerciality” test to all non-core university activities. Any university that receives direct federal funding, or indirect funding through tax-exempt or “non-profit” status, should be prohibited for using such institutions for the performance of commercial, tax generating activities otherwise available in the private sector.

5. Universities entering a commercial undertaking should be required to form a for-profit subsidiary that must obey all the same laws and regulations that apply to for-profit enterprises. It is only when we move beyond hidden subsidies and the ineffectual regulations of UBIT that both consumers and producers, and all taxpayers, will be able to enjoy the benefits of even-handed competition. In forming a commercial subsidiary, this would help implement a “commerciality clause”, and thus implement the “Yellow Pages’ Test”.

Unfair non-profit competition with the private sector, and small business, is a public policy issue deserving of immediate attention and reform. This hearing will provide an important forum for the private sector to discuss the broader aspects of this issue. As Congress seeks ways to grow the economy and create private sector jobs, as well as prepare comprehensive tax reform that lowers the corporate tax rate to make American business more competitive in the global market and simplify the tax code, BCFC respectfully recommends reform of the treatment of nonprofit organizations and UBIT so that unfairness is eliminated, appropriate revenue is raised, and counter-productive tax policy that disadvantages private, for profit companies, particularly small business, is implemented.

We commend your efforts to further explore private sector complaints in this area and advance the debate. The private sector seeks a competitive environment in which all participants play by the same rules including reforms to the tax code that enable, instead of hinder, the private sector.



May 17, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing On How Tax Reform Will Grow Our Economy And Create Jobs

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

The Businesses United for Interest and Loan Deductibility (BUILD) Coalition is submitting this letter in anticipation of the House Ways and Means Committee's May 18 hearing entitled "How Tax Reform Will Grow Our Economy and Create Jobs." We commend the Committee for exploring ways in which pro-growth tax reform can be achieved. As the Committee determines which of the various provisions of the tax code should remain or be reformed in order to encourage stronger growth, we want to reinforce the necessity of preserving the full deductibility of interest on debt.

The BUILD Coalition's members represent industries throughout the economy, including agriculture, manufacturing, real estate, retail, and telecommunications. We believe that in crafting measures to catalyze economic growth in the U.S., the last thing Congress should do is make it harder for companies to access capital that can be used to make investments, expand operations, and create more jobs.

Our first-hand experience managing the daily operations of our respective businesses compels us to relay the real-world implications of eliminating or limiting interest deductibility. We also want to dispel some of the misconceptions about this key part of our tax code, including notions that interest deductibility distorts financing decisions, that equity is an equal or appropriate substitute for debt financing, and that interest deductibility can be replaced by immediate expensing of capital expenditures.

Interest deductibility is a well-established, growth-promoting component of the tax code. Interest expense is a normal cost of doing business, and by guaranteeing businesses will not be taxed on the cost of accessing capital, interest deductibility affords us the correct tax treatment that encourages us to continue to invest in growing our businesses and creating more jobs. Not surprisingly, a study by Ernst & Young (EY) finds that limiting interest deductibility to help fund a lower corporate tax rate would negatively impact economic growth in the long-run.¹

Businesses of all sizes borrow in order to finance expansions or meet obligations, and the ability to deduct the interest expense gives business owners the certainty to make such decisions with confidence. For many firms, access to credit is essential for working capital, and many of these companies use debt to weather shifts in demand.

¹ EY's Quantitative Economics and Statistics (QUEST) Group. "Macroeconomic Analysis Of A Revenue-Neutral Reduction In The Corporate Income Tax Rate Financed By An Across-The-Board Limitation On Corporate Interest Expenses." EY. July 2013.



Our debt capital markets are the most liquid and efficient in the world. Small- to medium-sized banks supply the credit that is in turn the life blood of American businesses of all sizes and types—the businesses that provide the core growth in our economy.

Research has found that 75 percent of startups and 80 percent of small businesses rely on debt financing. Without access to affordable credit, these companies, along with medium-sized and larger businesses, will struggle to create jobs and grow the economy.²

Proponents of eliminating interest deductibility sometimes argue that the tax code favors debt over equity, and that this encourages companies to take on more leverage. And yet, research by economists from Duke, University of Pennsylvania, and Washington University in St. Louis³, as well as findings by Nobel Prize-winning economist Merton Miller⁴, show that the tax code has little to no impact on companies' leverage ratios.

Moreover, the argument that equity and debt financing are similar is a fallacy. Debt and equity do not serve identical purposes and are not interchangeable forms of financing. Thus, their differing tax treatment is appropriate. There are a variety of non-tax reasons that businesses like ours choose debt over equity when raising capital. To the extent that policymakers would like to assist equity financing, the answer is to eliminate the tax on dividends, not to punish and restrict debt financing by removing or limiting interest deductibility.

For one thing, many businesses don't have access to equity markets, making debt their only option. In contrast to the dilutive effects of equity, borrowing allows owners to access capital while retaining full control of their business. Debt is also a more cost-effective financing solution than equity because it is more secure for investors, who charge a premium for the risks associated with equity. Therefore, on both sides of the equation, debt and equity play separate and distinct roles in capital formation.

In addition, proposals to offer 100 percent expensing in place of interest deductibility miss the mark. Such proposals fail to account for the real-life implications of what such a trade-off means for businesses, namely that full and immediate capital expensing is not an acceptable alternative for interest deductibility.

For starters, introducing 100 percent expensing would offer no benefit to small businesses, which are already able to expense annual capital expenditures. For larger companies, such plans would amount to Congress raising their taxes by eliminating interest deductibility and lowering them to a lesser degree, if at all, through expensing. That's a far cry from pro-growth tax reform.

Once again, research supports these arguments. A recent Goldman Sachs Economics Research note predicts that proposals to eliminate interest deductibility in favor of 100 percent expensing "would raise the user cost of capital and reduce investment in the longer run."

While 100 percent expensing might boost cash flows in the near term by pulling forward depreciation schedules, "after the first year, however, the impact on cash flow would begin to decline and eventually turn negative," the Goldman Sachs study warns.⁵

² Cole, Rebel A. "Why Businesses Use Debt – And How Debt Benefits Businesses." June 2013.

³ Graham, John R., Mark T. Leary, And Michael R. Roberts. "A Century Of Capital Structure: The Leveraging Of Corporate America." June 2014.

⁴ Miller, Merton. "Debt And Taxes." *Journal Of Finance*. May 1977.

⁵ Mericle, David and Daan Struyven. "US Daily: Corporate Tax Reform: Trading Interest Deductibility for Full Capex Expensing." Goldman Sachs Economic Research. November 2016.



These harmful effects would not be cancelled out by lower rates, either. As UPenn professor Chris Sanchirico has explained, even proposals to lower the tax rate would "not temper" the harmful effects of the proposed trade-off between interest deductibility and expensing.⁶ As businesses that make these financing decisions every day, we know first-hand that you can't expense what you can't afford.

Lastly, some have claimed that debt inherently creates risk in the economy, and steps should be taken to discourage too much borrowing by businesses. This is by no means a given. In fact, a study published by the St. Louis Federal Reserve's Brent Glover, Joao F. Gomes, and Amir Yaron finds that limiting interest deductibility would actually *increase* volatility throughout the economy by raising the overall cost of accessing capital. The authors understand that limiting or eliminating the deduction for business interest expense would push firms to intentionally cap their size and rely more on operating leverage, making them more susceptible to default.

Glover, Gomes, and Yaron conclude: "Contrary to conventional wisdom, we find that eliminating interest deductibility results in an increase in the default frequency and average credit spreads. The intuition for this lies in the fact that this policy change makes external financing more costly, which results in riskier firms and higher credit spreads."⁷

All of these arguments also ignore the distributional impact of limiting interest deductibility. According to a report by the Small Business Administration (SBA), woman- and minority-owned small businesses typically have limited access to equity markets compared to businesses with male and white owners. Thus, woman- and minority-owned small businesses have to turn to bank loans, as well as alternative lending methods. By limiting interest deductibility, policymakers would further increase the existing financial burdens that woman and minority business owners face when trying to raise capital for investments.⁸

These are just the immediate dangers. Numerous policy proposals would also suffer if interest deductibility is limited. For example, President Donald Trump has announced his desire for a \$1 trillion infrastructure investment plan based in large part on public-private partnerships. Congressional leaders have discussed similar proposals, with anticipated leverage ratios of up to five-to-one. Of course, limiting interest deductibility would undermine these plans by increasing the cost of capital and making such investments less feasible for the private sector.

As this Committee investigates ways to promote stronger economic growth and faster job creation through tax reform, it must maintain provisions in the tax code that help achieve these goals. Interest deductibility is one of these provisions, and has been since the creation of the modern tax code a century ago.

While the BUILD Coalition fully supports the Committee's goal of achieving pro-growth tax reform, any proposal that seeks to limit interest deductibility will run counter this objective. We encourage the Committee, in any proposed tax legislation, to maintain the full deductibility of business interest expense as it exists under current law. By doing so, policymakers will give the U.S. economy the opportunity to achieve its full growth potential.

⁶ Sanchirico, Chris William. "Expensing and Interest in the GOP Blueprint: Good Deal? Good Idea?" *Tax Notes*. April 2017

⁷ Glover, Brent, Joao F. Gomes, and Amir Yaron. "Corporate Taxes, Leverage, and Business Cycles." St. Louis Fed. July 2011

⁸ Robb, Alicia. "Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms." *U.S. Small Business Administration*. April 2013.



Sincerely,

The BUILD Coalition
805 15th Street NW, Suite 200
Washington, D.C. 20037
202-822-1205



May 11, 2017

The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Brady and Ranking Member Neal:

The member companies represented by our trade associations provide broadband and other communications services to millions of customers living in rural and remote parts of our country.

Millions of Americans reap the benefit of connectivity due in large part to the success of the federal Universal Service Fund ("USF"). The USF, including the Connect America Fund, Mobility Fund, and other legacy High Cost support programs have been successful public/private partnerships that have evolved from providing near-ubiquitous voice service, to supporting networks capable of providing broadband connectivity via fixed and mobile technologies. Our member companies are dedicated to offering the best service despite the many challenges associated with providing reasonably comparable services to rural America as those enjoyed in urban areas.

As your Committee endeavors to reform the tax code, it is our hope that you will prioritize policies that encourage additional broadband investment. One area in which your Committee can immediately provide a boost to broadband investment is to clarify that funds received by companies from broadband programs such as the USF or future infrastructure funding mechanisms do not constitute taxable income.

If disbursements from USF and other broadband funding programs are treated as nontaxable income, companies that receive this support will be able to use more of the funds they receive to deploy broadband networks deeper into rural America. This could be one of the most innovative, efficient, and effective ways to enhance broadband deployment and create new jobs in economically challenged rural areas. Clarifying the federal tax code to treat disbursements from all federal broadband programs, including the USF, as non-taxable will further the public interest by enabling the increased investment in infrastructure that is

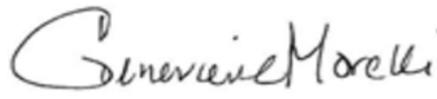
necessary to create jobs and serve rural consumers who are waiting to be connected to high-speed broadband.

We remain committed to working with you and your staff to find creative policy solutions that will continue to drive our American economy forward and make us more competitive around the world. If you should have any questions please contact Tim Donovan, SVP, Legislative Affairs for CCA at 202.747.0718 or by email at tdonovan@ccamobile.org or Paul Raak, Vice President of Legislative Affairs for ITTA at 202.898.1514 or by email at praak@itta.us.

Sincerely,



Steven K. Berry
President & CEO
Competitive Carriers Association



Genevieve Morelli
President
ITTA- the Voice of America's Broadband Providers

CC: Members of the Ways and Means Committee
The Honorable Greg Walden, Chairman, House Committee on Energy and Commerce
The Honorable Frank Pallone, Ranking Member, House Committee on Energy and Commerce
The Honorable Marsha Blackburn, Chairman, Subcommittee on Communications & Technology
The Honorable Mike Doyle, Ranking Member, Subcommittee on Communications & Technology

Comments for the Record
United States House of Representatives
Committee on Ways and Means and the Subcommittee on Tax Policy
Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

Thursday, May 18, 2017, 10:00 A.M.
1100 Longworth House Office Building

By Michael G. Bindner
Center for Fiscal Equity

Chairmen Brady and Roskam and Ranking Members Neal and Doggett, thank you for the opportunity to submit these comments for the record to the Committee on Ways and Means and the Tax Policy Subcommittee. As usual, we will preface our comments with our comprehensive four-part approach, which will provide context for our comments.

- 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%.
- 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.

First, allow us to address the current state of tax reform and the comments in the press release announcing this hearing and the recent remarks by the President about priming the pump. We will then identify how our four-part approach meets the goal of this hearing to create economic growth and more jobs. The latter should be familiar to those who read our comments submitted to the tax reform hearing of one year ago.

What the Center said in June of last year in response to the release of the Blueprint bears repeating. We have tried to reduce rates and broaden the base. In 1986, it actually happened, although second mortgage interest was left deductible, leading quickly to the savings and loan crisis and eventually the 2008 Great Recession, abetted by capital gains cuts which gave us the tech bubble. Efforts to call tax cuts a prelude to growth ring hollow and even those economists who backed them no longer support such theory.

In *The Economist*, President Trump and Secretary Mnuchin cast doubt on their support for the DBCFT, instead preferring to simply cut rates for pump priming. This would mainly benefit the wealthy, which is ill advised.

Lower marginal tax rates for the wealthiest taxpayers lead them to demand lower labor costs. The benefit went to investors and CEOs because the government wasn't taxing away these labor savings. In prior times, we had labor peace, probably to the extent of causing inflation, because CEOs got nothing back for their efforts to cut costs.

The tax reforms detailed here will make the nation truly competitive internationally while creating economic growth domestically, not by making job creators richer but families better off. The Center's reform plan will give you job creation. The current blueprint and the President's proposed tax cuts for the wealthy will not.

In September 2011, the Center submitted comments on *Economic Models Available to the Joint Committee on Taxation for Analyzing Tax Reform Proposals*. Our findings, which were presented to the JCT and the Congressional Budget Office (as well as the Wharton School and the Tax Policy Center), showed that when taxes are cut, especially on the wealthy, only deficit spending will lead to economic growth as we borrow the money we should have taxed. When taxes on the wealthy are increased, spending is also usually cut and growth still results. The study is available at

<http://fiscalequity.blogspot.com/2011/09/economic-models-available-to-joint.html>

and it is likely in use by the CBO and JTC in scoring tax and budget proposals. We know this because their forecasts and ours on the last Obama budget matched. Advocates for dynamic scoring should be careful what they wish for.

The national debt is possible because of progressive income taxation. The liability for repayment, therefore, is a function of that tax. The Gross Debt (we have to pay back trust funds too) is \$19 Trillion. Income Tax revenue is roughly \$1.8 Trillion per year. That means that for every dollar you pay in taxes, you owe \$10.55 in debt. People who pay nothing owe nothing. People who pay tens of thousands of dollars a year owe hundreds of thousands. The answer is not making the poor pay more or giving them less benefits, either only slows the economy. Rich people must pay more and do it faster. My child is becoming a social worker, although she was going to be an artist. Don't look to her to pay off the debt. Trump's children and grandchildren are the ones on the hook unless their parents step up and pay more. How's that for incentive?

The proposed Destination-Based Cash Flow Tax is a compromise between those who hate the idea of a value-added tax and those who seek a better deal for workers in trade. It is not a very good idea because it does not meet World Trade Organization standards, though a VAT would. It would be simpler to adopt a VAT on the international level and it would allow an expansion of family support through an expanded child tax credit. Many in the majority party oppose a VAT for just that reason, yet call themselves pro-life, which is true hypocrisy. Indeed, a VAT with enhanced family support is the best solution anyone has found to grow the economy and increase jobs.

Value added taxes act as instant economic growth, as they are spur to domestic industry and its workers, who will have more money to spend. The Net Business Receipts Tax as we propose it includes a child tax credit to be paid with income of between \$500 and \$1000 per month. Such money will undoubtedly be spent by the families who receive it on everything from food to housing to consumer electronics.

The high income and inheritance surtax will take money out of the savings sector and put it into government spending, which eventually works down to the household level. Growth comes when people have money and spend it, which causes business to invest.

Any corporate investment manager will tell you that he would be fired if he proposed an expansion or investment without customers willing and able to pay. Tax rates are an afterthought.

Our current expansion and the expansion under the Clinton Administration show that higher tax rates always spur growth, while tax cuts on capital gains lead to toxic investments – almost always in housing. Business expansion and job creation will occur with economic growth, not because of investment from the outside but from the recycling of profits and debt driven by customers rather than the price of funds. We won't be fooled again by the saccharin song of the supply siders, whose tax cuts have led to debt and economic growth more attributable to the theories of Keynes than Stockman.

Simplicity and burden reduction are very well served by switching from personal income taxation of the middle class to taxation through a value added tax. For these people, April 15th simply be the day next to Emancipation Day for the District. The child tax credit will be delivered with wages as an offset to the Net Business Receipts tax without families having to file anything, although they will receive two statements comparing the amount of credits paid to make sure there are no underpayments by employers or overpayments to families who received the full credit from two employers.

Small business owners will get the same benefits as corporations by the replacement of both pass through taxation on income taxes and the corporate income tax with the net business receipts tax. As a result, individual income tax filing will be much simpler, with only three deductions: sale of stock to a qualified ESOP, charitable contributions and municipal bonds – although each will result in higher rates than a clean tax bill.

For the Center, the other key motivator is expanding employee-ownership. We propose to do that by including an NBRT deduction, to partially reduce income to Social Security, to purchase employer voting stock, with each employee receiving the same contribution, regardless of salary or wage level. In short order, employees will have the leverage to systematically insist on better terms, including forcing CEO candidates to bid for their salaries in open auction, with employee elections to settle ties.

Employee-ownership will also lead multi-national corporations to include its overseas subsidiaries in their ownership structure, while assuring that overseas and domestic workers have the same standard of living. This will lead to both the right type of international economic development and eventually more multinationalism.

Simultaneously, the high income and inheritance surtax will be dedicated to funding overseas military and naval sea deployments, net interest payments (rather than rolling them over), refunding the Social Security Trust Fund and paying down the debt.

Both employee-ownership with CEO pay reduction and paying off the debt will lead to two things – less pressure to deploy U.S. forces overseas and sunset of the income tax.

Military spending both overseas and domestic will decline under this plan. The VAT will make domestic military spending less attractive and overseas spending on deployments will be fought by income taxpayers, who are currently profiteering from such expenses. Instead, defense spending can shift to space exploration, which also increases invention and economic growth while keeping the defense industrial complex healthy, although now they can pursue profitable enterprises rather than lethality.

In short, our plan promises both peace and prosperity, not for the few but for the many. Prosperity bubbles up. It has never flowed down and tax reform should reflect that.

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.

Contact Sheet

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**Committee on Ways and Means and the Subcommittee on Tax Policy
Hearing on How Tax Reform Will Grow Our Economy and Create Jobs
Thursday, May 18, 2017, 10:00 A.M.
1100 Longworth House Office Building**

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

May 17, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing On How Tax Reform Will Grow Our Economy And Create Jobs

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

I am submitting this letter ahead of the House Ways and Means Committee's scheduled hearing on May 18th entitled "How Tax Reform Will Grow Our Economy and Create Jobs." I commend the work your committee is doing in exploring different ways in which pro-growth tax reform can be achieved and help further strengthen the American economy. As the committee considers different proposals and ideas for reforming the tax code, I want to stress the importance of preserving the full deductibility of interest on debt.

When it comes to reforming America's tax code, my support for supporting interest deductibility comes from my first-hand experience of running the daily operations of Centurion LV. While there is certainly an important role for policymakers and policy thinkers in reforming the tax code, I also firmly believe that input from business owners is critical to setting the record straight on the practical implications of certain tax proposals. My support for full interest deductibility stems from my knowledge of how the tax code affects my ability to grow Centurion LV, create new jobs and strengthen the local economy.

Interest deductibility is a well-established, growth-promoting provision of the tax code that has been in existence for more than 100 years. Expensing interest is a normal cost of doing business. For me, it provides a peace of mind as well as a sense of stability and predictability by guaranteeing I will not be taxed on the cost of accessing capital, and that I can have more flexibility when making important long-term financial decisions.

If it weren't for interest deductibility, I wouldn't have been able to grow my business in such an effective manner. Being able to deduct interest has allowed me to employ many Utahns, and stimulate economic growth.

As a business owner who has experienced first-hand what works and doesn't work in the tax code, I can tell you that full interest deductibility works. I ask that you keep it in place.

Connor Pyle

Centurion LV

How Tax Reform Will Grow Our Economy and Create Jobs



Written Testimony of the
Coalition for a Prosperous America

Before the Committee on Ways and Means
U.S. House of Representatives
May 18, 2017

The Coalition for a Prosperous America (CPA) appreciates the opportunity to provide testimony to the Committee on Ways and Means regarding the likely impact of tax reform on the US economy. CPA is a national, non-partisan organization focusing upon improving American trade performance, eliminating our persistent trade deficit, and growing domestic supply chains as a means to achieving broadly based prosperity in the US. Our members are organizations, companies and individuals involved in or representing manufacturing, agricultural and worker interests.

1. Summary

1.1 The Coalition for a Prosperous America supports Chairman Brady's commitment to the principles of border adjustable, destination based taxation. Rate reduction is less important for trade competitiveness and economic growth than moving our tax mix towards border adjustability. However, CPA has no position on the optimum business tax rate.

1.2. CPA supports a new **border adjustable consumption tax (Goods and Services Tax) that funds a full credit against all payroll taxes.**

1.2.1. The US over consumes, under saves and underutilizes our labor capacity.

1.2.2. A new U.S. *goods and services tax* (GST) of approximately 12% should be enacted to shift taxation to consumption using the credit/invoice method.

1.2.3. GST proceeds should be applied as a full credit against the 15.3% rate of payroll taxes to reduce the cost of labor in the US while increasing after tax wages.

1.2.4. Exported goods and services would receive a full rebate. Imports would pay the GST.

1.2.5. Small business with less than, for example, one million dollars could be exempted without sacrificing significant tax revenue.

1.3. CPA also supports a change to a **border adjustable profit tax (sales factor apportionment - SFA)** for all business entities to replace the current corporate tax system.

1.3.1. SFA is a destination based profit tax. Pretax income is allocated to the US in proportion to the percentage of a company's total sales in the US.

1.3.2. Pre-tax income earned outside the US is not taxed.

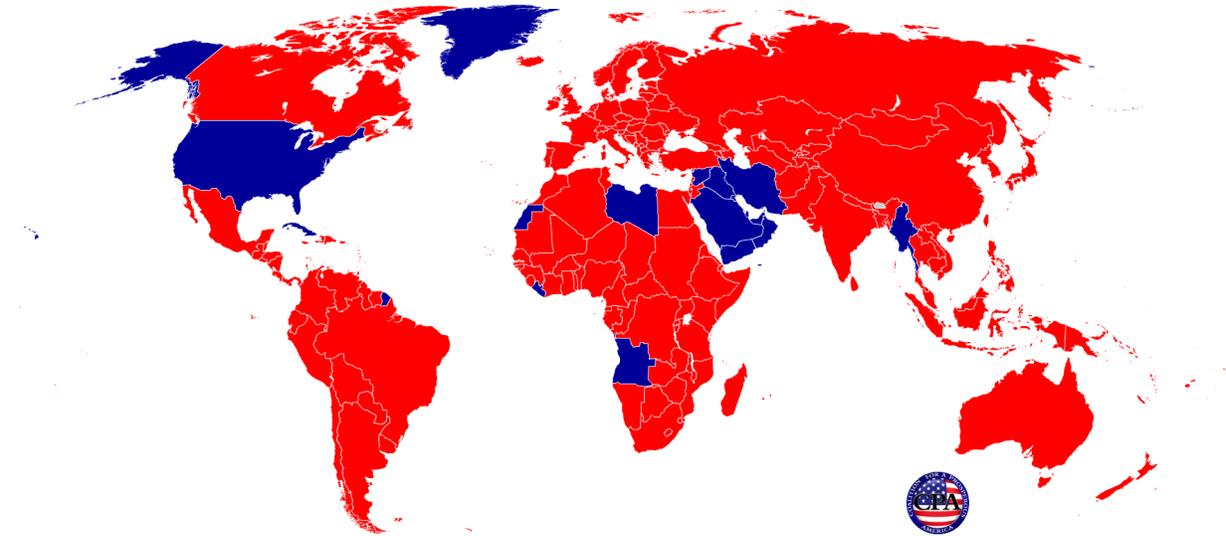
1.3.3. Tax rates can be lowered substantially while still meeting revenue targets.

2. Enact a 12% Consumption Tax and Eliminate the 15.3% Payroll Tax Burden

The US corporate tax system harms America's trade competitiveness, overtaxes income from wages, undertaxes consumption and is bad at actually collecting what is owed. It also enables rampant base erosion through economically fictitious offshoring of profits. Full reform centered around destination based, border adjustment principles can result in an efficient, trade competitive, and largely tamper proof tax system

2.1. Neutralizing foreign VATS for trade competitiveness: Most countries in the world have shifted a significant portion of their tax mix to border adjustable consumption taxes - value added taxes (VATs) or goods and services taxes (GSTs). GSTs are tariff and subsidy replacements - mimicking a currency devaluation - if a country raises the GST AND uses proceeds to lower purely domestic taxes and costs.

The map below shows which nations have consumption taxes (red) and which do not (blue). Because foreign consumption taxes are border adjustable, CPA members who export are double taxed. They pay US taxes and the foreign border tax. Importers can ship cheaper products because they do not pay US taxes and receive a consumption tax rebate from their home country.

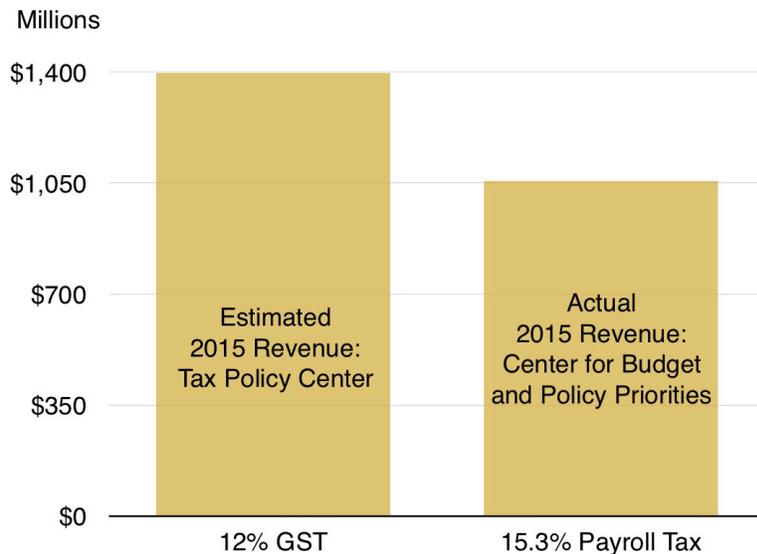


Consumption taxes are called goods and services taxes in Canada, Australia, New Zealand or value added taxes in other countries. Goods and services are taxed as to the incremental value that is added at each level of the supply chain. This is called the credit/invoice method. It is WTO legal. The figure below illustrates how it works.

How a Value-Added Tax Works			
	Price	Value Added	Tax at 5%
Raw materials	\$40	\$40	\$2
Manufactured product	140	\$100	5
Wholesale sale	200	\$60	3
Retail sale	300	\$100	5
Total		\$300	\$ 15

The US should eliminate this global tax discrimination by enacting a goods and services tax (GST), using the added revenue to provide a full credit against both the worker and company share of the 15.3% payroll tax.¹ The most significant economic gains from this shift arise from reducing domestic labor costs by 15.3% which are embedded in all US goods and services.

A broad based 12% GST could raise \$1.4 trillion in new revenue.² Payroll tax revenue in 2015 was 33% of total tax revenue at \$1.056 trillion.³



US trade competitiveness would be substantially improved because exports are freed from both the GST and payroll tax burden. Imports never include the cost of the US payroll tax but would pay the GST. This effect has been called Fiscal Devaluation because it mimics a currency

¹ We do not propose eliminating the payroll tax, but rather to apply a full credit against it. Consumption then funds Social Security, Medicare, Medicaid system. By avoiding payroll tax elimination in favor of a full credit, unnecessary political battles are also avoided.

² Toder, Nunns, Rosenberg, "Using a VAT to Reform the Income Tax," Tax Policy Center, 2012, pg 20.

³ "Policy Basics: Where Do Federal Tax Revenues Come From?" Center on Budget and Policy Priorities, March 4, 2016

devaluation for trade purposes.⁴ It only works if you combine a new GST with a ubiquitous domestic tax or cost reduction. The optimal domestic tax reduction is the payroll tax burden.

2.2. Domestic Prices vs. Wages would not Worsen: The domestic consumers and workers are held harmless for these reasons. The payroll tax is embedded in the cost of all goods and services. Thus eliminating it lowers goods and services prices - or increases wages depending upon the particular competitive forces in each product sector. A GST raises goods and services prices. The GST/payroll tax combination would largely cancel each other out thereby holding the domestic economy harmless.

2.3. Improve upon the modern GSTs of Canada, Australia and New Zealand: The more modern GSTs implemented by free market economies are in Canada, Australia and New Zealand. The compliance and administration burdens are relatively low in comparison to other taxation methods. The US can learn from those and other countries' experiences to implement the most modern, streamlined GST in the world.

3. Enact a Destination Based Profit Tax (Sales Factor Apportionment) to replace the Corporate Tax System

CPA favors a border adjustable business tax (for all entity types) which allocates pre-tax income based upon the destination of sales. Formulary apportionment based upon a single sales factor (sales factor apportionment or SFA) is well established at the state level. It solves most of the base erosion/profit shifting and tax haven abuse problems facing tax writing committees. SFA eliminates the disparate tax treatment between domestic companies (who pay the full income tax burden on worldwide income), multinationals (many of which shift profits to tax havens), and foreign companies (which pay a territorial income tax).

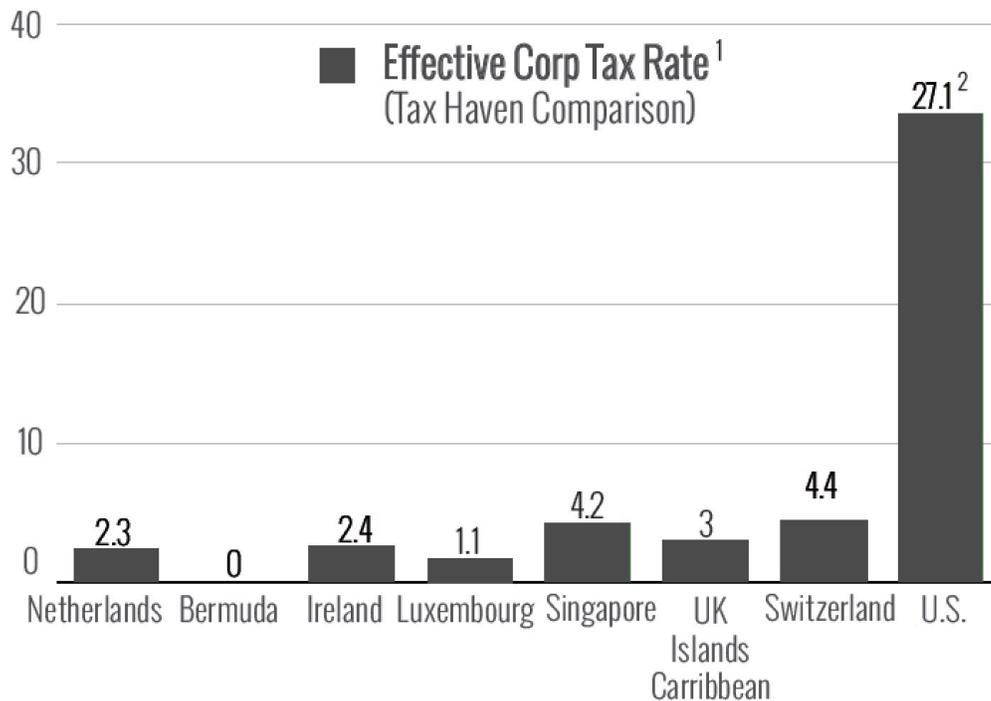
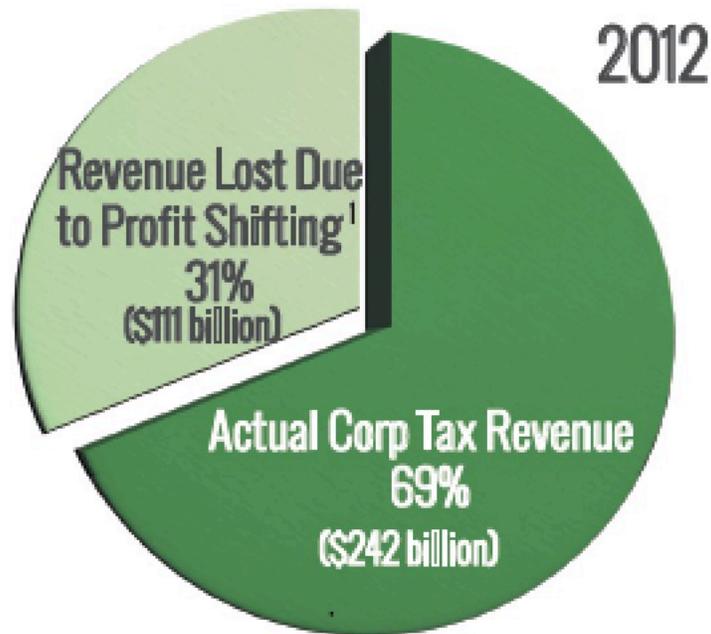
CPA's support is based upon our trade competitiveness preference for border adjustability. SFA taxes pre-tax income allocated to the US but not profits allocated to foreign sales. Domestic firms can legitimately "avoid" taxation by exporting more. Profits from imports are subject to tax. Domestic, multinational and foreign firms are on an equal tax footing.

The current corporate tax system cannot be fixed because it allows the fiction of intra-firm transactions to erode the tax base. Multinational companies use them to self-deal, strictly for tax purposes, shifting income to tax haven jurisdictions. Companies sell products or services to themselves, governed only by an "arms length" principle which allows them to create their own pricing terms subject to a nearly unenforceable "fair market value" constraint.

The intra-company transactions are not free market, arms length or true third party transactions. The only economically meaningful "sale" is one to a true third party outside the company. As much of 30% of tax revenue may be lost from profit shifting to tax haven

⁴ Farhi, Gopinath, and Itskhoki, "Fiscal Devaluations", Federal Reserve Bank of Boston, Working Paper 12-10, (October 18, 2012)

jurisdictions which have effective tax rates of 0-4%.⁵ These include Bermuda, Netherlands, UK Caribbean Islands, Ireland, Luxembourg, Singapore, and Switzerland.



⁵ Clausing, 2015

For example, assume a multinational corporation has worldwide sales of \$100 billion, \$50 billion sales in the US and company-wide pretax income of \$10 billion. Fifty percent of the profits, under SFA, are apportioned to the US. So the profits to be taxed in the USA in this case are \$5 Billion. Using a 20% corporate tax rate yields an SFA tax of \$1 billion. Intra-company transactions with a Bermuda subsidiary would be irrelevant.

Merely lowering the US corporate tax rate to, for example, 15% without further reform would not eliminate the tax competition with tax haven jurisdictions. SFA would make tax havens irrelevant because true sales to any foreign country would be ignored. IRS litigation centered around the proper fair market value of intra-firm transactions would disappear. Only profits allocated to the US in proportion to true third party sales would be taxable.

Virtually all states use formulary apportionment for their state corporate tax system to allocate pre-tax income fairly to the state tax base, ignoring income attributed to outside tax jurisdictions. Most states use a single sales factor, though some use payroll and property as factors.

SFA would allow a significant reduction in the business tax rate while collecting similar revenue because base erosion is largely fixed. By one estimate, a 13% corporate tax rate under SFA would collect the same revenue as the current system.⁶ Whether or not a 13% rate is the appropriate target given government revenue goals, it is clear that a lower rate is eminently achievable.

4. Conclusion

The US tax system should shift to more border adjustability through destination based taxation. If the House GOP Blueprint does not gain Senate or White House support, the Ways and Means Committee has solid alternatives to meet their goals. CPA supports enacting (1) a new GST to fund a full credit against payroll taxes, plus (2) a shift to sales factor apportionment of global profits as an alternative to our current corporate income tax system.

Respectfully submitted,

Daniel DiMicco, Chairman
Brian O'Shaughnessy, Vice Chairman
Michael Stumo, CEO

⁶ Michael Udell and Aditi Vashist, "Sales Factor Apportionment of Global Profits as an Alternate Construction of a Corporate Income Tax Base," District Economics Group, July 14, 2014 (pg 21).



**COALITION FOR FAIR
EFFECTIVE TAX RATES**

Statement for the record by the Coalition for Fair Effective Tax Rates

May 18, 2017

The Coalition for Fair Effective Tax Rates appreciates the opportunity to provide this statement in support of your effort to reform our nation's tax code. In short, our coalition encourages you to pursue comprehensive tax reform and to view its progress through the lens of effective tax rates, the amount that businesses actually pay in taxes expressed as a percentage of their income.

The Coalition for Fair Effective Tax Rates is a diverse group of national, regional and state associations representing more than 1,500,000 businesses, large and small, that support comprehensive tax reform. Our coalition is bound together by the belief that rates should be reduced for both corporations and pass-through entities and that now-wide disparities in effective tax rates paid by various industries should be eliminated.

The coalition believes that our federal income tax code is broken and must be overhauled. The tax system should be simplified and the tax base broadened to generate greater economic activity and job creation. To accomplish that, we believe that tax rates should be lowered for corporations as well as the vast majority of businesses that pay taxes through the individual rate system.

Large disparities exist between the amount of taxes paid by various industries regardless of how the companies are organized. Successful reform should be measured by lawmakers' ability to create a more level playing field for businesses of all sizes across all industry sectors based on effective tax rates.

The current disparity in effective tax rates paid by different U.S. industries is huge. According to the U.S. Treasury, effective actual federal corporate tax rates paid between 2007 and 2010 ranged from 30.3 percent to 14.5 percent. The gap is not only unfair to high-effective-rate-paying companies, it is hurting our economy by distorting the allocation of investment among industries and artificially subsidizing certain industries while penalizing others because tax preferences disproportionately favor one set of companies over others.



**COALITION FOR FAIR
EFFECTIVE TAX RATES**

This fact should be a fundamental guide for your committee's reform efforts. Entities should not pay radically different amounts of tax if they earn roughly the same amount of money. This is not just a matter of fairness, it's also about having a tax policy that is economically sound.

Thank you in advance for pressing forward with comprehensive tax reform.

Management Committee, Coalition for Fair Effective Tax Rates:

Associated Builders & Contractors

Associated General Contractors

International Foodservice Distributors Association

International Franchise Association

National Association of Wholesaler-Distributors

Small Business and Entrepreneurship Council



**COALITION FOR FAIR
EFFECTIVE TAX RATES**

MEMBERSHIP:

Alabama Retail Association
American Apparel & Footwear Association
American Council of Engineering Companies
American Lighting Association
American Rental Association
American Subcontractors Association, Inc.
American Supply Association
American Trucking Associations
American Veterinary Distributors Association
Arizona Builder's Alliance
Arizona Retailers Association
Asian American Hotel Owners Association
Associated Builders & Contractors
Associated Builders & Contractors of Alabama
Associated Builders & Contractors of Arkansas
Associated Builders & Contractors of Central Texas
Associated Builders & Contractors of Connecticut
Associated Builders & Contractors of Delaware
Associated Builders & Contractors of Greater Michigan
Associated Builders & Contractors of Hawaii
Associated Builders & Contractors of Metro Washington
Associated Builders & Contractors of Michigan
Associated Builders & Contractors of Minnesota & North Dakota
Associated Builders & Contractors of Mississippi
Associated Builders & Contractors of North Alabama
Associated Builders & Contractors of Southeast Texas
Associated Builders & Contractors of Virginia
Associated Builders & Contractors-Carolinas Chapter
Associated Builders & Contractors-Central Florida Chapter
Associated Builders & Contractors-Central Ohio Chapter
Associated Builders & Contractors-Central Pennsylvania Chapter
Associated Builders & Contractors-Eastern Pennsylvania Chapter
Associated Builders & Contractors-Empire State Chapter
Associated Builders & Contractors-Florida East Coast Chapter
Associated Builders & Contractors-Georgia Chapter
Associated Builders & Contractors-Greater Houston Chapter
Associated Builders & Contractors-Illinois Chapter
Associated Builders & Contractors-Inland Pacific Chapter



COALITION FOR FAIR EFFECTIVE TAX RATES

Associated Builders & Contractors-Iowa Chapter
Associated Builders & Contractors-Keystone Chapter
Associated Builders & Contractors-New Jersey Chapter
Associated Builders & Contractors-New Mexico Chapter
Associated Builders & Contractors-New Orleans/Bayou Chapter
Associated Builders & Contractors-Northern California Chapter
Associated Builders & Contractors-Northern Ohio Chapter
Associated Builders & Contractors-Pelican Chapter
Associated Builders & Contractors-Rhode Island Chapter
Associated Builders & Contractors-Rocky Mountain Chapter
Associated Builders & Contractors-San Diego Chapter
Associated Builders & Contractors-Southeastern Michigan Chapter
Associated Builders & Contractors-Southern California Chapter
Associated Builders & Contractors-Texas Gulf Coast Chapter
Associated Builders & Contractors-Western Michigan Chapter
Associated Builders & Contractors-Western Washington Chapter
Associated Equipment Distributors
Associated General Contractors
Associated General Contractors of America-Florida East Coast Chapter
Associated General Contractors of Michigan
Associated General Contractors of Ohio
Associated General Contractors of Tennessee
Associated General Contractors of Washington
Associated General Contractors-Central Texas Chapter
Association for Hose & Accessories Distribution (The)
Association of Pool & Spa Professionals
Auto Care Association
Business Solutions Association
California Business Properties Association
California Retailers Association
Colorado Retail Council
Connecticut Associated Builders & Contractors
Construction Financial Management Association
Convenience Distribution Association
Education Market Association
Equipment Marketing & Distribution Association
Far West Equipment Dealers Association
Food Industry Suppliers Association
Food Marketing Institute
Foodservice Equipment Distributors Association
FPDA Motion & Control Network



COALITION FOR FAIR EFFECTIVE TAX RATES

Gases and Welding Distributors Association
Health Industry Distributors Association
Healthcare Distribution Alliance
Heating, Airconditioning & Refrigeration Distributors International
Independent Electrical Contractors
Independent Insurance Agents & Brokers of America
Independent Office Products & Furniture Dealers Association
Industrial Supply Association
International Association of Plastics Distribution
International Foodservice Distributors Association
International Franchise Association
International Pizza Hut Franchisee Association
International Warehouse Logistics Association
Irrigation Association
ISSA-The Worldwide Cleaning Industry Association
Kentucky Retail Federation
Kentucky-Indiana Aftermarket Wholesalers Association
Louisiana Retailers Association
Material Handling Equipment Distributors Association
Metals Service Center Institute
Mid-America Equipment Retailers Association
Motorcycle Industry Council
National Association of Chemical Distributors
National Association of Electrical Distributors
National Association of Wholesaler-Distributors
National Beer Wholesalers Association
National Community Pharmacists Association
National Confectioners Association
National Electrical Contractors Association
National Funeral Directors Association
National Grocers Association
National Insulation Association
National Marine Distributors Association
National Restaurant Association
National Roofing Contractors Association
Nebraska Retail Federation
New Jersey Retail Merchants Association
North American Equipment Dealers Association
North Carolina Retail Merchants Association
North Dakota Retail Association
NPES-The Association for Suppliers of Printing, Publishing and Converting Technologies



COALITION FOR FAIR EFFECTIVE TAX RATES

Ohio Equipment Distributors Association
Ohio-Michigan Equipment Dealers Association
Outdoor Power Equipment & Engine Service Association
Pennsylvania Retailers Association
Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association
Printing Industries of America
Retail Association of Maine
Retailers Association of Massachusetts
S Corporation Association
Secondary Materials and Recycled Textiles Association
Security Hardware Distributors Association
Small Business and Entrepreneurship Council
South Carolina Retail Association
South Dakota Retailers Association
Taco Bell Franchise Management Advisory Council
Tennessee Retail Association
Texas Retailers Association
TEXO-The Construction Association
Textile Care Allied Trades Association
Truck Renting and Leasing Association
Virginia Retail Merchants Association
Water & Sewer Distributors of America
West Virginia Retailers Association
Wholesale Florist & Florist Supplier Association
Woodworking Machinery Industry Association
World Millwork Alliance

June 1, 2017

The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Peter Roskam
Chairman
House Subcommittee on Tax Policy
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
House Committee on Ways and Means
1106 Longworth House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
House Subcommittee on Tax Policy
1106 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Brady, Chairman Roskam, Ranking Member Neal, and Ranking Member Doggett:

We write regarding the Committee's recent hearing on tax reform's potential to grow our economy and create jobs. These are goals that our companies and organizations share. To that end, we welcome the opportunity to highlight the positive contributions of tax incentives for energy efficient investment. In particular, the Section 179D tax deduction for energy efficient commercial and larger multifamily buildings has leveraged billions of dollars in private capital, resulted in energy efficient enhancements to thousands of buildings, and created and preserved hundreds of thousands of jobs since its inception.

These benefits are confirmed by a recent economic impact study conducted by Regional Economic Models, Inc. ("REMI"), the executive summary of which is attached to this statement as an appendix. REMI's conclusion is unequivocal, finding that "**Section 179D is an engine of economic and employment growth.**" In particular, an enhanced tax incentive for energy efficient commercial buildings could support up to **76,529 jobs and contribute almost \$7.4 billion toward our national GDP each year.** These results represent a significant return on the taxpayer investment in Section 179D, well in excess of the provision's revenue cost.

The study also confirms that extending the current version of Section 179D or making more modest changes to the incentive would have a substantial positive impact on economic and employment growth. We encourage you to review the study in its entirety, by following this [link](#).

We urge you to keep the economic impact of Section 179D in mind as you consider comprehensive tax reform. Section 179D's proven ability to support economic growth and job creation aligns with the Committee's goals for tax reform. We look forward to working with you to ensure that tax incentives for energy efficient investment continue to be an engine of growth for our economy. Thank you for your consideration.

Sincerely,

Alliantgroup, LP
Ameresco, Inc.
American Institute of Architects
BLUE Energy Group LLC
Building Owners and Managers Association (BOMA) International

Concord Energy Strategies, LLC
Energy Systems Group, LLC
Energy Tax Savers, Inc.
National Electrical Manufacturers Association (NEMA)
Natural Resources Defense Council
U.S. Green Building Council, Inc.

cc: Members of the House Ways and Means Committee



**Analysis of Proposals to Enhance and Extend the Section
179D Energy Efficient Commercial
Buildings Tax Deduction**

Prepared by Regional Economic Models, Inc. (REMI) May 2017

Executive Summary

Section 179D of the Internal Revenue Code, the Energy Efficient Commercial Buildings Deduction, was originally enacted by Congress as part of the Energy Policy Act of 2005 to promote energy independence. Section 179D promotes the proper allocation of incentives in the real estate development process. A key challenge to realizing the benefits of energy-efficient improvements is that the associated cost savings flow to building occupants, not developers. By helping offset the cost of energy efficient investments, Section 179D allows building owners to share in the incentive to install energy-efficient improvements that help their occupants save money on electricity, water, and climate control costs. In so doing, Section 179D promotes private-sector solutions to improve conservation practices and modernize national infrastructure.

In this analysis, REMI evaluates the economic impact of three potential approaches to the Section 179D deduction, which most recently expired at the end of 2016:

1. **Strengthening and Modernizing Section 179D**,¹ which would increase the value of the deduction to \$3.00 per square foot from \$1.80, increase the applicable energy efficiency standards, make it available to support improvements to existing as well as new buildings, and extend the deduction.
2. **Extension of Current Law Section 179D plus Expansion to Non-Profits and Tribal Governments**,² modeled on 2015 legislation developed by the Senate Finance Committee under Chairman Orrin Hatch (R-UT), which would extend the deduction, expand availability of the deduction to nonprofit organizations and tribal governments and increase the applicable energy efficiency standards.
3. **Extension of Current Law Section 179D**,³ modeled on the two-year extension of current law enacted as part of the Protecting Americans from Tax Hikes (“PATH”) Act of 2015.

The results of this analysis show that in addition to advancing the goal of energy independence, **Section 179D is an engine of economic and employment growth**. As captured in the table below, this study quantifies these impacts, finding that:

- Strengthening and extending the Section 179D Energy-Efficiency Commercial Buildings Deduction will create jobs and expand the nation’s economy. These benefits would be compounded by increasing the dollar value of the deduction in accordance with several Congressional and administration proposals.
- These enhancements to Section 179D would support up to 76,529 jobs annually and contribute annually almost \$7.4 billion to national gross domestic product (“GDP”), as well as over \$5.7 billion towards national personal income.
- Expanding the availability of the deduction to nonprofit organizations and tribal governments, while increasing the applicable energy efficiency standards, also provide clear positive impacts to the economy.

¹ Proposals along these lines include Title I of S. 2189, sponsored by Senator Cardin (D-MD) in the 113th Congress and the President’s FY 2017 Budget Proposal. See Description of Certain Revenue Provisions Contained in the President’s Fiscal Year 2017 Budget Proposal, Joint Committee on Taxation, July 2016, JCS-2-16.

² See Description of the Chairman’s Mark of a Bill to Extend Certain Expired Tax Provisions, July 17, 2015, JCX-101-15, and Description of the Chairman’s Modification to the Chairman’s Mark of a Bill to Extend Certain Expired Tax Provisions, July 21, 2015, JCX-103-15. In addition to the Senate Finance Committee extenders bill, other proposals along these lines include H.R. 6376, sponsored by Congressman Reichert (R-WA) in the 114th Congress.

³ General Explanation of Tax Legislation Enacted in 2015, Joint Committee on Taxation, March 2016, JCS-1-16.

Table 1. Average Annual Economic Impacts for First Ten Years

	Strengthen and Modernize	Extension plus Expansion	Extension of Current Law
Jobs	76,529	39,388	40,749
GDP (millions of dollars)	7,398	3,730	3,860
Personal Income (millions of dollars)	5,729	3,017	3,128

May 31, 2017
JOINT STATEMENT FOR THE
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

ON BEHALF OF:
American Hospital Association (AHA)
National Association of College and University Business Officers (NACUBO)
National Association of Health and Educational Facilities Finance Authorities (NAHEFFA)

The associations listed above respectfully submit this statement to the House Committee on Ways and Means for the hearing on “How Tax Reform Will Grow Our Economy and Create Jobs” held on May 18, 2017.

Together, we represent thousands of U.S. colleges, universities and hospitals as well as the finance authorities dedicated to providing capital financing for not-for-profit healthcare and higher education institutions.

As Congress begins the hard work of reforming the nation’s tax code:

We respectfully urge Congress to protect and maintain tax-exempt bond financing, including qualified 501(c)(3) private-activity bonds, which is necessary for the missions and continued financial health of hospitals, colleges, universities, and other charitable organizations and which promotes critical infrastructure and economic development throughout the United States.

Low-cost access to capital helps keep these institutions strong, enabling them to keep infrastructure expenditures low so that they can efficiently fulfill their mission and focus on the work they do for the public good— making our lives, our economy, and our nation stronger.

While the recent hearing did not address the matter of tax-exempt bond financing, we observe the language in the House tax reform blueprint “A Better Way” which references repeal of “special-interest provisions” and are concerned that this may be construed to apply to tax-exempt bond financing.

One of the many ways the federal government invests in human capital and innovation in the United States is by granting tax-exempt status to hospitals, health clinics, colleges, universities, and other charitable institutions whose health, public service, education, and research missions provide a wide range of societal benefits. Hospitals, colleges, and universities are economic mainstays, providing stability and job growth in communities.

Hospitals employed more than 5.7 million people in 2015, and purchased more than \$852 billion in goods and services from other businesses. Each hospital job supports about 2 additional jobs, and every dollar spent by a hospital supports roughly \$2.30 of additional business activity.

There are more than 3,300 public and nonprofit colleges and universities in the U.S. educating nearly 19 million students, engaged in more than \$67 billion in research and development, and contributing to a vast array of public service endeavors.

Public universities and hospitals are typically a component of state or local governments, while independent, community-based institutions are recognized as tax-exempt organizations under section 501(c)(3) of the Internal Revenue Code. Tax-exempt bond financing available to public institutions is also referred to as *municipal bonds*; it is available to nonprofit colleges, universities, and hospitals as *qualified 501(c)(3) private activity bonds*.

Our member organizations use these financial instruments to acquire, construct, renovate, and expand capital infrastructure such as clinics, sheltered workshops, hospitals, academic buildings, residence halls, modern energy plants, museums, and more. In 2016, higher education bond sales reached \$18.4 billion and tax-exempt health care bond sales totaled \$49.6 billion.¹

In general, for institutional borrowers, the interest rate on municipal bonds is significantly lower than on taxable bonds, thus creating beneficial financial terms. Indeed, the interest rate spread between taxable and tax-exempt bonds typically ranges between 150 and 200 basis points. The lower interest rates create significant savings by lowering the financing cost of multi-million dollar construction projects, often financed over a 30-year period. The lower financing cost allows hospitals and health care institutions to keep charges lower than would be the case if taxable financing was used. For colleges and universities, the lower financing cost enables them to keep tuition lower than would be the case if taxable financing was used.

For many institutions, public or private, revenue from operations or from restricted gifts simply does not provide sufficient funds to build, expand, and renovate the physical plant, property, and equipment needs necessary to meet their respective missions, and taxable debt is more costly, often by a material amount.

These organizations employ bonds only after close scrutiny of risk and financial plans and manage them prudently. If an institution holds such tax-exempt debt, it is required to meet significant post-issuance disclosure and compliance requirements.

Limiting the Interest Exclusion Will Raise Costs. A number of proposals have been made to Congress to alter the tax treatment of tax-exempt bonds. We believe a cap on the income tax exemption of tax-exempt municipal bond interest, or even a partial tax, will cause investors to demand higher returns, again leading to higher infrastructure costs. Higher borrowing costs can result in diminished investment in infrastructure, higher costs, fewer jobs, reduced public services, increased charges and fees, and constraints on the ability to fulfill their public mission.

For example, according to a study conducted by IHS Markit², a 28 percent cap on tax-exempt interest exemption, based on average capital spending over the years 2003-2012, would reduce U.S. gross domestic product (GDP) by \$8.3 billion per year, costing the nation more than 104,000 jobs and \$5.5 billion in labor income annually. A complete elimination of tax-exempt interest would reduce GDP by \$23.6 billion and cost 299,000 jobs generating \$15.6 billion in labor income.

¹ The Bond Buyer Decade in Public Finance statistics.

² <http://www.naheffa.com/uploads/2/9/2/5/29251611/naheffa-economic-impact-report.pdf>

Proposals to reduce or eliminate the interest tax exemption would cost nonprofits billions more in interest expenses. Nonprofit organizations relied on 501(c)(3) tax exempt financing to raise \$554 billion for capital projects from 2003-2012. A 28 percent benefit cap on tax-exempt interest would have increased total interest expenses for nonprofits by \$58.2 billion from 2003-2012, while a complete elimination would have cost nonprofits an additional \$166.3 billion over that period.

Tax-exempt bond financing for not-for-profits is a proven tool with a decades-long record of success for providing cost-effective vital public services and strengthening communities. Bond issuance for private nonprofit hospitals and universities is typically overseen by a unit of state or local government or a municipal bond conduit authority, which is authorized by the state legislature to issue bonded debt.

Direct Pay Bonds. A variety of proposals have been made to restrict or alter tax-exempt financing mechanisms. One example is direct pay bonds, such as Build America Bonds (BABs). While these bonds were not available to nonprofits, many public colleges, universities, and hospitals issued BABs when they were available. While we would need to review the detail of any new proposals, we generally support direct pay programs if they are designed with adequate financial support to result in a financial instrument whose total costs are comparable with a tax-exempt bond. Should BABs be reinstated in some form, we support expanding eligibility to include private 501(c)(3) institutions.

However, if continuity of federal subsidy payments is unreliable, as demonstrated under recent sequestration orders, we are skeptical that institutions will see direct pay bonds as a dependable budget and planning tool to lower borrowing costs. We encourage Congress to consider direct pay bonds and other proposals as complements, and not alternatives, to tax-exempt bonds.

Contacts:

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Liz Clark, NACUBO, lclark@nacubo.org, (202) 861-2253
Mike Rock, AHA, mrock@aha.org, (202) 626-2325

June 1, 2017

The Honorable Kevin Brady
Chairman, Committee on Ways & Means
House of Representatives
1101 Longworth House Office Building
Washington, DC 20515

The Honorable Richard Neal
Ranking Member, Committee on Ways & Means
House of Representatives
341 Cannon House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

As Congress considers tax reform, we, the undersigned, write to express our strong support for preserving and expanding the tax-exempt status of Private Activity Bonds (PABs). PABs represent a critical source of funding for important qualified projects and programs, including infrastructure, mortgage financing, economic development, the funding and refinancing of student loans, and much more. PABs catalyze private investment in projects and industries that may otherwise not receive conventional financing and, as such, are a key tool for states and local governments.

PABs, which are one of the oldest tax policies on record and were included in our nation's first formal tax code, finance numerous projects and initiatives that are critical to citizens across the country. PABs are issued annually on behalf of thousands of private enterprises including small manufacturers, nonprofits, veterans, housing developers, universities, first-time farmers, cultural institutions, hospitals, and renewable energy providers. PABs are also used to fund low-cost non-federal education loans and refinancing loans, as well as housing programs for low- and moderate-income individuals and families. These projects and initiatives are supported and approved for PAB financing by state or local governments with the understanding that the projects are important to the economic development and long-range stability of their communities.

In addition to lowering the costs associated with the development of critical projects or initiatives, PABs are a highly efficient way for the federal government to support job creation and community and economic development initiatives. PABs are a non-recourse debt instrument that have zero impact on local, state, and federal tax revenues. As a result PABs lower the cost of capital for countless community and economic development ventures without endangering taxpayer dollars. Countless projects around the country have benefited from PABs, which have enabled projects that would not ordinarily be undertaken to succeed (see attached).

The Trump Administration recently recognized, in their 2017 Infrastructure Initiative, the vital importance PABs play in supporting program and project development. The Initiative calls for the expanded eligibility of certain non-federal public infrastructure projects to receive PAB funding, as well as a removal of the cap on PABs that finance highway and freight transfer projects. We, the undersigned, believe Congress should follow suit, by expanding and preserving tax-exempt Private Activity Bonds as it works to reform the tax code.

Respectfully,

Council of Development Finance Agencies

Education Finance Council

National Council of State Housing Agencies

National Development Council

Performance Based Building Coalition

Projects Benefitting from Private Activity Bonds

Project Name: Colgan Meadows Apartments
Location: Santa Rosa, CA
Jobs Supported: 290
Description: Multifamily housing bonds assisted financing of 84-unit affordable rental complex.

Project Name: Holt Dairy Farms
Location: Enterprise, UT
Jobs Supported: 90
Description: Industrial development bonds financed the construction of a disposal and utilizations system for manure from a dairy farm.

Project Name: Austral Shipyard
Location: Mobile, AL
Jobs Supported: 1,900
Description: These bonds helped Austral USA nearly double both its workforce and shipyard to complete work on US Navy contracts.

Project Name: Appalachian Power Co.
Location: Winfield, WV
Jobs Supported: 95
Description: The company acquired, constructed, and equipped certain solid waste disposal facilities with these bonds.

Project Name: I-495 Capital Beltway HOT Lanes
Location: Northern Virginia
Description: This highway project was financed with Qualified Highway or Surface Freight Transfer Facilities bonds.

Project Name: Rapid Bridge Replacement Project
Location: Pennsylvania
Description: This highway project was financed with Qualified Highway or Surface Freight Transfer Facilities bonds.

Project Name: Andaluas Highway Expansion
Location: Mission, TX
Jobs Supported: 210
Description: The highway expansion, financed with tax-exempt bonds, will increase trade between Texas and Mexico.

Project Name: Vermont Center for the Deaf and Hard of Hearing
Location: Brattleboro, VT
Jobs Supported: 228
Description: Energy saving improvements and campus renovations were made possible with 501(c)(3) bonds.

Initiative Name: I Am College Bound/I Applied
Location: Concord, NH
Students Supported: 1,054
Description: This New Hampshire project helped 1,054 students at 24 public high schools submit 2,221 college applications. Each participating high school received one \$500 scholarship.

Project Name: Oconee Memorial Hospital
Location: Seneca, SC
Jobs Supported: 1,099
Description: Acquisition of a 174,000 sq. ft. expansion and renovation to existing hospital facilities was made possible with these bonds.

Project Name: North Tarrant Express
Location: Fort Worth, TX
Description: This highway project was financed with Qualified Highway or Surface Freight Transfer Facilities bonds.

Project Name: Goethals Bridge Replacement
Location: Staten Island, NY
Description: This highway project was financed with Qualified Highway or Surface Freight Transfer Facilities bonds.



COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

CHAIRMEN

MITCH DANIELS
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CAROL COX WAIT
DAVID M. WALKER
JOSEPH WRIGHT, JR.

Committee for a Responsible Federal Budget
Statement for the Record for the Committee on Ways and Means
Hearing on “How Tax Reform Will Grow Our Economy and Create Jobs
Across America.”
May 18, 2017

Chairman Brady, Ranking Member Neal, and distinguished Members of the Committee on Ways and Means:

Thank you for the opportunity to provide written testimony for the Committee’s May 18 hearing on “How Tax Reform Will Grow Our Economy and Create Jobs Across America.”

It has been more than 30 years since the United States last reformed the federal tax code, and the need for modernization is as great as ever. The current code is a drag on growth—discouraging work, savings, and investment while encouraging investment decisions based on tax planning rather than sound business practice. Our statutory corporate income tax rate is among the highest in the world, discouraging foreign investment and putting American businesses at a disadvantage relative to international competitors. The code also includes [\\$1.6 trillion](#) in annual tax breaks that lose revenue, undermine fairness, and distort economic decision-making.ⁱ

At a time when demographic headwinds will make it much harder to achieve the high growth rates experienced in the past, tax reform is one of the most important tools for boosting growth that policymakers have at their disposal.

Deficit-Financed Tax Cuts Can Be Counterproductive. While comprehensive tax reform can help grow the economy, debt-financed tax cuts are less likely to be effective and may even slow growth. Higher government debt crowds out private investment, which over time can dampen economic activity more than lower tax rates boost it. The best way to ensure tax reform promotes economic growth is to reduce both tax rates and budget deficits.

Fiscally Responsible Reform Is More Pro-Growth. The Joint Committee on Taxation (JCT) has [estimated](#) that revenue-neutral individual tax reform that lowers rates and broadens the tax base could increase the size of the economy by 1.1 to 1.8 percent in the long-run.ⁱⁱ JCT also estimated that revenue-*raising* tax reform of the same design would be even more pro-growth, increasing the long-run size of the economy by 1.7 to 2.2 percent, because it would help slow the unsustainable rise in government debt that is otherwise projected to crowd out private investment and hold the economy back.



Faster Growth Would Help the Fiscal Situation. There are enormous benefits to faster economic growth, including higher wages, more jobs, and greater economic security. Faster growth also means more taxable income and thus tax revenue generated without increasing tax rates. A 0.2 percentage point increase in the annual growth rate, for example, would reduce deficits by about \$550 billion over a decade and reduce debt in 2027 by about 4 percent of Gross Domestic Product (GDP), a small but meaningful down payment.

Dynamic Revenues Should Be Devoted to Deficit Reduction. Given our daunting long-term fiscal gap, any revenue tax reform might generate through greater economic growth should go toward reducing projected budget deficits. Here you should follow the lead of former Chairman Dave Camp. JCT estimated that his “Tax Reform Act of 2014” would have generated between \$50 and \$700 billion in dynamic revenue, which Chairman Camp [devoted](#) to deficit reduction rather than additional rate cuts.ⁱⁱⁱ

Importantly, if the gains from growth are used to finance tax reform, they cannot also be used to help address our mounting debt. The same funds cannot be used twice.

As the Committee moves forward in developing the pro-growth tax reform the country needs, we stand ready to work with you to help develop a plan that is fair, pro-growth, and fiscally responsible. Our principles for tax reform are available [here](#).^{iv}

ⁱ <http://www.crfb.org/blogs/jct-estimates-record-16-trillion-tax-breaks-2017>

ⁱⁱ [https://www.finance.senate.gov/imo/media/doc/Comprehensive Tax Reform for 2015 and Beyond5.pdf](https://www.finance.senate.gov/imo/media/doc/Comprehensive%20Tax%20Reform%20for%202015%20and%20Beyond5.pdf), p. 336

ⁱⁱⁱ <http://www.crfb.org/blogs/camp-makes-more-fiscally-responsible-choices>

^{iv} <http://www.crfb.org/papers/principles-responsible-tax-reform>



United States House Committee on Ways and Means Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

May 18, 2017

CompTIA

515 2nd Street NE

Washington, D.C. 20002

Thank you for the opportunity to express our views on this very important subject. On behalf of the Computing Technology Industry Association (CompTIA), I urge members of the House Committee on Ways and Means, and the Congress as a whole, to pursue much-needed reforms to our corporate tax code.

The Computing Technology Industry Association is a non-profit trade association serving as the voice of the information technology (IT) industry.¹ With approximately 2,000 member companies, 3,000 academic and training partners, and nearly 2 million IT certifications issued, CompTIA is dedicated to advancing industry growth through educational programs, market research, networking events, professional certifications, and public advocacy.

A competitive tax policy that lowers the corporate rate, employs territoriality, and incentivizes innovation and investment in the United States, is critical for American technology companies to thrive in the United States and the world. Our industry and many others are constrained by an outmoded and complex federal tax code that is in need of overhaul to reflect the dynamism of American ingenuity. The U.S. corporate tax rate is among the highest in the industrialized world, and of the countries that employ a territorial tax system, it is more than 50 percent higher (39 percent) than the next ranking country (23 percent).²

Our members support leveling the playing field both domestically and internationally, seeking to eliminate the inequities of the current tax code, including the ever-increasing costs associated with tax compliance. Any corporate tax reform proposals must treat the information technology

¹ "About Us." CompTIA. <https://www.comptia.org/about-us>

² "Corporate Income Tax Rates Around the World, 2016." Tax Foundation. August 18, 2016. <https://taxfoundation.org/corporate-income-tax-rates-around-world-2016/>

industry equitably – both large companies, as well as small- and medium-sized businesses. Specifically, CompTIA supports the following principles within the broader context of corporate tax reform:

- **Reduce the corporate tax rate to 20 percent.** U.S. companies are burdened with the highest corporate tax rate among OECD countries, making them less competitive with their foreign counterparts. We support reducing the corporate tax rate to no higher than 20 percent, without increasing taxes on small- and medium-sized businesses.
- **Enact a territorial international tax system.** The U.S. is one of a handful of developed countries that taxes corporate earnings on a global basis. This means that a U.S. company's foreign earnings are subject to U.S. tax when repatriated, increasing the foreign tax rate on these earnings to the U.S. rate. We support enactment of a territorial international system that would remove the punitive tax that prevents foreign earnings from being repatriated to the U.S.
- **Tax repatriated profits at a lower rate.** We support legislation that incentivizes U.S.-based companies to reinvest profits back into the U.S. by allowing those repatriated profits to be taxed at a lower rate. Currently, companies are discouraged from repatriating their profits because of the high corporate tax rate that would result.
- **Tax "innovation box profits" at a lower rate than the corporate rate.** We support policies that foster innovation such as a "patent box" to attract and retain domestic intellectual property development and ownership. A lower rate of taxation on innovation would encourage companies to continue to reinvest in domestic IP development while remaining competitive globally.
- **Make the CFC look-through rule permanent.** The territoriality provisions of most other developed countries allow domestically-based companies operating abroad to structure their foreign operations without the additional home country tax of the sort imposed by the U.S. Subpart F rules. In December 2015, the rule was extended through FY20 in the FY16 omnibus. Making the CFC look-through permanent would allow U.S. based companies to marshal their capital outside the U.S. in a way that would enable them to compete on a more level playing field with their foreign counterparts.

The last major tax reform occurred in 1986. While many support reform, Congressional debate continues, and timing for action remains uncertain. Such uncertainty hinders growth. The United States has long been the global hub for innovation, but absent broad, commonsense reforms to our tax code, innovation, job, and economic growth could all be stifled, threatening our position as the global leader.

CompTIA welcomes this opportunity to offer our perspective on this issue and others facing the IT industry and nation. The information, communication and technology sector is one of the largest industry sectors in the U.S. economy. The market is \$3.7 trillion globally, and \$1 trillion in

the United States, employing approximately 7 million Americans.³ To put this into perspective, the gross output of the technology sector exceeds that of the legal services industry, the automotive industry, the airline industry, the motion picture industry, the hospitality industry, the agriculture industry and the restaurant industry, just to name a few examples (source: U.S. Bureau of Economic Analysis).

The technology industry not only helps drive economic growth in a multitude of ways, but it continues to significantly enrich how we live, work, and play. We stand ready to work with you, and I am happy to address any questions you may have.

Respectfully,



Elizabeth Hyman

Executive Vice President, Public Advocacy

³ "Cyberstates 2017." CompTIA. March 2017. <http://cyberstates.org/#>



CRANECOALITION

Cost Recovery Advances the Nation's Economy

**STATEMENT FOR THE RECORD
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
HEARING ON HOW TAX REFORM WILL GROW THE ECONOMY AND CREATE JOBS**

MAY 18, 2017

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The CRANE Coalition is the voice of companies and trade groups representing industries that invest heavily in business equipment and machinery in the United States. The tax code can make a critical difference in the economics of domestic investment and thus can help determine the risk-tolerance and budget for investment by individual companies. In turn, the level of national investment in the latest and most productive equipment and machinery is a key determinant of the country's future prosperity and standard of living.

During the previous tax reform efforts in this committee and in the Senate Finance Committee, starting in 2011, CRANE members were deeply concerned about efforts in both committees to cut back accelerated depreciation of capital investments -- cutbacks that that would have hiked the cost of capital for domestic investment. CRANE published a study in 2015 explaining the adverse economic consequences of cuts in MACRS – the tax code's longstanding system of accelerated depreciation. CRANE also published a study in 2015 showing the long-term revenue consequences of cuts in MACRS and demonstrating why such cuts are an inappropriate revenue offset for permanent tax reforms.

What CRANE members understand well is that rapid cost recovery is fundamentally about cash flow and that, for most companies, cash flow is a key determinant of investment. While some U.S. companies may be in a position to freely access the capital markets for all their capital needs, most are not – for financial, prudential, or other reasons. For most companies, if cash flow declines because of cuts in MACRS, investment inevitably will decline along with it.

In short, as we have pointed out for the last two years, accelerated depreciation promotes domestic investment and economic growth. Its repeal has no logical place in a tax reform measure meant to help get the tax code out of the way of the country's economic growth. The superiority of rapid capital cost recovery as a tool for promoting economic growth in tax reform has been documented both in a study by the Treasury Department under President George W. Bush and in a 2011 article by

three economists on the staff of the Joint Tax Committee on Taxation, among other sources.¹ The Treasury study determined explicitly that improvements in capital cost recovery would boost economic growth more effectively than other tax reform options.

CRANE members strongly support the shift of thinking in this committee, reflected in the tax reform “blueprint,” in the direction of more-rapid recovery of capital costs and away from cutbacks in MACRS. Although a tax reform measure can serve multiple purposes, clearly the main driver of such a bill will be to spur faster economic growth for the benefit of all Americans. Rapid cost recovery is key to stimulating investment and spurring growth.

For today’s hearing record, we believe it is important for the committee to understand accelerated depreciation from an historical perspective. For more than six decades, Congress has taken a series of steps to speed up the pace of cost recovery as a means of stimulating domestic investment and boosting economic growth. Congress today would be acting in a manner fully consistent with the history if it took further steps to speed up cost recovery to boost growth.

The federal income tax was in place for four decades before the first permanent allowances for accelerated depreciation were added into the tax code, in 1954. The Internal Revenue Code of 1954 authorized the use of the double declining balance method and sum of the years’ digits method of depreciation for assets with a useful life of more than three years. In adopting those provisions, a committee report explained that the provision would boost investment and economic growth:

More liberal depreciation allowances are anticipated to have far-reaching economic effects....The acceleration in the speed of the tax-free recovery of costs is of critical importance in the decision of management to incur risk. The faster tax write-off would increase available working capital and materially aid growing businesses in the financing of their expansion. For all segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living.²

Over the decades from 1954 to the present, accelerated depreciation has gradually become more deeply embedded in federal tax policy. In 1958 and again in 1962, Congress liberalized the rules in a number of ways, such as by enacting section 179, which then, as today, was meant to provide rapid write-offs for smaller businesses. During the 1960s and 1970s, the administrative rules and regulations under which taxpayers determined the depreciable lives for assets moved steadily toward shorter lives.³ The asset depreciation range (ADR) system prescribed by the Treasury Department in 1971 explicitly allowed taxpayers to select depreciable lives shorter than the Treasury’s calculation of industry average.

¹ U.S. Department of the Treasury, *Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century*, Dec. 20, 2007, p 48; Bull, Dowd, and Moomau, "Corporate Tax Reform: A Macroeconomic Perspective," *National Tax Journal*, Dec. 2011, 64(4), p. 940.

² See U.S. Treasury Department, Office of Tax Analysis, "A History of U.S. Tax Depreciation Policy," OTA Paper 64 (May 1989), p. 13.

³ *Id.*, at 12-19.

In the 1980s, Congress further embedded accelerated depreciation in the tax law by enacting the accelerated cost recovery system (ACRS) and its scaled-back version, the modified accelerated cost recovery system (MACRS). As the rules settled out in 1986, most types of equipment were depreciable over either five years or seven years. Depreciation periods longer than five years applied to real property, public utility property, some transportation property, and certain other long-lived assets, but those periods were shorter than the periods applicable in the 1970s. Accelerated methods of depreciation (such as the double declining balance method) continued to apply to most types of assets other than real property. The accelerated depreciation rules adopted in the 1980s have persisted to the present day.

During the last 15 years, rapid recovery of capital costs has become even more central to the U.S. tax system as Congress has provided an add-on system of bonus depreciation during most of those years. Bonus depreciation has allowed taxpayers to deduct in the first year a prescribed portion of the cost of assets, ranging from 30 percent to 100 percent, depending on the particular year. The regular depreciation allowance (computed with respect to portion of the cost basis, if any, remaining after the bonus depreciation deduction) has remained applicable. Most depreciable assets other than public utility property and other such long-lived assets are eligible for bonus depreciation. Bonus depreciation is currently in effect through 2019.

Finally, in 2015 Congress made the expensing provision of section 179 permanent at the level of \$500,000.

In sum, accelerated depreciation represents an evolutionary process by the federal government over more than six decades to tilt the federal tax system in a direction that promotes investment and long-term economic growth. Tax writers today would be acting out of that tradition in further speeding up cost recovery and promoting domestic investment. The very gradual pace of adoption of MACRS, bonus depreciation, and the \$500,000 level of section 179 – over more than 60 years – is an obvious indication that the opportunities for such changes do not come along frequently. The current tax reform debate is the right time for Congress once again to consider deploying the tool of rapid cost recovery to boost the economy.

Again, the CRANE coalition strongly applauds the renewed focus of the committee on the critical importance of domestic capital investment and on the tax tool that has long proved effective at stimulating it.



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May 18, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House of Representatives
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

On behalf of the Credit Union National Association (CUNA), I am writing in strong support of the preservation of the credit union tax status. CUNA represents America's credit unions and their more than 110 million members. Credit unions are Americans' best option for financial services, and the credit union tax status represents one of the best investments that the government makes in its citizens. We urge Congress to retain and reaffirm the credit union tax status.

The importance of having not-for-profit credit unions as vibrant and viable alternatives in the financial services marketplace is as significant today as it has ever been. Credit unions provide accessible and affordable basic financial services to people of all means and encourage the equitable distribution of capital across all individuals, families, communities and small businesses. Credit unions infuse financial market competition with multiple and differentiated competitive business models. They help keep financial services accessible – and affordable – for all consumers, whether they are members of a credit union or not.

In the aftermath of the financial crisis, more Americans are choosing credit unions as their best financial partner. In fact, more than 12 million Americans have joined credit unions since 2008. Some may have joined because their bank failed, moved or was acquired by another institution; and others may have joined because they grew frustrated with the policies and fees of the for-profit sector. What's important is that when they needed an alternative, a healthy credit union system with the capacity to grow was ready to serve them, and as credit union members, they benefit from conducting their financial services with an institution that they own. The credit union tax status is crucial to encourage and support the continued existence of this alternative, cooperative component of the financial system.

America's credit unions were deeply appreciative that H.R. 1, the *Tax Reform Act of 2014*, would have retained the credit union exemption from federal income tax. This reflects what we believe is the Committee's deep understanding that the structure and mission of credit unions are the bedrock upon which the tax status is based and what makes credit unions unique within the financial services sector.

This letter provides a brief background on credit unions and their tax treatment as well as an overview of the reasons that Congress should retain the tax status. In addition, this letter addresses the issue of UBIT, the Unrelated Business Income Tax.

Congress should preserve the credit union tax status because:

- the tax treatment for credit unions continues to serve the purpose for which it was conveyed;
- the tax status represents good public policy, because it causes the creation of substantial benefits to the public, far in excess of its cost; and,
- taxing credit unions would represent a tax increase on 110 million Americans—taxpayers who paid a total of \$1.2 trillion in taxes in 2014—and would likely lead to the elimination of many, if not most, credit unions.

Background on Credit Unions and the Credit Union Tax Status

Credit unions are member-owned, democratically governed, not-for-profit cooperative financial institutions generally managed by volunteer boards of directors, with a specified mission of promoting thrift and providing access to credit for provident purposes to their members, especially those of modest means.¹ Membership in a credit union is restricted to its field of membership, a concept that was originally used as a creditworthiness tool. Today, credit union fields of membership can include geographical areas in addition to employee, church or associational fields. An individual is not eligible to join any credit union, but we believe there is at least one credit union that every American is eligible to join. Some of the earliest credit unions were formed to provide small business credit to members to fund entrepreneurial endeavors; over the years, credit unions have adapted to meet the credit needs of their members, whether it is short term, small dollar personal loans, mortgage loans, car loans or small business loans.

Credit unions were established at the Federal level during the Great Depression, but existed in many states as far back as 1908; their inception was driven by a demand for access to basic financial services – loans and savings. Through the enactment of the Federal Credit Union Act and the credit union tax status, as well as enabling legislation in all 50 states, Congress and the states have sanctioned and encouraged the development of a dual-charter credit union system that is an alternative to the for-profit banking sector, comprised of financial institutions controlled by members and accessible to all.

¹ 14 USC 12 § 1751.

The tax code from its earliest days has properly recognized the unique status and structure of credit unions. From the beginning, credit unions' tax treatment has been based on their structure and mission.² This basis has been reaffirmed several times since 1917, including in 1937 when Congress made clear in statute the tax status of Credit Unions; and in 1998, when Congress enacted the Credit Union Membership Access Act. Today, federally chartered credit unions' tax status is made clear by Section 501(c)(1) of the Internal Revenue Code; state chartered credit unions tax status is made clear by Section 501(c)(14) of the Internal Revenue Code. These tax policies were reaffirmed by the Internal Revenue Act of 1986. This is an important distinction as other tax policies were not specifically affirmed by the Act.

The Tax Treatment of Credit Unions Continues to Serve the Purpose for which Congress Conveyed it

Credit unions' federal income tax treatment has been conveyed in order to support and sustain a system of cooperative financial services in the United States. The existence of this thriving set of alternative consumer-owned financial institutions benefits not only the members of credit unions, but also customers of for-profit banks and other institutions. A safe, sound and growing credit union system is a clear indication that the tax treatment of credit unions continues to serve the purpose for which it was conveyed.

As the years have passed, the financial services sector has developed, and the entities providing financial services—including credit unions—have evolved. Some have suggested that with the evolution of expanded services offered by credit unions, they have become simply untaxed banks. That position ignores the very real differences that distinguish investor-owned and cooperative firms. The fact of the matter is that even though credit union services have evolved, their structure and mission have remained the same. Precisely because of their cooperative structure, credit unions behave differently from investor-owned financial institutions, and that difference in behavior produces substantial benefits both to the nation's 110 million credit union members, and also to non-members and the economy as a whole.

² Credit unions were first made tax exempt in 1917 through a ruling by the United States Attorney General. The ruling noted that, "On examination of the purpose and object of such association, it appears that they are substantively identical with domestic building and loan associations or cooperative banks 'organized and operated for mutual purpose and without profit' [quoting from the 1916 statute]. It is to be presumed that the Congress intended that the general terms used in Section 11 should be construed as not to lead to injustice, oppression, or an absurd consequence." This served as the basis for the exemption of state chartered credit unions from federal income tax until 1951, when mutual savings banks lost their tax exemption because they were deemed to have lost their mutuality but credit unions retained their tax exemption because, as is the case today, they hold firm to their mutuality and cooperative principles. Federally chartered credit unions were made exempt from federal income tax in 1937.

Two features of the cooperative structure are crucial in generating substantial benefits to society: their total focus on member value and service, and their tendency to risk aversion. Because of credit unions' strong member focus, driven by their democratic governance structure, credit unions have every incentive to not only "pass on" but also to leverage the benefits of their tax status rather than diverting it in some form of expense preference.³ The cooperative structure also discourages excessive risk taking by credit unions. Because they take on less risk, they tend to be less affected by the business cycle, and therefore can serve as an important counter cyclical economic force in local markets, softening the blow of economic downturns in local economics.⁴ In addition, credit unions' member focus and the absence of a strong profit motive allow them to offer significant advantages to their members of modest means.

The Credit Union Tax Status Is Good Public Policy and the Benefits Resulting From the Status Vastly Outweigh the Costs

As a consequence of their member-focused, cooperative structure, credit unions confer on their members, and the rest of society reaps, benefits that far exceed the amount of revenue the Treasury would ever gain by imposing a new tax on credit unions. These benefits are multi-dimensional and include financial benefit, high quality member service and financial education.

The financial benefits that credit unions provide to both members and others amount to an estimated \$14.2 billion in just 2016. Their tax status is leveraged because credit unions do not pay dividends to stockholders, generally do not compensate their directors, and do not compensate senior executives as highly as banks do when stock options and grants are taken into consideration.

Credit unions provide benefits directly to their members in the form of lower fees, lower rates on loans, and higher yields on deposits than those available at other financial institutions. Applying rate differentials from a third party source (Informa Research Services) to the volumes of various loan and deposit accounts at credit unions, and applying fee differentials to credit union non-interest income, allow us to calculate the total amount that members benefit from using credit unions. In 2016, we calculate the total of member benefits to have been \$10.2 billion.

³ *Expense preference* refers to managerial behavior that places the preferences of managers (inflated salaries and benefits, perquisites, lavish offices, etc.) ahead of the otherwise recognized goals of the firm. In an investor owned firm, expense preference behavior would result in sacrificing profit (investor value) for managerial preferences. For tax-exempt credit unions, expense preference behavior would imply providing excessive managerial emoluments rather than using or leveraging the tax exemption for the benefit of members. There is NO evidence of expense preference resulting from the tax exemption: Comparing similarly sized banks and credit unions, both have expense-to-asset ratios in the range of 3 to 3.5%; the aggregate 11.0% credit union capital ratio is four percentage points higher than the level regulators consider to be "adequate" but is no higher than the aggregate bank equity capital ratio; also, as noted elsewhere in this letter, compensation comparisons between banks and credit unions show lower compensation for credit union senior executives at similar sized institutions – and substantially lower compensation when data on bank stock options, grants and similar non-cash compensation is considered.

⁴ James A. Wilcox, *The Increasing Importance of Credit Unions in Small Business Lending*, Office of Advocacy, Small Business Administration, September 2011. p v.

In addition, several independent researchers have found that credit unions have a moderating influence on bank pricing: raising bank deposit interest rates and lowering bank loan rates.⁵ Based on this research, we estimate that bank customers saved about \$4 billion in 2016 from more favorable pricing due to the presence of credit unions in their local markets.

Compared to historical measures of these consumer benefits, the total of \$14.2 billion in 2016 was relatively subdued because of the unusually low level of most interest rates during the year. When all interest rates are compressed near zero, there is less room for typical differences between credit union and other rates. Prior to the financial crisis, the combined member and non-member benefits totaled more than \$12 billion annually, and these levels are likely to be achieved again in the future once interest rates rise.

In addition to these quantifiable benefits, credit unions also provide consumers of financial services significant intangible benefits. As member-owned and governed institutions, credit unions focus on providing exceptional member (customer) service. This too places competitive pressure on banks to follow suit. In the 21 years from 1985 to 2005, the *American Banker* newspaper published an annual survey of consumers of financial services, and each year credit unions scored much higher than banks in customer service. We are aware of sessions at bank conferences with titles such as “Emulating the Customer Service of Credit Unions.” This is just another way that the existence of a cooperative alternative to investor-owned banks has value not only to credit union members but also to bank customers.

Credit unions offer full and fair service to all of their members, and credit union membership tends to be concentrated in the working class of Americans. Over half of credit union members who rely primarily on their credit union for financial services have incomes between \$25,000 and \$75,000. Credit unions also do not shy away from serving their members where they are most needed. Nationwide, 49% of credit union branches are located in CDFI investment areas, compared to only 42% of bank branches in such areas.

Compared to other providers, credit unions offer services to lower-income members at prices that are very attractive, and with less of a price differential to services offered to higher income members. In fact, credit unions sometimes charge their lower-income members less for a service than banks charge even their higher-income customers. For example, a recent study found that the fees banks collect on an annual basis on low balance checking accounts (\$218) are two and a half times what they collect on their high-balance accounts (\$90). In contrast, fees credit unions

⁵ Robert J Tokle, *The Influence of Credit Unions on Bank CD Rate Payments in the US*, New York Economic Review, Fall 2005. Timothy H. Hannan, *The Influence of Credit Unions on the Rates Offered for Retail Deposits by Banks and Thrift Institutions*, Federal Reserve Board of Governors, September 2002. Robert M. Feinberg, *The Competitive Role of Credit Unions in Small Local Financial Services Markets*, Review of Economics and Statistics, August 2001. Robert M. Feinberg, *The Effects of Credit Unions on Bank Rates in Local Consumer Lending Markets*, Filene Research Institute, 2001.

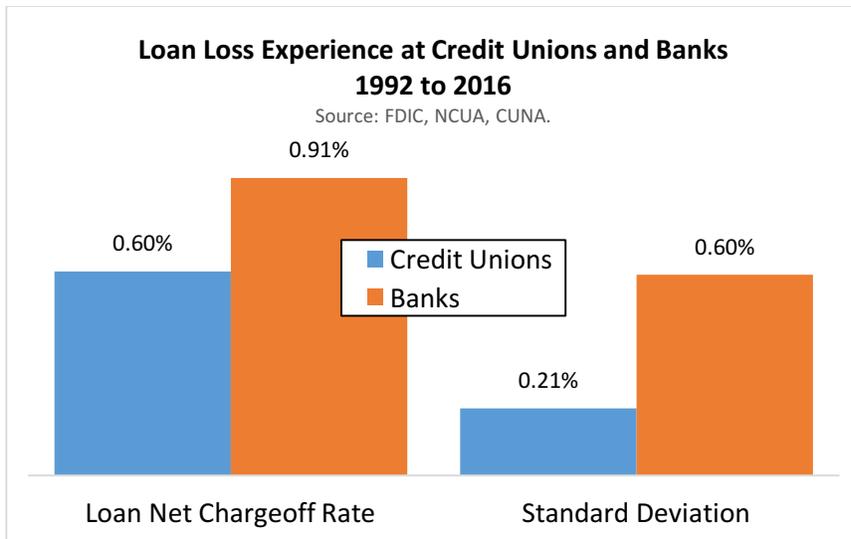
collect on low-balance accounts (\$80) are less than a third of those collected by banks on low-balance accounts, are even less than what banks collect on high-balance accounts, and are less than twice what they collect on their own high-balance accounts (\$42). In other words, consumers generally get better deals from credit unions than from banks, and this is particularly true for lower income members.

In addition to providing access to financial services, credit unions also endeavor to provide financial literacy education to their members, and to encourage individual and family level thrift and saving. Sixty nine percent of credit union members belong to a credit union that offers some form of financial education. Fifty seven percent of credit unions members belong to a credit union that offers financial literacy workshops. Twenty percent of credit union members belong to a credit union that operates one or more in-school branches. Credit unions engage in this activity not just through altruism, but also because it is in the best interest of the credit union to have members who are educated on how to best use the cooperative.

Through these and other activities, credit unions employ the tax status to fulfill the purpose for which it was created. As a result, the credit union tax status has proved not only to be good public policy but also to represent an incredible return on the investment that the government has made.

The incentives faced by credit union management (generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits) induce management to eschew higher-risk, higher-return strategies.⁶ As a result, credit union operations are less risky, and subject to less volatility over the business cycle. For example, from 1992 to 2016, the average annual net charge-off rate on credit union loans was 0.60%, with a standard deviation of 0.21%. In contrast, the similarly computed average at banks over the same period was 0.91%, with a much greater standard deviation of 0.60%.

⁶ Edward J. Kane and Robert J. Hendershott, *The Federal Deposit Insurance Fund that Didn't Put a Bite on U.S. Taxpayers*, *Journal of Banking and Finance*, 20 (September, 1996), pp. 1305-1327. Kane and Hendershott describe how the cooperative structure of credit unions presents credit union decision makers with incentives that are strikingly different from those faced by a for-profit financial institution, making it less feasible for credit union managers to benefit from high-risk strategies.



Because of this lower-risk profile, credit unions were able to continue lending during the recent financial crisis while other financial institutions failed or had to curtail operations due to damaged balance sheets caused by riskier practices leading up to the crisis.

Homeowners benefited from having credit unions in the market during the financial crisis. As the secondary market for residential mortgages collapsed in 2007, the amount of first mortgages originated by credit unions actually rose by 11% in 2007 and 18% in 2008.

Likewise, credit unions were an oasis for small business owners when banks withdrew their offerings and exited the market. From June 2007, the onset of the financial crisis, to December 2016, small business loans outstanding at credit unions grew by 145.3% while such loans at banks actually declined by 11.7%. A Small Business Administration study found, “that credit unions are increasingly important sources of small business loans as a longer-run development and in response to fluctuations in small business loans at banks.”⁷

The tax status, by fostering the continued existence of credit unions as a cooperative alternative in the market, supports this countercyclical lending role for credit unions.

Taxing Credit Unions Would Increase Taxes on more than 100 Million Americans and Likely Lead to the Elimination of Many—if not most—Credit Unions

Some in the for-profit financial services sector would like to see Congress repeal the credit union tax status. Doing so, however, would undoubtedly result in negative consequences for savers and borrowers, the most severe of which would be the erosion of a credit union option for millions of Americans. If taxed, a very significant number of larger credit unions are expected to

⁷ Wilcox. p v.

covert to banks to take advantage of the much greater flexibility of a bank charter, and an equally significant number of smaller credit unions would simply liquidate. The remaining credit unions would have to pass the burden of taxation through to their members, because they are wholly owned cooperatives. This would substantially increase the cost of accessing mainstream financial services to American households, by far more than any additional revenue to Treasury.

One of the motivations behind comprehensive tax reform is to reduce distortions of resource allocation caused by preferences and exemptions, thereby allowing a reduction in corporate tax rates by expanding the tax base. There would be little to be gained by imposing a new tax on credit unions. For the past two decades credit unions have accounted for only 6% to 7% of the assets in US depository institutions. Nevertheless, as I described above, more than 110 million working-class Americans—taxpayers who in 2016 paid \$1.2 trillion in taxes—benefit in an amount much greater than any possible amount the Treasury could collect from a misguided new tax imposed on credit unions. If credit unions were taxed in 2016, the receipts would have accounted for only 0.05% of 2016 federal government spending – an amount that would have funded U.S. government operations for five hours. It makes absolutely no sense to wipe out the substantial benefit Americans receive from having a credit union option for five hours of government operation. We encourage Congress to retain and reaffirm the credit union tax status.

The Unrelated Business Income Tax (UBIT) Hinders Credit Unions' Fulfillment of the Statutory Mission

All credit unions are exempt from the federal corporate income tax under §501(c)(1) of the Internal Revenue Code for federally-chartered credit unions and under §501(c)(14)(A) for state-chartered credit unions. However, income from state-chartered credit unions that the Internal Revenue Service (IRS) deems to be unrelated to the credit union's tax exempt purpose is subject to taxation under §511-513.

Income that is subject to UBIT is defined as any net income derived from any “unrelated trade or business” – defined as “activity not substantially related to organization's exempt purpose.” Income is “substantially related” if it “contributes importantly to accomplishment of the organization's exempt purposes.” UBIT was designed to prevent unfair market competition by tax-exempt entities and taxpaying for-profit entities. Credit unions' “exempt purposes” include promoting thrift, creating a source of credit, mutuality and member service.

The IRS requires that state-chartered credit unions file annual Form 990s, like most other tax-exempt entities. These credit unions must also file a Form 990-T (UBIT Form) if the tax-exempt entity has unrelated business taxable income to report.

State-chartered credit unions began operating in the United States in 1909, before there was any federal income tax. The purpose of these credit unions has always been defined by state law and vary from state to state. But those purposes can be boiled down to this: state-chartered credit unions are intended to promote thrift and provide a source of credit to their members on a

cooperative, not-for-profit basis. State-chartered credit unions have and continue to serve this purpose.

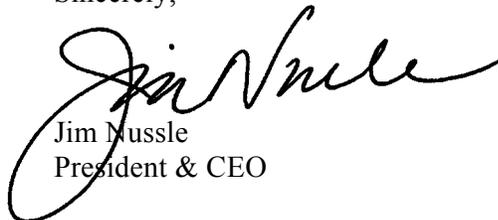
In 1934, credit unions formed an insurance company, CUNA Mutual Group, concurrently with Congress's passage of the Federal Credit Union Act and the establishment of the first federal credit unions. Insurance products have been offered by both federal and state-chartered credit unions ever since. Congress was presumably well aware of this fact when it codified the exemption for state-chartered credit unions in 1951.

In the 1970s, Congress adopted the Unrelated Business Income Tax ("UBIT") for tax-exempt organizations. It provides that certain income that is not substantially related to the tax-exempt purpose of such organizations is subject to corporate income tax. Over the years, individual state-chartered credit unions were occasionally audited by the IRS for unrelated business income taxes, but the IRS provided no guidance to credit unions or its field staff beyond three private letter rulings in the 1970's that said certain insurance products sold by credit unions were exempt from UBIT.

H.R. 1, the *Tax Reform Act of 2014*, included several provisions expanding UBIT. On the day that Chairman Dave Camp released his proposed draft of H.R. 1, his senior staff members acknowledged to CUNA that it was not the intention of the Ways and Means Committee to impart any additional taxes on federal or state credit unions. Further, they told us that anything that would impose taxes on credit unions--including UBIT--was unintentional and that was why they established a process that included the release of a discussion draft. It is our sincere hope that the Committee will avoid including these or any similarly harmful UBIT provisions in any future tax reform draft or legislation.

On behalf of America's credit unions and more than 110 million members, thank you very much for your consideration of our views.

Sincerely,

A handwritten signature in black ink, appearing to read "Jim Nussle", written in a cursive style. The signature is positioned above the printed name and title.

Jim Nussle
President & CEO

To: Members, Committee on Ways & Means

From: Douglas Holtz-Eakin

Re: Border Adjustment and the House Blueprint

Date: May 17, 2017

Thank you for the opportunity to submit materials regarding the proposal to border-adjust the cash-flow tax contained in the House of Representatives “A Better Way” Blueprint for Tax Reform. Attached please find six papers on the topic by myself, Alan Auerbach of the University of California, Berkeley, and my American Action Forum colleague Gordon Gray. I hope you find them of use in your deliberations.

Let me make a few additional comments on border adjustment that reflect the state of the debate. In particular:

- Border adjustment is a piece of *tax* policy and not *trade* policy. As such, it is neutral with respect to trade flows and adds to the desirable neutrality in the Blueprint regarding market of sale, location of production, length of asset life, type (tangible versus intangible) of asset, and form of financing. The Blueprint thus rewards competitive excellence over tax-based rent-seeking and tax law prowess.
- Border adjustment is *not* a new or separate tax. It is the simultaneous imposition of the cash-flow tax on imports and the exemption of exports from the same tax. The phrase “border adjustment tax” is an oxymoron that reveals a lack of understanding of the proposal.
- The most important role played by border adjustment is its elimination of the incentive for profit-shifting to tax havens. Some such base-erosion protection is essential in a territorial system; hence, the correct statement of choices is between the Blueprint with border adjustment or the Blueprint with, e.g., Camp-draft base erosion rules. Assertions that one could pass the Blueprint simply omitting border adjustment are simply incorrect.
- The economics dictate that the exchange rate should adjust *once* by roughly 25 percent to offset any trade impact of border adjustment (leaving it trade-neutral). I anticipate that this would happen quickly after passage. This is different from saying that the dollar will be 25 percent higher after passing tax reform. There are many influences on currency valuations – equity market performance, interest rates, innovating investment opportunities, confidence effects, and so forth – and the Blueprint itself has many provisions that will affect the dollar over a sustained period. I have no idea what the value of the dollar will be after tax reform.

- There is no direct evidence of a currency responding purely to a border adjustment in isolation because border adjustments have always been adopted in concert with other tax changes that may also affect exchange rates. Previous reforms (like the Blueprint) have included other reforms that would influence growth rates, rates of return, the current account and the exchange rate. But the size and speed of the needed changes are well within historical experience and the success of border adjustment in 160-odd countries around the world should give lawmakers confidence in the reform.
- Border adjustment raises revenue in the 10-year budget window, easing the difficult task of revenue-neutral tax reform. Revenue neutrality is necessary for reform to be permanent when passed using reconciliation protections. Since permanent reforms provide powerful incentives to innovate, invest, hire and grow in the U.S., border adjustment can be a strong contributor to pro-growth tax reform. (I am aware of the reality that the U.S. cannot run a trade deficit forever, but the likely reversal is decades in the future and not a central concern at this moment.) Moreover, a reduction in profit shifting because of the border adjustment represents a permanent revenue gain.

In closing, I would note that in many of my discussion with firms of the impact of the Blueprint on incentives, business leaders have expressed the desire for a more vibrant, faster-growing economy, while wishing to keep their business models unchanged. This is simply a nonsensical internal contradiction, as the economy changes only when the businesses operating in it do. Tax reform is deliberate, disruptive change for the purpose of great benefits to the population as a whole. I wish the Committee well in its efforts and stand ready to help at any time.

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The Role of Border Adjustments in International Taxation

Alan J. Auerbach, University of California, Berkeley
Douglas Holtz-Eakin, American Action Forum
November, 2016

Executive Summary

Border adjustments are taxes or tax exemptions that apply when payments for goods and services cross international borders. While familiar in the context of value added taxes, border adjustment has arisen in the context of possible U.S. tax reforms. In this regard, five points merit attention:

- Border adjustments may be implemented as taxes on imports and rebates on exports, or by excluding overseas sales and purchases from the computation of taxable income;
- Unlike tariffs on imports or subsidies for exports, border adjustments are not trade policy. Instead, they are paired and equal adjustments that create a level tax playing field for domestic and overseas competition;
- Border adjustments do not distort trade, as exchange rates should react immediately to offset the initial impact of these adjustments. As a corollary, border adjustments do not distort the pattern of domestic sales and purchases;
- Border adjustments eliminate the incentive to manipulate transfer prices in order to shift profits to lower-tax jurisdictions; and
- Border adjustments eliminate the incentive to shift profitable production activities abroad simply to take advantage of lower foreign tax rates.

These conclusions apply to border adjustments *per se*; there may be many other impacts when border adjustments are implemented as one part of a larger reform.

Introduction

Border adjustments are taxes or tax reductions that apply when payments for goods and services cross international borders. At present, they are used primarily in the context of the *value added tax* (VAT). Under a value added tax, taxes collected in a country are generally refunded through a border adjustment when goods or services produced in that country are exported; likewise, when goods and services are imported into that country a border adjustment is imposed on the value of imports. The main function of these existing border adjustments is to ensure that the VAT functions as a tax on consumption within the taxing jurisdiction; i.e., domestically produced goods and services consumed in other countries escape taxation, but goods and services produced elsewhere and consumed domestically are taxed. But border adjustments have other effects as well, notably to limit the extent to which companies operating across borders can manipulate the location of their tax base. This enhances the attractiveness of border adjustments as part of a well-functioning tax system.

On the other hand, border adjustments lack some other apparent benefits that have been attributed to them. In particular, border adjustments, in themselves, should not influence international trade, either by discouraging imports or encouraging exports. The belief that they do have these influences on international trade has proved to be something of a mixed blessing, not only generating support for their adoption but also leading critics to conclude that they violate generally accepted norms of international taxation. As discussed below, border adjustments can play an important role in tax reform, but that role is to help generate a more efficient, equitable and administrable system of business taxation, not to encourage exports or discourage imports.

How Border Adjustments Work

Under the standard VAT, domestic producers collect tax on their *value added* – revenues less purchases – at each step of production, including both intermediate production and final retail sales. As the value of imports included in the chain of production has not been taxed domestically at the production level, a border adjustment at the VAT rate is applied to imports. Thus, the entire value added in producing a good or service will have been taxed when the final sale occurs. If that sale is to domestic consumers, the result is a tax on domestic consumption. But if the final sale occurs to a foreign buyer the entire tax collected is refunded, through a border adjustment. Table 1 provides an illustration of how border adjustments operate.

Table 1. VAT and Border Adjustments

Business	Revenues	Purchases	VAT Base	Border Adjustment	Net Tax Base
Farmer	50	25	25	25	50
Manufacturer	80	50	30	0	30
Retailer:					
Domestic Sale	100	80	20	0	20
Export	100	80	20	-100	-80

In the example in the table, there are three stages of production, with a farmer selling to a manufacturer, the manufacturer selling to a retailer, and the retailer making a final sale, either to a domestic consumer or a foreign buyer. The farmer’s input is imported, and hence faces a border adjustment. Thus, all of the farmer’s revenues are effectively subject to tax. If the retailer sells to a domestic consumer, the total VAT base is 100, equal to the revenues from consumer sales. If the retailer sells abroad, the border adjustment wipes out all levels of the VAT and hence there is no net VAT collected. Note that the border adjustment is typically implemented by imposing tax or providing a refund to the foreign party. In this case, the foreign buyer would receive a tax refund equal to the VAT rate times 100, and the foreign seller to the farmer would pay tax on the import value of 25. This means that the Retailer’s tax base is positive, even if it sells abroad and there is a border adjustment on the sale.

An alternative, and in some respects simpler, approach to implementing a border adjustment (as discussed in Auerbach, 2010) would be to impose the border adjustments on the relevant domestic businesses, adding 25 to the Farmer’s tax base and subtracting 100 from the Retailer’s in the export case. This approach would effectively exclude any export revenues from the tax base, since the 100 in revenues included in the tax base would be exactly offset by the 100 border adjustment; likewise for the costs of imported inputs, where the deduction of 25 would be exactly offset by the border adjustment of 25. This “netting” approach would leave only transactions between domestic parties in the tax base. Under this alternative approach, however, the Retailer would have a negative tax base, even though its value added is positive. How to deal with such losses is discussed below.

This alternative method of implementing border adjustments is helpful in understanding why border adjustments eliminate an important avenue for tax base shifting. Suppose, for example that the Retailer’s foreign buyer is the Retailer’s own foreign subsidiary, and that the Retailer wished to reduce its domestic tax base by selling its export at a below-market price of 90. This would reduce its domestic tax base from 20 to 10, ignoring the border adjustment. But with the border adjustment in place, there would be no net change in the Retailer’s

domestic tax liability. Hence, it would have no incentive to underprice its exports. Indeed, to the extent that its subsidiary's corresponding understatement of the cost of its imported inputs increased tax liability abroad, the Retailer might actually face *higher* taxes overall from understating its export revenues in this manner.

Border Adjustments and International Trade

It is generally accepted by economists that border adjustments themselves do not distort international trade (see, for example, the discussion in Auerbach, 1997). But this view often puzzles others, given that each of the components of border adjustments – a tax on imports and a tax refund for exports, equivalent to an export subsidy – are commonly seen as trade distortions and in violation of international norms and trade agreements. The key point is that the rate of border adjustments is paired and symmetric. Thus, the effects on trade of these two components – the import tax and the export subsidy – are offsetting. Adopting them together imposes no trade distortions even though adopting either separately would do so.

To see this, consider them in turn. An export subsidy would make domestic exporters more competitive internationally, increasing foreign demand for their products. If adopted by the United States, such a policy would also strengthen the dollar as a result of the surge in demand for exports, which would partially reduce this demand surge by raising the cost of US goods abroad. But we would expect only a partial offset to the initial increase in export demand. With the exchange rate rising, there would also be a rise in US imports (due to foreign goods being cheaper as a consequence of the stronger dollar). If the dollar rose fully to offset the impact of the export subsidy, there would be a worsening of the trade balance, since only imports would be rising. A worsening trade balance is inconsistent with the rise in the dollar, so one can conclude that in isolation the export subsidy would raise net exports.

A tax on imports, on the other hand, would raise the US price of imports and reduce demand for them. This would also lead to dollar appreciation (because of weaker US demand for imports), but not enough to offset the increase in import prices and the reduction in import demand. The same logic applies. A higher dollar and no decline in imports means there would have to be a fall in exports, and worsening of the trade balance, which again is inconsistent with the rise in the dollar. Once more, in isolation the import tax would raise net imports.

However, imposing the same rate of export subsidy and an import tax would lead to dollar appreciation, the first by stimulating net exports and the second by discouraging net exports. Combining the two policies, at the same tax rate – that is, introducing border adjustments – would result in a policy in which each component leads to dollar appreciation, but where the effects on trade would offset. For, if the dollar appreciates by enough to eliminate any price changes facing purchasers that result from the border adjustments (i.e.,

raising the foreign cost of exports to offset the export subsidy and lowering the domestic cost of imports to offset the import tariff), there would be no change in US exports or US imports, no change in the trade balance, and no inconsistency of the trade balance with dollar appreciation.

A corollary is that the border adjustment also does not distort domestic sales and consumption. Firms that sold domestically will continue to do so and consumers will continue their same pattern of purchases.

These conclusions hold when the export subsidy and import tariff are at equal rates, as is the case with border adjustments. It would not be true if the rates differed, in which case the net effect would be in the direction of the policy instrument with the higher rate. Nor is this analysis valid in the case of *targeted* export subsidies or import tariffs, which would favor exports and discourage imports for the domestic industries affected at the expense of unprotected domestic industries. But for a broad-based VAT, or any other broad-based domestic tax system that includes border adjustments as they exist under the VAT, the border adjustments themselves neither encourage nor discourage trade.

It should also be stressed that this neutrality with respect to trade applies to border adjustments specifically, but not necessarily to a broader change in the tax system. This is an especially important caveat in the context of current U.S. tax proposals. For example, if the US were to adopt a tax system that encourages saving relative to consumption, the resulting weakening of demand for imported consumer goods could well improve the US trade balance. But this would be a consequence of the change in the incentive to save, not because of the border adjustments.

One final question might be what might happen if exchange rates are managed, for example if some US trading partners seek to peg their exchange rates to the dollar. There are two potential responses to this question. First, countries pegging exchange rates typically do so to maintain competitiveness of their domestic producers, and in this case maintaining competitiveness means allowing the dollar to appreciate to offset the effects of border adjustments. Second, to the extent that countries do seek to maintain their existing exchange rates relative to the dollar, they would be making the US more competitive with respect to their own economies.

Border Adjustments and Business Tax Reform

While border adjustments are a familiar part of existing VATs, there is no logical reason why their use should be limited to VATs. The original use of border adjustments may have been motivated by their role in making the VAT into a tax on domestic consumption. But border

adjustments also effectively shift the locus of taxation from the country of production to the country of sale, and this can be a considerable benefit in reducing the incentives and ability of multinational companies to shift taxable profits to low-tax jurisdictions.

In recent years, border adjustments have been put forward as a component of business cash flow taxation in proposals by the President’s Advisory Panel on Tax Reform (2005), Auerbach (2010), Auerbach, Devereux and Simpson (2010), and the House Republicans (2016). A cash flow tax has many advantages over the existing corporate income tax, including encouraging new domestic investment through the provision of immediate investment expensing and balancing incentives to use debt and equity finance through elimination of interest deductions. These proposals also include a transition away from the current US approach to worldwide taxation, by excluding the offshore profits of US corporations from taxation. But adopting a cash flow tax on a territorial basis – that is, without border adjustments – would leave in place the existing incentive for companies to shift profitable operations and reported profits from the United States to low-tax jurisdictions.

The most important difference between a cash flow tax and a VAT is that the cash flow tax would allow a deduction for domestic wages and salaries. Table 2 repeats the example from Table 1, showing how a cash flow tax with border adjustments would work, with changes from Table 1 indicated in red.

Table 2. Cash Flow Tax and Border Adjustments

Business	Revenues	Wages & Salaries	Purchases	Cash Flow Tax Base	Border Adjustment	Net Tax Base
Farmer	50	5	25	20	25	45
Manufacturer	80	15	50	15	0	15
Retailer:						
Domestic Sale	100	10	80	10	0	10
Export	100	10	80	10	-100	-90

Because of the deduction for wages and salaries, the cash flow tax base is narrower than that of the VAT. But the border adjustment would work exactly as under a VAT, applying to export revenues and import purchases. As such, it would be possible, as discussed in the case of the VAT, to combine the border adjustments with the tax calculations of domestic producers, as offsets to the inclusion of export revenues and the deduction for import costs, effectively leaving both export revenues and import costs out of the tax base. The result would be a cash

flow tax on domestic transactions, with cross-border transactions (as well as offshore transactions) ignored by the tax system.

Although a cash flow tax operates as just described, it could also be implemented through a combination of a VAT plus a reduction in payroll taxes. For example, suppose that there is an existing payroll tax of 15 percent (roughly the current rate of the combined employer and employee OASDI tax). Then, introducing a 15 percent VAT and eliminating the payroll tax would be equivalent to introducing a 15 percent cash flow tax. For example, the manufacturer in Tables 1 and 2 has 30 of value added, consisting of 15 of cash flow and 15 of wages and salaries. If the 15 of wages and salaries currently faces a payroll tax, then replacing the payroll tax with an equal-rate VAT would increase the tax base from 15 to 30, subjecting cash flow, in addition to wages and salaries, to tax. This is precisely what would happen if the payroll tax were left in place and an equal-rate cash flow tax introduced.

With no VAT currently in place in the United States, there might seem little reason to dwell on this equivalence between tax policies. However, the equivalence is important for two reasons. First, economists believe that taxes with equivalent structures should have identical or very similar economic effects, including how businesses and individuals respond to taxes and who ultimately bears the tax burden, i.e., the incidence of taxation. Second, international agreements and tax treaties aimed at ensuring that tax policies adhere to particular norms regarding trade and other economic activities should, to be coherent, treat two equivalent policies in the same manner.

Border Adjusted Cash Flow Taxation: Some Illustrations

Suppose that the current system of corporate taxation were replaced with a business cash flow tax with border adjustments. How would this affect the tax liability and the after-tax earnings of different types of firms? We consider several examples, in each case asking how the tax base and after-tax earnings change from those under the current tax system. It should be kept in mind that a company's taxes and after-tax income would also be affected by a change in the applicable tax rate. Importantly, for purposes of illustration, we shall assume that the rate remains constant under the two systems. Thus, this analysis focuses on border adjustments *per se*, and not an economic analysis of broader tax reforms.

1. Company A, with production operations exclusively in the United States

The next six examples consider the case of a firm that has operations exclusively in the United States, but may export or import.

A. With all sales to domestic buyers and all purchases from domestic sellers

Assume that company A has the characteristics of the manufacturer in Tables 1 and 2, with domestic sales of 80, domestic input purchases of 50, and wages and salaries of 15. Suppose also that that A has interest expense of 5, that 20 of the input purchases are for capital goods, and that under existing rules the company receives depreciation deductions of 15 on its current and past purchases of capital goods. Table 3 shows the tax base for company A under the current system and the new cash flow tax.

Table 3. Current and New Tax Base: Domestic Firm with no Exports or Imports

Tax Base	Revenues	Wages & Salaries	Capital Purchases	Depre- ciation	Other Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	80	15	20	---	30	---	15

In this example, the firm has the same tax liability under the new system as under the current system, because the higher deductions for expensing rather than depreciation just offset the elimination of the interest deduction. Firms with more debt in their capital structure would generally fare worse under the new system, while firms with more capital investment would generally fare better.

B. With some sales to foreign buyers and all purchases from domestic sellers

Suppose now that the same firm has one eighth of its sales to foreign purchasers, so that revenues from taxable sales equals 70 under the cash flow tax. The firm's tax base is now lower under the new system, as illustrated in Table 4.

Table 4. Current and New Tax Base: Exporting Firm

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depre- ciation	Other Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	70	15	20	---	30	---	5

However, this tax saving does not mean that the firm does better after-tax under the new system, because the revenues from exporting will fall. Assuming that the world price – the

price in the currencies of other countries, where economic circumstances have not changed – of the goods being exported remains the same, and that the dollar appreciates to offset the border adjustment – as would be consistent with no change in the US trade balance – the firm’s export revenues will be less than 10, because foreign-currency sales receipts buy fewer appreciated dollars. If the tax rate is 20 percent, then the firm’s export revenues will be 8 rather than 10. This, in turn means that the firm’s after-tax cash flow will be the same in the two cases, 80 percent of 15 = 12 under the current system, and 80 percent of 5 = 4 + nontaxable receipts of 8 = 12 under the new system.

C. With all sales to domestic buyers and some purchases from foreign sellers

Suppose now that the firm’s sales are all domestic but that it purchases one third of its inputs from foreign sellers, so that expenses from deductible (non-capital) purchases now equals 20 under the cash flow tax. The firm’s tax base is now higher under the new system, as illustrated in Table 5.

Table 5. Current and New Tax Base: Importing Firm

Tax Base	Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	80	15	20	---	20	---	25

However, this higher tax cost does not mean that the firm does worse after-tax under the new system, because its costs of imported goods will fall. Again assuming that the world price of the goods remains the same, and that the dollar appreciates to offset the border adjustment, the firm’s import costs will be 8, rather than 10, if the tax rate is 20 percent. This again means that the firm’s after-tax cash flow will be the same in the two cases, 80 percent of 15 = 12 under the current system, and 80 percent of 25 = 20 – nondeductible expenses of 8 = 12 under the new system.

D. With some sales to foreign buyers and some purchases from foreign sellers

Combining the two previous cases, suppose that one eighth of the firm’s sales are exports and one third of its inputs are from foreign sellers, so that revenue from taxable sales equals 70 and the cost of deductible purchases equals 20 under the cash flow tax. The firm’s tax base is now once again the same under the two systems, as illustrated in Table 6. And, once again, the firm’s after-tax cash flows are the same, 80 percent of 15 = 12 under the current

system versus 80 percent of 15 + nontaxable receipts of 8 – nondeductible expenses of 8 under the new system = 12.

Table 6. Current and New Tax Base: Importing and Exporting Firm

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	70	15	20	---	20	---	15

E. With substantial sales to foreign buyers and all purchases from domestic sellers

Consider again case B, but with the firm exporting a larger share of its production, say one quarter rather than one eighth. The effect of this increase in exports is shown in Table 7.

Table 7. Current and New Tax Base: Firm with Substantial Exports

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	60	15	20	---	30	---	-5

In this case, the firm shows a net loss for tax purposes. But its underlying economic profitability is unchanged. Mechanically, the after-tax cash flows are 80 percent of 15 = 12 under the current system versus 80 percent of -5 (= -4) plus nontaxable receipts of 16 = 12 under the new system. The only issue is how to handle the losses.

While one approach to dealing with this loss is to follow the current system’s approach, i.e., allowing loss carrybacks and carryforwards, the reasons for the loss are different in this case, because the firm has underlying profitability. The usual logic of using carrybacks and carryforwards as an averaging mechanism may not suffice – a firm for which exports may account for a large share of revenues may remain both very profitable and yet in a loss position indefinitely. Thus, alternative approaches may be needed if further analysis suggests that an important share of business activity is among firms facing such circumstances. One option would be to allow companies to offset losses against other taxes they pay, such as payroll taxes. An alternative is to maintain a separate calculation for border adjustments and make those

refundable, rather than taking the simplified approach of netting border adjustments against export revenues.

F. With all sales to domestic buyers and substantial purchases from foreign sellers

Suppose now that the firm's sales are all domestic but that it purchases two thirds of its inputs from foreign sellers, up from the one third in the example in Table 6. The expenses from deductible non-capital purchases now equal 10 under the cash flow tax. The firm's tax base is now even higher under the new system, as illustrated in Table 8.

Table 8. Current and New Tax Base: Firm with Substantial Imports

Tax Base	Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	80	15	20	---	10	---	35

Once more, however, this higher tax cost does not mean that the firm does worse after-tax under the new system, because its costs of imported goods will fall. Again assuming that the world price of the goods remains the same, and that the dollar appreciates to offset the border adjustment, the firm's import costs will be 16, rather than 20, if the tax rate is 20 percent. This again means that the firm's after-tax cash flow will be the same in the two cases, 80 percent of 15 = 12 under the current system, and 80 percent of 35 = 28 – nondeductible expenses of 16 = 12 under the new system.

2. Company B, producing in the United States and a low-tax foreign country

We now consider the case of a multinational company with operations in the United States and abroad, perhaps a US parent company with a foreign subsidiary. For the sake of simplicity, we assume that the foreign subsidiary does not repatriate profits to the US parent during the period under consideration. We further assume that the US parent company purchases some of its inputs from its foreign subsidiary and exports some of its output to the foreign subsidiary. Finally, we assume that the foreign jurisdiction has a territorial system with a low tax rate.

A. Arm's length transfer prices

In this example, the US parent sells one-eighth of its output (10) for export and imports one third of its non-capital inputs (10), just as in case 1D and Table 6. The foreign subsidiary's inputs include the US parent's exports (10) as well as purchases from third party companies

abroad (10), and its exports include those to the US parent (10) as well as sales to third party companies abroad (20).

Table 9. Current and New Tax Base: Arm’s Length Transfer Pricing

US Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	70	15	20	---	20	---	15
Foreign Tax Base							
Current	30				20		10
New	24				16		8

In this example, the US tax bases under the old and new system are just as in Table 6. For the foreign tax base, and assuming again that the US tax rate is 20 percent, there is a decline, measured in dollars, in the sales by the foreign subsidiary (from 30 to 24, including a decline in the value of sales to the US parent from 10 to 8), and in input purchases (from 20 to 16, including a decline in the value of purchases from the US parent from 10 to 8), with a corresponding change in the foreign tax base, valued in dollars (and no change when expressed in the foreign currency). Note that this effect on the value of the foreign tax base applies more generally to everything measured in foreign currency; because of dollar appreciation, the values of cash flows and assets abroad will also decline in dollar terms.

B. Manipulated transfer prices

In the next example, the US company understates the value of its exports to its foreign subsidiary and overstates the value of its imports from the foreign subsidiary.

We assume that exports are reported at half their true value (5) and imports at 150 percent of their true value (15). This results, under the current system, in an increase in the reported value of US imports from the foreign subsidiary equal to 5, and a decline in the reported value of US exports to the foreign subsidiary equal to 5, and a shift in profits equal to 10 from the US parent to the foreign subsidiary. (Compare the results in Tables 9 and 10.) This shift reduces the company’s overall tax burden, because the tax rate in the foreign country is lower than that in the United States.

Table 10. Current and New Tax Base: Manipulated Transfer Pricing

US Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	75	15	---	15	35	5	5
New	70	15	20	---	20	---	15
Foreign Tax Base							
Current	35				15		20
New	28				12		16

Under the new system, however, there is no change in the US tax base as a result of the change in transfer prices – it remains at 15, its value in Table 9 – while the foreign tax base doubles from 8 to 16. Thus, the multinational would have no incentive to use transfer prices to shift profits away from the United States, even if the tax rate in the foreign country is very low. Indeed, it would benefit by shifting profits to the United States, to reduce the taxes it pays in the low-tax country.

3. Company C, producing only in the United States or a low-tax foreign country

Border adjustments do not just eliminate the incentive for multinational firms to shift profits to low-tax countries. They also eliminate the incentive to shift actual operations to low-tax countries. Consider the case of a company selling in the United States and deciding whether to produce exclusively in the United States or in a low-tax country. For simplicity, we assume that aside from taxes the costs of production are the same in the two countries. Tables 11 (for domestic production) and 12 (for foreign production) show how the US and foreign tax bases would be affected by the tax reform, assuming the same revenues and costs as in previous examples. In the case of foreign production, we assume that the final sale to US purchasers is still made by the company’s US operation.

Under current law, the tax base would be 15 in the United States and 0 abroad for domestic production, and 0 in the United States and 15 abroad for foreign production. Thus, profits before tax would be 15 overall regardless of whether production occurs in the United States or abroad. The company would have a very strong incentive to locate its production in the low-tax country, where its after-tax profits based on the before-tax profits of 15 would be higher.

Under U.S. adoption of the destination-based cash-flow tax, there would be no change in the company’s tax base if it produces domestically – it would still be 15 in the United States and 0 in the foreign country. If the company produces abroad, its foreign tax base would

remain the same in foreign currency, but reduced from 15 to 12 by the dollar's appreciation. The company's US sales would be fully taxable, because the border adjustment would eliminate the deduction of its import from its foreign operation. This would leave after-tax domestic profits at 0, as the after-tax revenues of 64 (80 percent of 80) would just cover the non-deductible import costs of 64. Thus, the company's overall revenue would be the foreign before-tax profits of 12 less foreign taxes. As after-tax profits with domestic US production are 12, the company would choose to produce in the United States, even if the tax rate in the foreign country is very low.

Table 11. Current and New Tax Base: Domestic Production and Sales

US Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15
New	80	15	20	---	30	---	15
Foreign Tax Base							
Current	0	0			0		0
New	0	0			0		0

Table 12. Current and New Tax Base: Foreign Production

US Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
Current	80	0	---	0	80	0	0
New	80	0	0	---	0	---	80
Foreign Tax Base							
Current	80	15	---	15	30	5	15
New	64	12		12	24	4	12

Border Adjustments, Tax Revenue and Tax Burden Distribution

Leaving aside any other elements of a business tax reform plan, US adoption of border adjustments would have a positive impact on tax revenue for two distinct reasons. First, with a large trade deficit, the US would collect far more from taxing imports than it would lose from forgiving tax on exports. This effect could well change in the future, to the extent that the US trade balance improves, as many expect must happen.

Second, because multinational companies would have strong incentives to expand US production activities, dynamic scoring of the effects of border adjustments should increase projected revenues.

The economic incidence of border adjustments comes about through dollar appreciation, which, as discussed in relation to Tables 9-12, reduces the dollar value of foreign cash flows to US owners. Thus, it is these owners who bear the burden of the border adjustment. It should be kept in mind, however, that border adjustments will also induce behavioral responses that are likely to strengthen the US economy and benefit the owners of assets in the United States.

Border Adjustments and the WTO

There is an open question whether a destination-based cash flow tax (DBCFT) would be determined to be compliant with the rules of the World Trade Organization. There are two primary issues here. First, WTO rules currently limit border adjustments to “indirect” taxes – taxes on transactions (e.g., sales, payroll, etc.) rather than “direct” taxes on individuals or businesses. It is not clear that a DBCFT would be successfully characterized as an indirect tax, even though it is economically equivalent to a policy based on indirect taxes (a VAT and a reduction in payroll taxes), and even though the distinction between direct and indirect taxes has little meaning and no bearing on any economic outcomes.

In addition, there might be concern under existing WTO rules regarding the combination of border adjustments with a deduction for domestic labor costs, since the border adjustment assessed on imported goods applies to the entire cost of the imports, with no deduction for the labor costs that went into the production of these imported goods. Some might see this treatment as favoring domestically produced goods over imported ones. But such an inference makes little sense from an economic perspective. Again, consider the equivalent policy of introducing a VAT and reducing payroll taxes, both elements of which are compatible with WTO rules. A reduction in payroll taxes would indeed encourage domestic production and employment to the extent that it lowered domestic production costs. But this is true of any reduction in taxes on US production, and it is difficult to comprehend why international trade rules should dictate the tax rate a country applies uniformly to its own domestic economic production activities.

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About that \$1700: A Review of the Data on Border Adjustment and Tax Reform

Executive Summary

- Opponents of border adjustment claim the policy will dramatically increase prices for consumers, to the tune of \$1700 per capita.
- The \$1,700 figure is unsubstantiated, cannot be replicated without more methodological transparency, and has been called “baloney” by fact-checkers.
- The price effects associated with this claim ignore the economics literature related to currency effects, but even if taken at face value appear overstated.
- The \$1,700 price effect claim appears inconsistent with other more objective analyses.

Introduction

The House Blueprint for Tax Reform would scrap the deeply flawed current tax regime and move the United States’ tax code towards a more efficient and pro-growth system. As part of this reform, the Blueprint would move the U.S. business tax system to a destination-based cash flow tax.¹ Under this system, only domestic consumption would be taxed. To isolate these transactions, the Blueprint would include imports in the tax base, and exclude exports, a policy known as border adjustment. The consensus view in the economic literature is that this would leave trade flows unaffected. Accordingly, all else being equal, importing firms would be no worse off, nor exporting firms better off.²

However, some industry groups that rely heavily on imports have strenuously opposed the border adjustment element of the Blueprint. As part of this opposition, these groups have argued that the border-adjustment would harm consumers, specifically because the new taxes on imports would be passed along to consumers. The most conspicuous of these arguments is one advanced by the retail industry, which states that the border adjustment would increase prices for consumers by \$1700. This brief examines this claim and identifies several critiques that this claim invites.

The Central Claim and Its Flaws

The claim that consumers would face a \$1,700 price increase is an assertion made by the National Retail Federation (NRF) on its website. It offers no substantiation for this claim besides

¹ <https://waysandmeans.house.gov/taxreform/>

² See Alan J. Auerbach, “The Future of Fundamental Tax Reform” *American Economic Review* 87, 2 (1997): 143–46 and Martin Feldstein and Paul Krugman, “International Trade Effects of ValueAdded Taxation,” in A. Razin and J. Slemrod, eds., *Taxation in the Global Economy* (Chicago, IL: University of Chicago Press, 1990), 263–82. Also see <https://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/> for a further review of the literature.

a broad explanation of the methodology behind it. Rather, it is asserted to be based on several data sources and third party analysis, but is ultimately just an assertion made by the trade group. Without greater transparency, it is difficult to replicate or verify. Indeed, it has already been labeled, “baloney,” by a fact-checking organization.³

Setting aside this basic lack of substantiation, several observations about how this claim was constructed can be made. First, the claim explicitly dismisses any currency appreciation effects that would mitigate any consumer impact. Second, the claim is based on the share of imports by industry from the Bureau of Economic Analysis’s (BEA) Input-Output tables.⁴ Using this dataset, it is possible to examine broad categories of industry with higher relative shares of imports. According to the NRF, these import shares are then further applied to consumer spending data from the BEA and the Bureau of Labor Statistics (BLS) to arrive at \$1,700. The NRF doesn’t provide these calculations or an associated table. Rather, the single data point (and presumably the most dramatic) that is provided is that households would face “an increase of over \$350 per year for clothing alone.” This is the only insight into the composition of the \$1,700 price increase asserted by NRF. However, even this data point raises questions.

The apparel industry is among the most heavily import dependent industries in BEA’s dataset, at about 30 percent of domestic supply stemming from imports. Accordingly, it should represent the most dramatic price appreciation based on the assumptions made by NRF. And indeed, a \$350 annual increase in clothing costs for a household would be dramatic. According the BLS Consumer Expenditure survey, the average household expenditure on apparel and related services (dry cleaning, tailoring, etc) was \$1,846 in 2015.⁵ A \$350 increase would represent more than an 18 percent increase in apparel costs for an average household, an increase that is dubious on its face. Taxing the 30 percent import share of apparel at 20 percent suggests a rough price effect, ignoring currency effects, of about 6 percent – a third of the figure that NRF has provided. While this discrepancy may be explained by legitimate methodological or data issues, without greater substantiation for the NRF claim, it suggests the effects are overstated.

It is understandable that import dependent firms may be skeptical of border adjustment. However, and particularly with respect to industries such as retailers that face high-effective tax rates under current law, the dramatic price effect claims from detractors of border-adjustment appear to be overstated. Indeed, an analysis by Goldman Sachs bears this out.⁶ According to the Goldman analysis, virtually all industries are better off with border adjustable tax system and a 20 percent rate. The Goldman analysis finds that the apparel industry – the most heavily affected in their dataset would only need to increase prices by 7 percent, again, assuming no currency effects. This analysis is very difficult to square with the NRF \$1,700 claim.

³ <http://www.factcheck.org/2017/02/border-adjustment-baloney/>

⁴ https://www.bea.gov/industry/io_annual.htm

⁵ <https://www.bls.gov/news.release/pdf/cesan.pdf>

⁶ David Mericle, Alec Phillips and Daan Struyven, “US Daily: What Would the Transition to Destination-Based Taxation Look Like?,” Goldman Sachs & Co., December 8, 2016

Conclusion

Tax reform as envisaged by the House Blueprint would represent a dramatic shift in the U.S. approach to taxation, and it follows that some industries are wary of the policy risk from such an overhaul. However, these industries should examine the totality of the proposal and evaluate it fairly. A revised tax system that lowers the corporate rate and moves away from a structure that encourages firms to locate facilities overseas would benefit the American consumer and prioritize economic growth.

Tax Topics: Border-Adjustments and Tax Avoidance

The new administration and Congress have signaled their intention to undertake fundamental tax reform in the coming months. Lawmakers will need to weigh the costs and benefits of numerous policy trade-offs as they undertake this effort. Among the most visible debates already underway concerns “border adjustability,” or moving the U.S. tax code to a cash-flow tax with a destination-basis.⁷

This reform, as proposed in the House Republican Tax Reform Blueprint, moves the U.S. toward a consumed-income tax base.⁸ Under this proposal, the current system of depreciation for capital investment would be swapped for full expensing, while the current deductibility of interest expense would be repealed. Levying this tax on a destination basis would remove exports from the tax base, while fully taxing imports.

The latter element has sparked considerable debate among policymakers, industry, and other observers. On its face, the reform appears to favor exports over imports, a misperception that the reform’s proponents and detractors both seemingly feed. This view ignores the consensus in the economics literature that such a reform would be trade-neutral, owing to currency appreciation.⁹ Leaving this effect out of the debate provides an incomplete picture as ignoring the tax rate or other key elements of the reform.

This potential reform would chart a significant departure from current U.S. tax policy and should be scrutinized carefully. This policy brief seeks to build on existing analysis of this potential reform and provide additional examples of how this proposal would work in practice, in this instance by demonstrating how a destination-based system with border adjustments eliminates the need for complicated tax planning through manipulation of a multinational firm’s internal costs (transfer prices).¹⁰

Table 1: Example Multinational Firm Under Current Law

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
U.S. Tax Base	80	15	---	15	30	5	15
Foreign Tax Base	30				20		10

In this example, consider a multinational U.S. firm under current law. The U.S. parent has \$80 in revenues, \$10 of which comes from exports. It has \$65 in deductible expenses: \$15 in wages and salaries, \$15 in depreciation allowances for certain business investments (such as machines

⁷ <https://www.americanactionforum.org/insight/tax-topics-destination-vs-origin-basis/>

⁸ https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf

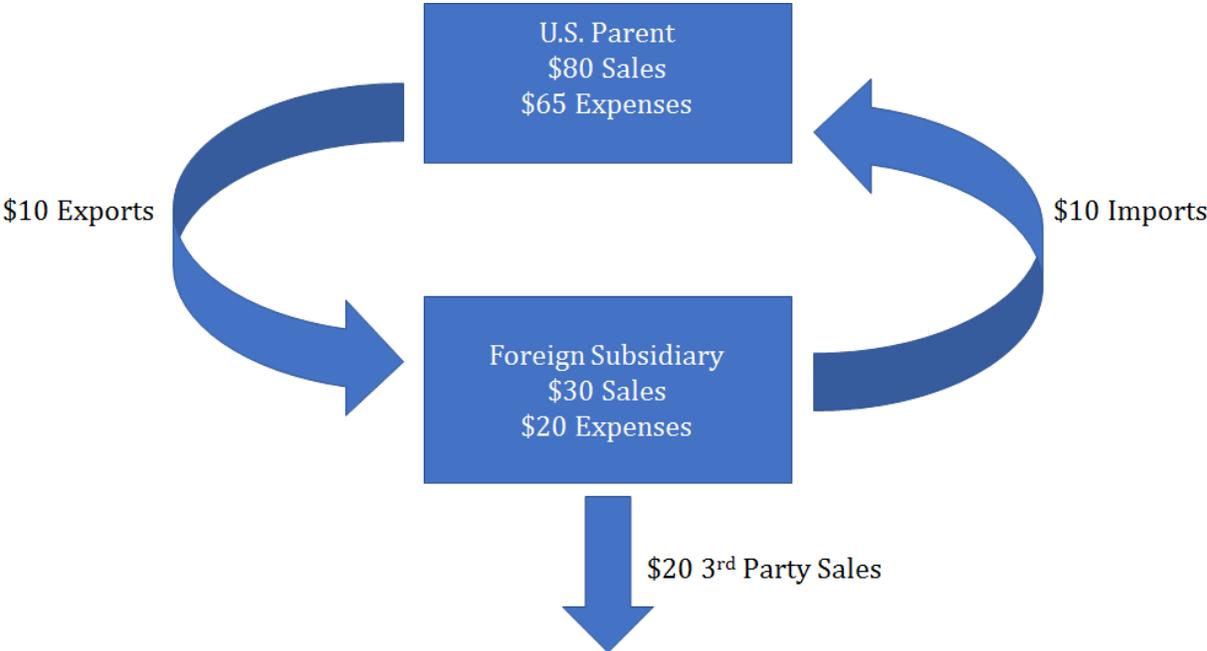
⁹ See Alan J. Auerbach, “The Future of Fundamental Tax Reform” *American Economic Review* 87, 2 (1997): 143–46 and artin Feldstein and Paul Krugman, “International Trade Effects of ValueAdded Taxation,” in A. Razin and J. Slemrod, eds., *Taxation in the Global Economy* (Chicago, IL: University of Chicago Press, 1990), 263–82. Also see <https://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/> for a further review of the literature.

¹⁰ <https://www.americanactionforum.org/research/14344/>

or equipment) \$5 in deductible interest (such as loans to finance its machines) and \$30 other deductible business expenses, of which \$10 are imported. This leaves a \$15 taxable profit.

Its foreign subsidiary has \$30 in revenues, of which \$10 are sold to the U.S. parent while \$20 are sold to other firms abroad. It also has \$20 in deductible purchases, of which \$10 are the \$10 in exports from the U.S. parent.

Figure 1: Example Multinational Firm Under Current Law



Now consider the firm’s tax base in a move to a destination-based cash-flow tax.

Table 2: Example Multinational Firm Under a Destination-Based Cash-Flow Tax *without* Currency Effects

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
U.S. Tax Base	70	15	20	---	20	---	15
Foreign Tax Base	30				20		10

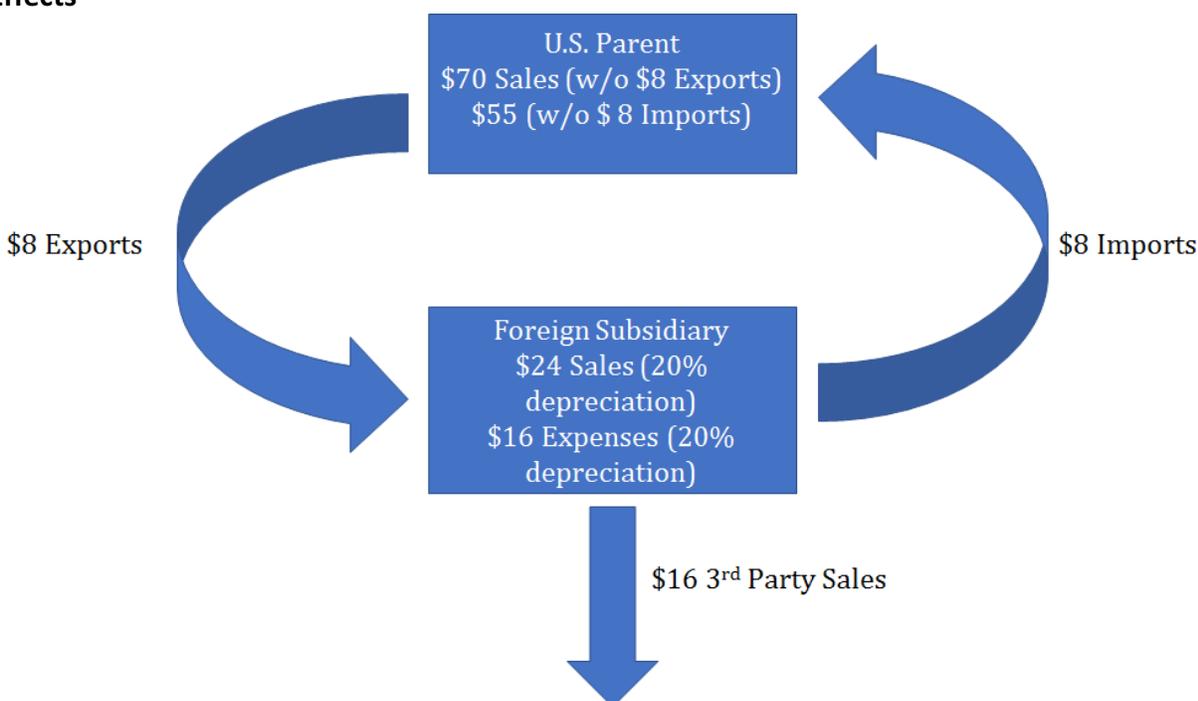
Under the new tax system, a few things change. First, the move to a cash flow tax also replaced the current system of depreciation and interest deduction in favor of full expensing. For the sake of this example, we assume these are equivalent in dollar terms. More significantly for this example and consistent with a destination-based or border adjusted tax system, we exclude the \$10 in exports sales from the firm’s revenues and exclude the \$10 in imports from the firm’s deductible expenses. What is left is still a tax base of \$15. For the purpose of illustration, the example firm’s new tax base calculation is shown without consideration of currency appreciation that should occur consistent with the economics literature.

Table 3 Example Multinational Firm Under a Destination-Based Cash-Flow Tax *with* Currency Effects

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Deducted Purchases	Interest Expense	Total
U.S. Tax Base	70	15	20	---	20	---	15
Foreign Tax Base	24				16		8

Factoring in the effects of currency appreciation alters the prices of imports and exports vis-a-vis the foreign subsidiary. These effects are not reflected in the U.S. parent’s taxable sales or deductible expenses, because the exports are excluded from sales and the imports are not included in the firm’s deductible expenses.

Figure 2: Example Multinational Firm Under a Destination-Based Cash-Flow Tax *with* Currency Effects



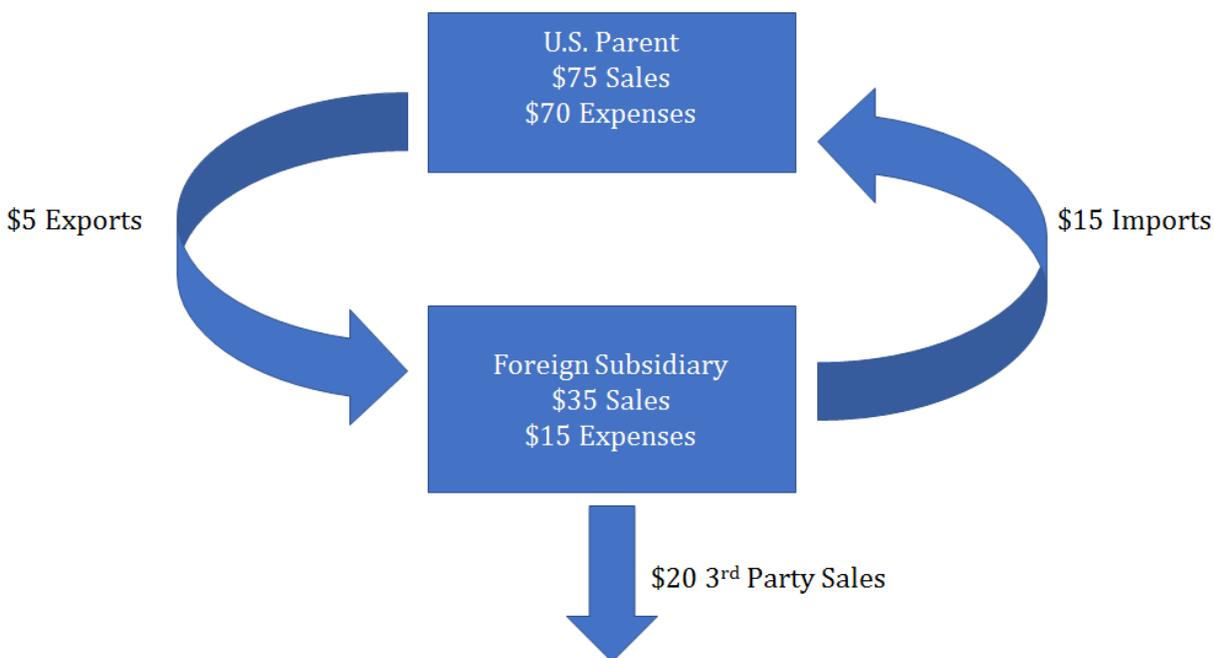
The currency effects are reflected in the transactions between the parent and subsidiary and in the dollar-value of goods sold abroad in foreign currency by the foreign subsidiary. However, the U.S. tax base remains the same. \$15 in this example.

Table 4: Example Multinational Firm Under Current Law *with* Manipulated Transfer Prices

System	Tax Base	Revenue			Expenses			Tax Base
		Real Sales	Transfer Price Manipulation	Reported Sales	Deductible Expenses	Transfer Price Manipulation	Reported Expenses	
Current	U.S.	80	-5	75	65	+5	70	5
Current	Foreign	30	+5	35	20	-5	15	20

In this example, we consider the same multinational firm under current law, but with manipulated transfer prices. Multinational firms engage in sophisticated tax planning and avoidance strategies to shift income to lower tax jurisdiction. In this instance, we assume that the firm artificially undervalues its exports to its subsidiary and inflates the value of its imports by \$5. The result is a higher tax base in the low-tax foreign jurisdiction.

Figure 3: Example Multinational Firm with Manipulated Transfer Prices Under Current Law



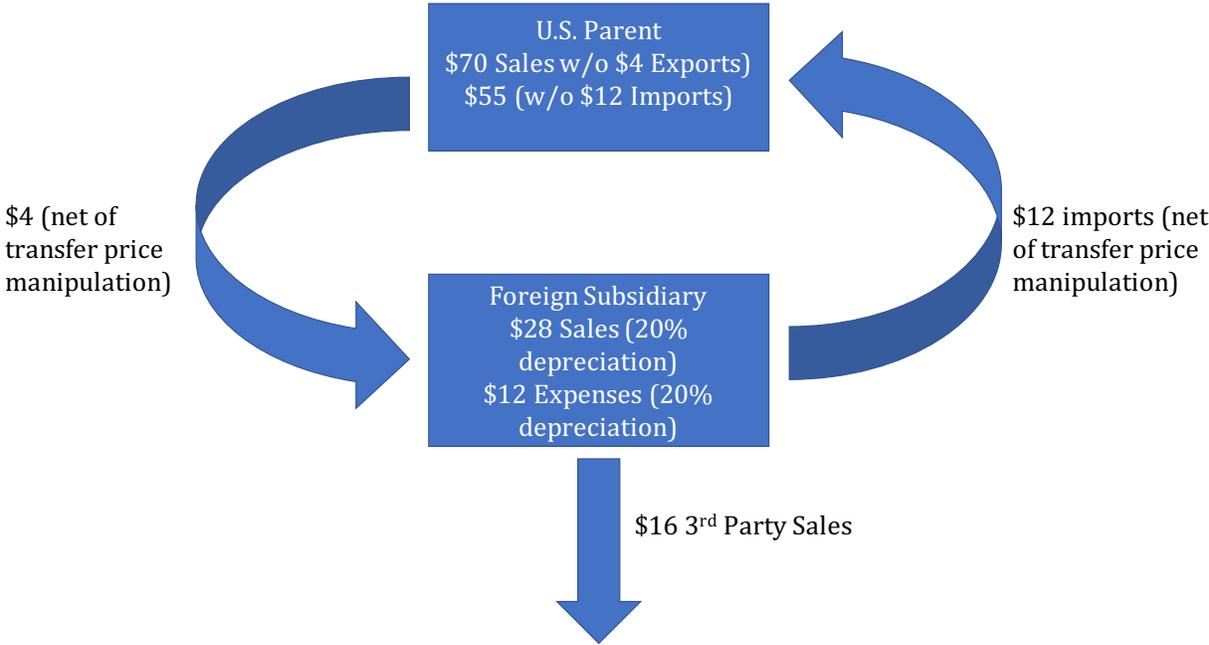
While simplistic, this illustration reflects the underlying goal of these tax strategies and the incentive under current law to shift income to lower-tax jurisdictions overseas and shift costs to the U.S.

Table 5: Example Multinational Firm Under a Destination-Based Cash-Flow Tax *with* Currency Effects *and* Manipulated Transfer Prices

System	Tax Base	Revenue				Expenses				Tax Base
		Taxable Sales	Untaxable Sales	Transfer Price Manipulation	Reported Sales	Deductible Expenses	Non-Deductible Expenses	Transfer Price Manipulation	Reported Expenses	
New	U.S.	70	8	-4	70	55	8	+4	55	15
New	Foreign	24	0	+4	28	16	0	-4	12	16

Table 5 illustrates how manipulating transfer pricing simply does not work under a destination-based cash flow tax system. The artificially lower exports (-\$4) are excluded from tax, regardless of their value, as are the artificially inflated import costs, which are not deductible, leaving the original sales of \$70 and \$55 for taxable sales and expenses, respectively, and thus the original \$15 U.S. tax base, and a higher foreign tax base of \$16.¹¹

Figure 4: Example Multinational Firm Under a Destination-Based Cash-Flow Tax with Currency Effects and Manipulated Transfer Prices.



Under a destination-based cash-flow tax, manipulating transfer prices ultimately leaves the multinational worse-off, by leaving the U.S. tax base untouched, while increasing the foreign tax base.

Conclusion

These examples demonstrate that the switch to a border adjusted tax system, accounting for associated currency appreciation, does not result in a material change to a typical company’s

¹¹ Note that this example by design ignores the effects of moving from the current high rate to a lower rate and the positive economic effects of expensing for the purpose of isolating the implications of moving to a destination-based tax system.

U.S. tax base. Furthermore, this transition would remove the incentive for firms to manipulate transfer pricing, ensuring that the U.S. tax base remains intact. Discussions of a change to this kind of cash-flow tax with a destination basis should take these important considerations into account.

Tax Topics: Border-Adjustments and Off-Shoring

The new administration and Congress have signaled their intention to undertake fundamental tax reform in the coming months. Lawmakers will need to weigh the costs and benefits of numerous policy trade-offs as they undertake this effort. Among the most visible debates already underway concerns “border adjustability,” or moving the U.S. tax code to a cash-flow tax with a destination-basis.¹²

This reform, as proposed in the House Republican Tax Reform Blueprint, moves the U.S. toward a consumed-income tax base.¹³ Under this proposal, the current system of depreciation for capital investment would be swapped for full expensing, while the current deductibility of interest expense would be repealed. Levying this tax on a destination basis would remove exports from the tax base, while fully taxing imports.

The latter element has sparked considerable debate among policymakers, industry, and other observers. On its face, the reform appears to favor exports over imports, a misperception that the reform’s proponents and detractors both seemingly feed. However, this is a flawed view that ignores the consensus in the economics literature that such a reform would be trade-neutral, owing to currency appreciation.¹⁴ Leaving this effect out of the debate provides an incomplete picture as ignorance of the tax rate or other key elements of the reform.

This potential reform would chart a significant departure from current U.S. tax policy and should be scrutinized carefully. This policy brief seeks to build on existing analysis of this potential reform and provide additional examples of how this proposal would work in practice, in this instance by demonstrating how a destination-basis system with border adjustments removes incentives for U.S. firms to move manufacturing and production overseas for sales back to the U.S.¹⁵

Table 1: Example Manufacturer Under Current Law

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15

In this example, consider a U.S. manufacturing firm under current law. The firm has \$80 in revenues, for the purpose of this example, all of which are to domestic consumers. It has \$65 in deductible expenses: \$15 in wages and salaries, \$15 in depreciation allowances for certain business investments (such as machines or equipment) \$5 in deductible interest (such as loans

¹² <https://www.americanactionforum.org/insight/tax-topics-destination-vs-origin-basis/>

¹³ <https://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-PolicyPaper.pdf>

¹⁴ See Alan J. Auerbach, “The Future of Fundamental Tax Reform” *American Economic Review* 87, 2 (1997): 143–46 and artin Feldstein and Paul Krugman, “International Trade Effects of ValueAdded Taxation,” in A. Razin and J. Slemrod, eds., *Taxation in the Global Economy* (Chicago, IL: University of Chicago Press, 1990), 263–82. Also see <https://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/> for a further review of the literature.

¹⁵ <https://www.americanactionforum.org/research/14344/>

to finance its machines) and \$30 other deductible business expenses, of which \$10 are imported. This leaves a \$15 taxable profit.

Now consider the firm’s tax base in a move to a destination-based cash-flow tax.

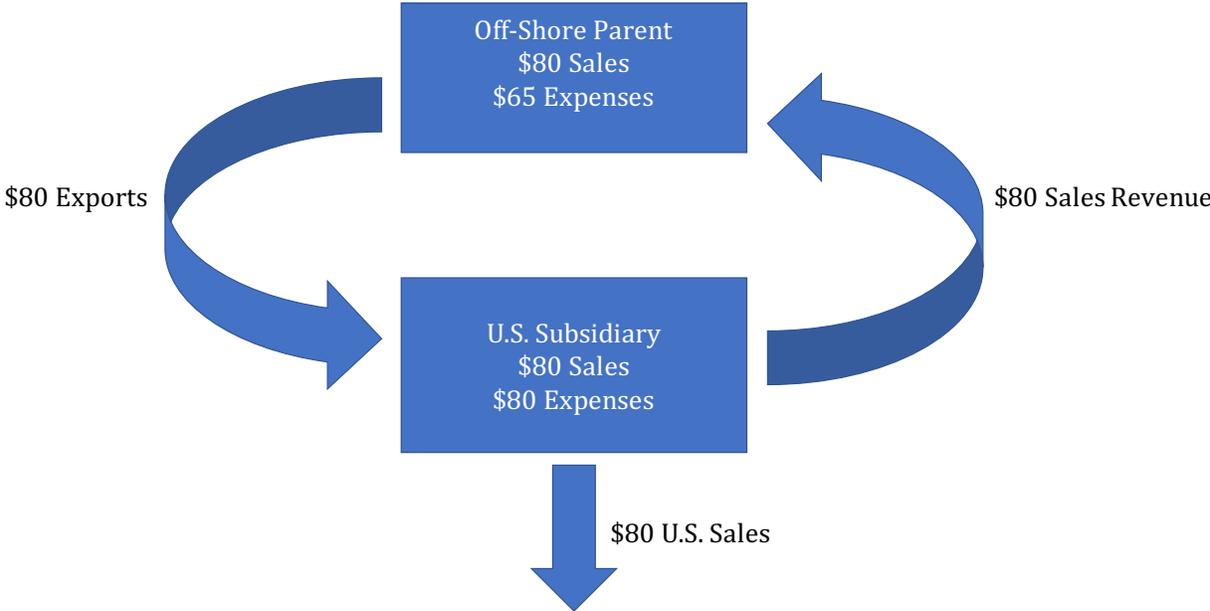
Table 2: Example Manufacturer Under a Destination-Based Cash-Flow Tax

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
New	80	15	20	0	30	0	15

Under the new tax system, a few things change. The move to a cash-flow tax replaces the current system of depreciation and interest deduction in favor of full expensing. For the sake of this example, we assume these are equivalent in dollar terms. Since the example firm has no imports or exports, the firm is unaffected by the border-adjustment elements of the new tax plan. The firm’s tax base remains \$15.

Now we consider the incentives of the current system to move production overseas.

Figure 1: Example Manufacturer Moves Production Overseas Under Current Law



In this example, we assume the formerly U.S.-based firm moves its production facility to a lower tax jurisdiction and sells its products back to the U.S. through a U.S. subsidiary.

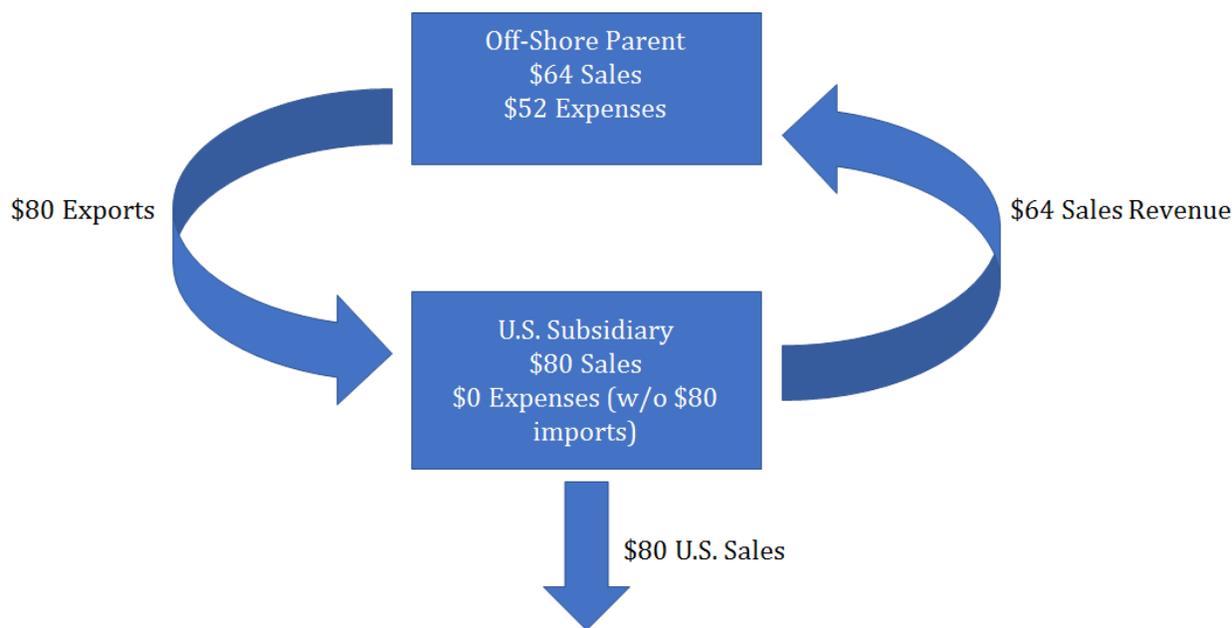
Table 3: Example Manufacturer Moves Production Overseas Under Current Law

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
U.S. Tax Base	80	0	---	0	80	---	0
Foreign Tax Base	80	15	---	15	0	---	15

Under current law, the new U.S. subsidiary would have no taxable income, as it can deduct all imports received from the off-shored parent. The parent’s tax base remains the same as if it remained in the U.S., but insofar as we assume the tax rate is lower in the new jurisdiction, the firm’s after-tax profit would be higher.

Now consider how this firm would fare under a destination-based cash-flow tax.

Figure 2: Example Multinational Firm Under a Destination-Based Cash-Flow Tax with Currency Effects



The off-shored manufacturer faces a much different calculation under a destination-based cash-flow tax.

Table 4: Example Off-Shored Manufacturer Under a Destination-Based Cash-Flow Tax with Currency Effects

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
U.S. Tax Base	80	0	---	0	0	---	80
Foreign Tax Base	64	12	---	12	24	4	12

Table 4 illustrates the combined effects of currency appreciation and moving to a destination basis on the example firm. First, the U.S. subsidiary can no longer deduct the costs of its

imports, exposing the full \$80 in sales to tax. For the purposes of this example, we assume the U.S. tax rate is 20 percent. This leaves \$64 in after-tax income for the U.S. subsidiary, which covers the costs for the \$64 in imported goods – the value of the goods will have declined in dollar terms owing to currency appreciation. Currency appreciation also would shrink the parent firm’s costs in dollar-terms, leaving deductible costs at \$52, and netting to a foreign-tax base total of \$12 in taxable income.

Table 5: After-Tax Profits of Example Off-Shored Manufacturer Under a Destination-Based Cash-Flow Tax with Currency Effects

System	Scenario	Tax Base	Taxable Sales	Untaxable Sales	Deductible Expenses	Non-Deductible Expenses	Pre-Tax Profit	Tax Rate (%)	Tax Base	After-Tax Profit
New	Remain in U.S.	U.S.	80	+	0	-	65	-	0	= 15 - (20 X 15) = 12
New	Off-Shored	U.S.	80	+	0	-	0	-	64	= 16 - (20 X 80) = 0
New	Off-Shored	Foreign	64	+	0	-	52	-	0	= 12 - (? X 12) ≥ 12

As table 5 demonstrates, under a destination-based cash-flow tax the manufacturer has no incentive to move overseas for tax purposes. Under this example, if the firm had remained in the U.S., it’s after-tax profit on its \$15 taxable income would have been \$12 – while the example off-shored firm has *pre-tax* income of \$12.

Tax Topics: Border-Adjustments and Importing Firms

The new administration and Congress have signaled their intention to undertake fundamental tax reform in the coming months. Lawmakers will need to weigh the costs and benefits of numerous policy trade-offs as they begin this effort. Among the most visible debates already underway concerns “border adjustability,” or moving the U.S. tax code to a cash-flow tax with a destination-basis.¹⁶

This reform, as proposed in the House Republican Tax Reform Blueprint, moves the U.S. toward a consumed-income tax base.¹⁷ Under this proposal, the current system of depreciation for capital investment would be swapped for full expensing, while the current deductibility of interest expense would be repealed. Levying this tax on a destination basis would remove exports from the tax base, while fully taxing imports.

The latter element has sparked considerable debate among policymakers, industry, and other observers. On its face, the reform appears to favor exports over imports, a misperception that the reform’s proponents and detractors both seemingly feed. However, this ignores the consensus in the economics literature that such a reform would be trade-neutral, owing to currency appreciation.¹⁸ Leaving this effect out of the debate provides as incomplete a picture as ignoring the tax rate or other key elements of the reform.

This potential reform would chart a significant departure from current U.S. tax policy and should be scrutinized carefully. This policy brief seeks to build on existing analysis of this potential reform and provide additional examples of how this proposal would work in practice, in this instance with respect to an importing firm.¹⁹

Table 1: Example Firm under Current Law with \$10 in Imports

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15

In this example, consider a firm that under current law has \$80 in revenues. It has \$65 in deductible expenses – \$15 in wages and salaries, \$15 in depreciation allowances for certain business investments (such as machines or equipment) \$5 in deductible interest (such as loans to finance its machines) and \$30 other deductible business expenses, \$10 of which are from imports. This leaves a \$15 taxable profit. Now consider the firm’s tax base in a move to a destination-based cash-flow tax.

¹⁶ <https://www.americanactionforum.org/insight/tax-topics-destination-vs-origin-basis/>

¹⁷ <https://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-PolicyPaper.pdf>

¹⁸ See Alan J. Auerbach, “The Future of Fundamental Tax Reform” *American Economic Review* 87, 2 (1997): 143–46 and artin Feldstein and Paul Krugman, “International Trade Effects of ValueAdded Taxation,” in A. Razin and J. Slemrod, eds., *Taxation in the Global Economy* (Chicago, IL: University of Chicago Press, 1990), 263–82. Also see <https://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/> for a further review of the literature.

¹⁹ <https://www.americanactionforum.org/research/14344/>

Table 2: Example Firm under Destination-Based Cash-Flow Tax with \$10 in Imports

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
New	80	15	20	---	20	---	25

Under the new tax system, a few things change. First, the move to a cash flow tax replaced the current system of depreciation and interest deduction in favor of full expensing. For the sake of this example, we assume these are equivalent in dollar terms. More significantly for this example we exclude the \$10 in imports from the firm's deductible expenses. What is left is a tax base of \$25. If there were no applicable tax rate, then despite the difference in the tax bases between the old and new system, the firm would still be left with \$15 in both cases, since it still paid for the \$10 in imports, even if it can't deduct them.

Table 3: After-Tax Profits of Example Firm *without* Currency Effects

Tax Base	Taxable Sales	Deductible Expenses	Non-Deductible Expenses	Pre-Tax Profit	20% Tax (Tax Base)	After-Tax Profit				
Current	80	-	65	-	0	= 15	-	3 (15)	=	12
New	80	-	55	-	10	= 15	-	5 (25)	=	10

In this example, we consider the same firm's profitability under the old and new system with a 20 percent rate applied *without* considering currency effects. In this hypothetical, the importing firm is clearly worse off under the new system, which would seem on its face to be disfavor importers. But the goal of the tax system is not to favor exports or disadvantage imports. The goal of the tax reform is to improve the tax system, and be trade neutral. Consideration of the economics of the proposal and the effect of a proportional currency appreciation reveals this to be the case.

Table 4: After-Tax Profits of Example Firm *with* Currency Effects

Tax Base	Taxable Sales	Deductible Expenses	Non-Deductible Expenses	Pre-Tax Profit	20% Tax (Tax Base)	After-Tax Profit				
Current	80	-	65	-	0	= 15	-	3 (15)	=	12
New	80	-	55	-	8	= 17	-	5 (25)	=	12

A 20 percent tax rate should lead to a 25 percent dollar appreciation, which makes foreign goods cheaper. This diminishes the cost of the example firm's foreign inputs to \$8, leaving the exporting firm's profitability the same under both the current tax system and the new system. Thus, the firm remits higher tax payments, but it's fundamental profitability is the same.²⁰

²⁰ Note that this example by design ignores the effects of moving from the current high rate to a lower rate and the positive economic effects of expensing for the purpose of isolating the implications of moving to a destination-based tax system.

Tax Topics: Border-Adjustments and Exporting Firms

The new administration and Congress have signaled their intention to undertake fundamental tax reform in the coming months. Lawmakers will need to weigh the costs and benefits of numerous policy trade-offs as they undertake this effort. Among the most visible debates already underway concerns “border adjustability,” or moving the U.S. tax code to a cash-flow tax with a destination-basis.²¹

This reform, as proposed in the House Republican Tax Reform Blueprint, moves the U.S. toward a consumed-income tax base.²² Under this proposal, the current system of depreciation for capital investment would be swapped for full expensing, while the current deductibility of interest expense would be repealed. Levying this tax on a destination basis would remove exports from the tax base, while fully taxing imports.

The latter element has sparked considerable debate among policymakers, industry, and other observers. On its face, the reform appears to favor exports over imports, a misperception that the reform’s proponents and detractors both seemingly feed. However, this ignores the consensus in the economics literature that such a reform would be trade-neutral, owing to currency appreciation.²³ Leaving this effect out of the debate provides as incomplete a picture as ignoring the tax rate or other key elements of the reform.

This potential reform would chart a significant departure from current U.S. tax policy and should be scrutinized carefully. This policy brief seeks to build on existing analysis of this potential reform and provide additional examples of how this proposal would work in practice, in this instance with respect to an exporting firm.²⁴

Table 1: Example Firm under Current Law with \$10 in Exports

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
Current	80	15	---	15	30	5	15

In this example, consider a firm that under current law has \$80 in revenues of which \$10 come from exports. It has \$65 in deductible expenses – \$15 in wages and salaries, \$15 in depreciation allowances for certain business investments (such as machines or equipment) \$5 in deductible interest (such as loans to finance its machines) and \$30 other deductible business expenses. This leaves a \$15 taxable profit. Now consider the firm’s tax base in a move to a destination-based cash-flow tax.

²¹ <https://www.americanactionforum.org/insight/tax-topics-destination-vs-origin-basis/>

²² <https://abetterway.speaker.gov/assets/pdf/ABetterWay-Tax-PolicyPaper.pdf>

²³ See Alan J. Auerbach, “The Future of Fundamental Tax Reform” *American Economic Review* 87, 2 (1997): 143–46 and artin Feldstein and Paul Krugman, “International Trade Effects of ValueAdded Taxation,” in A. Razin and J. Slemrod, eds., *Taxation in the Global Economy* (Chicago, IL: University of Chicago Press, 1990), 263–82. Also see <https://www.aei.org/publication/border-tax-adjustments-wont-stimulate-exports/> for a further review of the literature.

²⁴ <https://www.americanactionforum.org/research/14344/>

Table 2: Example Firm under Destination-Based Cash-Flow Tax with \$10 in Exports

Tax Base	Taxable Revenues	Wages & Salaries	Capital Purchases	Depreciation	Other Purchases	Interest Expense	Total
New	70	15	20	---	30	---	5

Under the new tax system, a few things change. First, the \$10 in export income is removed from the firm's tax base, leaving \$70 that was derived from domestic sales in this example. The move to a cash flow tax also replaced the current system of depreciation and interest deduction in favor of full expensing. For the sake of this example, we assume these are equivalent in dollar terms. What is left, is a taxable profit of \$5. If there were no applicable tax rate, then the firm would end up with the same profit of \$15 in both cases.

Table 3: After-Tax Profits of Example Firm *without* Currency Effects

Tax Base	Taxable Sales	Untaxable Sales	Expenses	Pre-Tax Profit	20% Tax (Tax Base)	After-Tax Profit				
Current	80	+	0	-	65	= 15	-	3 (15)	=	12
New	70	+	10	-	65	= 15	-	1 (5)	=	14

In this example, we consider the same firm's profitability under the old and new system with a 20 percent rate applied *without* considering currency effects. In this hypothetical, the exporting firm is clearly better off under the new system, which would seem on its face to be attractive at least for exporters. But the goal of the tax system is not to favor exports or disadvantage imports. The goal of the tax reform is to improve the tax system, and be trade neutral. Consideration of the economics of the proposal and the effect of a proportional currency appreciation reveals this to be the case.

Table 4: After-Tax Profits of Example Firm *with* Currency Effects

Tax Base	Taxable Sales	Untaxable Sales	Expenses	Pre-Tax Profit	20% Tax (Tax Base)	After-Tax Profit				
Current	80	+	0	-	65	= 15	-	3 (15)	=	12
New	70	+	8	-	65	= 13	-	1 (5)	=	12

A 20 percent tax rate should lead to a 25 percent dollar appreciation, which would leave foreign buyers with 80 percent of their buying power of U.S. goods. This diminishes the foreign sales in our example in dollar-terms to \$8, leaving the exporting firm's profitability the same under both the current tax system and the new system.²⁵

²⁵ Note that this example by design ignores the effects of moving from the current high rate to a lower rate and the positive economic effects of expensing for the purpose of isolating the implications of moving to a destination-based tax system.

Economic Policy Institute

May 17, 2017

Representative Kevin Brady
Chairman
Committee on Ways & Means, U.S. House of Representatives
Washington, DC

Representative Richard Neal
Ranking Member
Committee on Ways & Means, U.S. House of Representatives
Washington, DC

Dear Chairman Brady, Ranking Member Neal, and Distinguished Members of the Committee:

We welcome the opportunity to submit these comments to the Committee record on behalf of the Economic Policy Institute Policy Center (EPI-PC). EPI is a nonprofit, nonpartisan think tank created in 1986 to include the needs of low- and middle-income workers in economic policy discussions.

The Committee will convene on May 18 to discuss how tax reform could grow the U.S. economy and create jobs. While we agree that many tax policy changes could strongly benefit low and middle-income Americans, we do not think that Speaker Paul Ryan's "Better Way" tax reform proposal and other likely principles of the Congressional majority's plan for tax reform will do this. Instead, the outcome of efforts based on these plans and principles will simply lead to large, regressive tax cuts for corporations and the wealthiest Americans that will expire at the end of the budget window because they have not been paid for.¹ According to the Tax Policy Center, in the first year of Speaker Ryan's "Better Way" proposal, fully 76 percent of the benefits would go to the top 1 percent.² Ten years later, this share will be an astounding 99.6 percent going to the top 1 percent. This level of regressivity is sometimes hard to fully understand. An easy way to grasp it is to contrast it with a lump-sum tax cut that shared benefits equally. A lump-sum cut would provide benefits for the bottom 60 percent of American households 10 times

¹ Blair, Economic Policy Institute, 2017. "[Likeliest outcome of tax reform is a deficit-financed tax cut for the rich that will expire in a decade.](#)"

² Nunns, Burman, et al. Tax Policy Center, 2016. "An analysis of the House GOP Tax Plan."

larger than what the “Better Way” plan would. But it would result in tax cuts for the top 1 percent that were *99 percent smaller*.³

Of course, a lump-sum tax cut is just illustrative and proponents of “Better Way” style plans would argue that the incentive effects of their plan would spur growth. These effects are hugely overrated however. We would like to focus here in particular on the popular idea that corporate tax rate cuts are an effective way to spur economic growth.

First, proponents of corporate tax cuts often argue that U.S. corporations face higher tax rates than those of our peer countries, and claim that this differential hurts U.S. “competitiveness” (a word these proponents rarely define) and discourages companies from investing in the U.S. Consequently, they further claim that cutting corporate tax rates would increase American companies’ “competitiveness,” which they imply (but rarely argue directly) would redound to the benefit of most American families.

Our research has found this central argument—that U.S. corporations face high corporate taxes—to be empirically false.⁴ While U.S. *statutory* tax rates are higher, the *effective* tax rate paid by corporations is in fact roughly equivalent to the effective tax rates of our peer countries, due to loopholes in the U.S. tax code. Further, we find that even if the effective corporate tax rate were higher (if loopholes were closed), economic theory and data do not support the idea that cutting these rates would encourage further investment in the U.S. or benefit the vast majority of Americans. Instead, such cuts would primarily benefit a small number of high-income capital owners while increasing the regressivity of the tax system overall.

Claims regarding the economic benefits of cutting corporate tax rates rarely relate these cuts to the three influences that *could* boost living standards for the vast majority of American households: *employment generation*, *productivity growth*, and a more *progressive distribution of income*. Unless corporate tax rate cuts help boost any of these influences, they will not raise living standards for the vast majority and hence should not be a priority of policymakers.

Corporate rate cuts are inefficient as employment generators

Currently, the economy remains below full employment, with aggregate demand (spending by households, businesses and governments) still too low to absorb all the hours of work Americans want to offer. So, fiscal policy changes that spurred aggregate demand would be good. However, corporate tax cuts are the least-efficient way to boost aggregate demand and job creation.

³ Blair, Economic Policy Institute, 2017. [“Republicans’ opening bid for tax reform is egregiously tilted to the rich.”](#)

⁴ Bivens, Blair, Economic Policy Institute, 2017. [“Competitive’ distractions: Cutting corporate tax rates will not create jobs or boost incomes for the vast majority of American families.”](#)

In the short run, corporate rate cuts are passed through to shareholders, who are overwhelmingly well-off and much more likely to save rather than spend the extra money. If the government wants to cut taxes in the short run to spur employment, those tax cuts should be aimed at low- and middle-income households, not high-income shareholders. A better way to spur employment would be to boost public spending — on infrastructure or other public investments, or increases in income support programs.

Corporate rate cuts will have trivial effects on productivity

There is a better theoretical case that corporate tax cuts might help boost productivity. When the economy is at full employment, cutting the corporate rate should increase the post-tax return to capital. This should incentivize more private savings, which should in turn lower interest rates and increase capital investment.

The increased investment would provide workers with more and newer capital goods, boosting labor productivity. But while the theoretical channel linking corporate rate cuts and productivity growth is valid, there isn't real-world evidence arguing that this link is strong. First, there's already a well-known glut of savings. This savings glut has kept interest rates low for years and will likely continue to keep them low in the future.

With savings already high and interest rates already low, corporate tax cuts just won't have much traction in boosting investment. Second, cutting the corporate rate can boost private savings, but if the rate cut isn't paid for, this boost to private savings will be offset by decreased public savings (i.e., higher budget deficits). The deficit will increase, eventually pushing up interest rates and reversing the theoretical channel through which corporate rate cuts could increase productivity.

Corporate rate cuts clearly exacerbate post-tax inequality

Finally, besides being a terribly inefficient job-creator and having only weak real-world effects in boosting productivity, a strategy of cutting corporate rates is unambiguously regressive. The corporate income tax is typically assumed to ultimately fall largely on capital owners. Capital income is highly-concentrated at the top of the income distribution — with the top 1 percent of households holding 54 percent of all capital income.

In theory, some of this regressive effect could be mitigated by a boost to productivity. But, as we noted, this is far from a sure bet. But even if productivity does increase, it turns out that most of the benefits of productivity growth haven't trickled down in decades. The hourly pay of the vast majority of U.S. workers has lagged far behind productivity growth due to rising income inequality.

Any policy change—including corporate tax reform—that is supported by claims that it will boost the living standards of the vast majority of American households *must* tell a convincing story of how it will (a) generate employment, (b) raise productivity, or (c) distribute income toward the vast majority. Needless to say, any policy change that cannot claim to boost the living standards of the vast majority is not worth doing.

If we wish to reform corporate tax policy to benefit the vast majority of Americans—and not just a wealthy few—we should not be talking about lowering corporate tax rates or offering other tax breaks to corporations; we should instead be focusing on closing loopholes in the system that have eroded the corporate income tax base, to ensure the corporate sector is paying its appropriate share of taxes.

Sincerely,

Josh Bivens, Ph.D

Director of Research, Economic Policy Institute Policy Center

Hunter Blair

Budget Analyst, Economic Policy Institute Policy Center

Appendices:

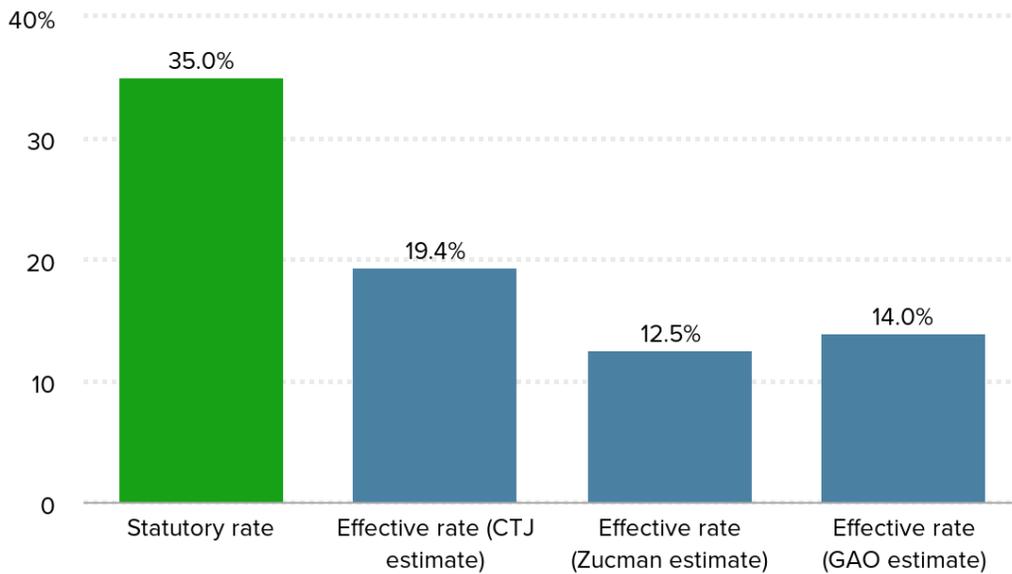
- Figure A: Comparison of U.S. statutory and effective average corporate tax rates
- Figure B: After-tax corporate profits versus corporate tax revenue, as a share of GDP, 1952-2015

Appendices

Figure A

Actual U.S. corporate tax rates are about half the official 35 percent rate

Comparison of U.S. statutory and estimated average effective corporate tax rates



Sources: Americans for Tax Fairness (ATF) and EPI analysis of McIntyre, Gardner, and Phillips (2014a, i); Zucman (2014, 132–133); and GAO (2016, 13)

Figure B

Corporate profits are way up, corporate taxes are way down

After-tax corporate profits versus corporate tax revenue, as a share of GDP, 1952–2015



Source: *Corporate tax chartbook: How corporations rig the rules to dodge the taxes they owe*, Economic Policy Institute and Americans for Tax Fairness, 2016

Economic Policy Institute



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**STATEMENT FOR THE RECORD:
THE EDISON ELECTRIC INSTITUTE**

**Hearing on “*How Tax Reform Will Grow Our Economy and Create Jobs*”
United States House of Representatives
Committee on Ways and Means
May 18, 2017**

The member companies of the Edison Electric Institute (EEI)—our nation’s investor-owned electric companies—strongly support pro-growth tax reform that boosts the economy and increases U.S. competitiveness, encourages private investment in critical energy infrastructure, creates jobs, and keeps energy bills as affordable and predictable as possible for customers.

The electric power industry is the nation’s most capital-intensive industry and supports more than 7 million American jobs and contributes \$880 billion (or 5 percent of GDP) to the U.S. economy. EEI’s members invest more than \$100 billion each year to build smarter energy infrastructure and to transition to an even cleaner generation fleet.

There are five tax provisions that we believe are essential to supporting long-term investments in America’s critical energy infrastructure. These are maintaining the federal income tax deduction for interest expense, as well as the federal income tax deduction for state and local taxes; providing for the continuation of normalization, including addressing excess deferred taxes resulting from a reduction in the tax rate; and keeping dividend tax rates low and on par with capital gains.

Each of these provisions helps to keep the cost of capital low so electric companies can continue to invest in the infrastructure necessary to provide American homes and businesses with reliable and affordable electricity.

Maintain the Federal Income Tax Deduction for Interest Expense

Due to their capital-intensive nature, investor-owned electric companies use a balanced combination of equity and long-term debt and maintain high credit quality to invest more than \$100 billion each year in very long-life assets. These investments are overseen by independent state public utility commissions (PUCs), meaning that how much electric companies can earn on these investments and the rates they can charge their customers are highly regulated.

Our industry traditionally has maintained a capital structure of 55 percent long-term debt, which currently equates to more than half a trillion dollars. In addition to this stable capital structure, we have been steadily strengthening our credit quality, which is currently BBB+. The goal of this debt-equity capital structure, which also is overseen by state PUCs, is to keep the cost of capital low so electric companies can continue to invest in energy infrastructure.

The loss of interest deductibility will increase the cost of capital, which is reflected in electric rates paid by our customers. Moreover, unlike in other industries, full expensing will potentially lead to less, rather than more, investment by electric companies. The costs of an electric company's investments are factored into customer bills over time rather than immediately. As a result, the full expensing of capital does not have the same stimulative economic effect for investor-owned electric companies as it does for other industries. When the deduction for interest on debt is replaced with the ability to fully expense capital costs in the first year, a company is trading a permanent deduction for a temporary benefit. Applied to electric companies' rate-making formula, this means that the tax component of rates will increase.

Electric companies work hard to achieve the lowest cost of capital, and they rely upon the federal income tax deduction for interest costs to help keep electricity rates as low as possible. If electric companies are unable to deduct interest costs for infrastructure projects, they would pass any tax increases and related higher costs on to their customers.

To avoid potentially negative impacts on customers' electricity bills, we believe the interest expense deduction should remain in place.

Maintain the Deduction for State & Local Taxes

To support our energy infrastructure, electric companies own significant real estate. As a result, they pay a substantial amount in taxes to states and municipalities, and usually are the largest payers of property taxes in their respective states.

Communities with a large electric company presence rely on this funding to support a myriad of programs. These state and local taxes support jobs, local schools, public safety departments (such as police and fire departments), local road construction and maintenance, and other important community infrastructure projects.

The deduction for state and local taxes has long been considered a normal business expense. Removing it would increase taxes on electric companies, even with a reduction in corporate tax rates. These increased taxes would make it harder to support investments in the energy grid and would raise the cost of electricity. Electric companies support maintaining the deduction for state and local taxes as a normal business expense.

Maintain Tax Normalization and Address Excess Deferred Taxes

Customers count on their electric companies and their state regulators to help keep energy bills as predictable as possible. That is why the costs of long-term investments, including tax benefits, are spread out or normalized over the life of the investment rather than being reflected immediately in customers' rates at the time the investment is made.

At the same time, electric companies and regulators have long recognized that when tax policy changes are made that can destabilize rates in the short term, these changes should be treated in the same way as long-term investments and should be spread out or normalized over the same period as the long-life assets to which they relate. This concept of normalization has been around since the 1960s, and the policy should be continued going forward.

One potential transition issue that could arise under tax reform is the treatment of excess deferred taxes, resulting from a reduction in the tax rate. If corporate tax rates are reduced, a company's future tax liability is also reduced because of the new, lower tax rate. This creates a situation under which excess deferred taxes that were collected in rates must be refunded to customers.

Tax normalization should be retained in any fundamental overhaul of the tax code to provide a fair and equitable treatment of excess deferred taxes. This will ensure that these benefits are returned to customers over the remaining life of the investments and also will address any investment incentives that are retained in the code.

Keep Dividend Tax Rates Low and On Par With Capital Gains

EEl commends Congress for maintaining low tax rates on dividends that are at parity with the tax rates on capital gains as part of the American Taxpayer Relief Act of 2012 (ATRA). ATRA set the top tax rate for both dividends and capital gains at 20 percent. We also commend Congress for making these rates permanent instead of providing another temporary extension.

EEl's member companies feel strongly that federal tax policy should not distort investment decisions, and taxing dividends at higher rates than capital gains would create a tax policy that favors growth stocks over dividend-paying investments. Maintaining low tax rates and parity between dividends and capital gains is essential.

We recommend that the current tax rates on dividend income be maintained and kept in line with capital gains in any comprehensive tax reform legislation.

Conclusion

As you consider tax reform proposals, please remember that tax changes that may help to promote growth in other industries often have the opposite effect on rate-regulated industries like ours. We look forward to working with the Committee to find tax reform

solutions that will benefit customers and encourage much-needed investment in critical energy infrastructure by helping to keep the cost of capital as low as possible.

Education Finance Council Statement for the Record

Hearing: “How Tax Reform Will Grow Our Economy and Create Jobs”
House Committee on Ways and Means
Submitted: May 19, 2017

Education Finance Council (EFC) is the national trade association representing nonprofit and state-based higher education finance organizations. These organizations are public-purpose entities that operate with the mission of increasing postsecondary access, affordability, and success. Collectively, they serve as critical resources for students and families in their states, assisting families with every facet of the higher education financing experience. Many of these organizations use the proceeds of Qualified Student Loan Bonds to fund supplemental education loans as well as education refinancing loans.

EFC shares the Committee’s vision for a simpler and fairer tax system, and we appreciate the opportunity to provide the following important recommendations:

Preserve Tax-Exempt Qualified Student Loan Bonds¹

As Congress works to reform the tax code, it is imperative that policymakers preserve tax-exempt Qualified Student Loan Bonds to maintain the ability of nonprofit and state-based organizations to offer low-cost financing options that afford middle-income families the ability to pay for their college dreams.

As college costs continue to rise, many middle-income families require low-cost financing options in addition to the Federal Direct Student Loan Program. Nonprofit and state-based student loan funding providers have the unique ability to utilize tax-exempt bond financing — in the form of Qualified Student Loan Bonds — to help families fill the gap with low-cost, consumer-friendly loans. Policymakers should keep in mind, as they work to reform the tax code, that repealing the tax exemption would dramatically increase the cost of these loans, adversely affecting middle-income families, who already bear a significant portion of the \$1.4 trillion student debt burden.

There are currently 19 state-based and nonprofit lenders who offer education loans with low interest rates, low or no origination fees, and lower monthly payments than many other education loan options, including the Federal Direct PLUS program. For example, families who work with one

¹Qualified Student Loan Bonds fall under the municipal bond tax exemption. Initially, student loan bonds were treated as governmental bonds, and were not what the 1954 Internal Revenue Code described as industrial development bonds (and that are now known as “Private Activity Bonds”, which are subject to many more restrictions than governmental bonds). In 1984, Congress changed the tax-exempt bond rules to make interest on what were described as “Private Loan Bonds” taxable. But “Qualified Student Loan Bonds,” under then-applicable Section 103(o), were not treated as “Private Loan Bonds” for this purpose.

When the 1986 Tax Act put the Internal Revenue Code of 1986 in place, the concept of a qualified student loan was incorporated into Section 144(b) of the Code. Qualified Student Loan Bonds are now Private Activity Bonds and are subject to volume cap limitations.

state-based program can save an average of \$2,500 over ten years on a \$10,000 loan, compared to if they had taken out a PLUS loan.

Most of these organizations also provide the in-depth counseling that borrowers need to understand and manage their loan responsibilities and guide borrowers through all repayment options available to them — with special attention paid to working with borrowers who experience economic hardship. In the past year, EFC Members directly worked with over 2.5 million families to help them successfully plan, save, and pay for college. And, during the 2015-16 fiscal year, nonprofit and state-based organizations helped over 76,000 students and their families close the gap in college funding with more than 87,000 loans to more than 76,000 borrowers, totaling \$1.1 billion. Collectively, their outstanding portfolios include 1.56 million in loans totaling \$11.25 billion, representing more than 628,000 borrowers.

Additionally, 13 nonprofit and state-based organizations offer refinancing loans, making education debt more manageable for families by providing a refinancing tool that consolidates high-interest rate education loans into a single loan, reducing overall debt burden and, in many cases, reducing monthly payments by as much as \$200 or \$300 per month — saving borrowers anywhere from \$3,000 to \$5,000 over a ten-year repayment term.

Tax-exempt Qualified Student Loan Bonds also allow nonprofit and state-based student loan organizations to serve as critical resources for the citizens of their states, assisting families with every facet of the higher education financing experience. These organizations use any excess revenues to help fund extensive free programs to counsel students to choose the best-fit school, borrow appropriately, complete their degree, maximize their earning potential, and successfully repay their loans.

In the past year, these organizations worked directly with 2.5 million students and families, and:

- Granted over **\$655 million** in scholarships
- Hosted programs at over **14,000** schools, community centers, libraries, and other sites
- Assisted **1 million** students with their college applications
- Awarded **\$577 million** in grant funds
- Assisted in the filing of more than **76,000 FAFSAs**
- Hosted over **16,000** community presentations for students and parents surrounding college planning and financial aid
- Presented programs on financial literacy, budgeting, and college planning to over **520,000** high school students and their families
- Presented programs on financial literacy, budgeting, and college planning to over **50,000** elementary and middle school students and their families
- Provided financial literacy training and programs to over **57,000** students and families
- Distributed over **4.5 million** brochures, fact sheets, guides, newsletters, and webinars
- Held over **2,300** counselor- and teacher-training workshops

In order to retain the ability of nonprofit and state-based organizations to provide low-cost, consumer-friendly loans to middle-income families, and their ability to offer extensive free outreach programs, it is critical to preserve tax-exempt Qualified Student Loan Bonds.

Eliminate the Alternative Minimum Tax

EFC supports the proposed elimination of the Alternative Minimum Tax (AMT), which would minimize costs to education loan borrowers. Congress' previous temporary elimination of the AMT on income earned from Private Activity Bonds resulted in lower borrowing rates for student loan issuers, with those savings passed directly to student loan borrowers.

For example, a student borrowing \$20,000 could save \$500 or more in lower interest payments on a ten-year loan with the elimination of the AMT. Nonprofit and state-based education finance organization are committed to once again passing any savings from the elimination of the AMT directly to borrowers in the form of lower interest rates.

Update "Qualified Scholarship Funding Corporation" Rules

As noted above, nonprofit and state-based education loan financing providers, through the issuance of Qualified Student Loan Bonds, are uniquely situated to make supplemental education loans with the best possible terms and to make education refinancing loans at low interest rates. However, certain nonprofit and state student loan funding providers — "qualified scholarship funding corporations" under Section 150(d) of the Internal Revenue Code — are currently ineligible to issue Qualified Student Loan Bonds to finance supplemental education loans and refinance education loans.

Section 150(d) allows only qualified scholarship funding corporations to issue Qualified Student Loan Bonds to acquire education loans incurred under the HEA, which was the Federal Family Education Loan Program (FFELP). An update is needed to the Internal Revenue Code to allow qualified scholarship funding corporations to utilize Qualified Student Loan Bonds to fund supplemental education loans and refinancing loans.

EFC endorses H.R.480, the *Student Loan Opportunity Act*, introduced by Rep. Bill Flores (R-TX), which would allow qualified scholarship funding corporations to issue Qualified Student Loan Bonds to fund supplemental education loans for students attending school and provide low-cost refinancing loans to borrowers once they leave school. We recommend that H.R.480 be included in tax reform efforts currently underway so as to extend the same opportunities to residents of all states. This would ensure that students and borrowers have the broadest access possible to low-cost supplemental education and refinancing loans.

Stop Taxing Death & Disability

EFC strongly supports efforts to exempt from federal income tax private and federal education loans that are discharged due to the death or total and permanent disability of a student, and to allow the parent of a student that becomes totally and permanently disabled to have their federal loan discharged.

Adding federal and private student loan discharges as a result of death or total and permanent disability to the existing list of tax-exempt discharges is a common-sense and compassionate reform, modeled on current exemptions that public sector employees and borrowers with a closed-school discharge already receive.

EFC endorses the bicameral, bipartisan *Stop Taxing Death and Disability Act* and recommends it be included in the current tax reform effort.



**Statement for the Record
House Committee on Ways and Means
Hearing on “How Tax Reform Will Grow Our Economy and Create Jobs”**

May 18, 2017

Stephanie Silverman
President & Executive Director
Employee-Owned S Corporations of America
1341 G Street, NW, 6th Floor
Washington, DC 20005

On behalf of the Employee-Owned S Corporations of America (ESCA), thank you for the opportunity to submit comments to the House Committee on Ways and Means. We commend the Committee for its continued focus on policies to drive the economy thru tax policy and job growth, which is essential to not only the industry, but also to working Americans, their families and their communities.

About ESCA

ESCA represents private employee-owned companies operating in every state across the nation, in industries ranging from heavy manufacturing to construction to grocery stores. The expansion of subchapter S corporation employee stock ownership plans (S ESOPs), following Congress’ creation of that structure in 1998, is testimony to the fact that this business model offers a valuable way to transition ownership, empower workers and boost productivity.

Currently, there are about 3,000 S corporation ESOPs; they employ 470,000 workers across the country and support nearly a million jobs in all. We would respectfully suggest to the Committee that a vital means of promoting economic opportunity for working Americans is to expand the availability of S corporation ESOPs through targeted tax policy updates.

S ESOPs Promote Jobs and Savings

The evidence is compelling that expanding the availability of S corporation ESOPs for more companies and their workers would not only boost the retirement savings of countless Americans, but would also create more jobs, generate more economic activity, and help businesses be more stable and successful.

A 2016 [study](#) by Jared Bernstein showed that ESOP companies provide more stable employment than other businesses, pay better wages and reduce wealth inequality. A 2015 study by EY’s Quantitative Economics and Statistics practice found that S ESOPs outperformed the S&P 500 in total return per

participant by an impressively large margin (62%) and distributions to participants totaled nearly \$30 billion from 2002 to 2012. A 2008 University of Pennsylvania/Wharton School of Business study found that S ESOPs contribute ***\$14 billion in new savings for their workers each year beyond the income they would otherwise have earned***, and that these companies offer workers greater job satisfaction and stability. The study also found that S ESOPs generate a collective ***\$19 billion in economic value that otherwise would not exist***.

S corporation ESOPs are doing exactly what Congress intended: generating economic activity, creating jobs, and promoting retirement savings. By any measure, these companies have been a remarkable success story, and a bright spot in an economy characterized over the course of the last decade or more by sluggish growth, anemic job creation, worker insecurity and wealth inequality.

It stands to reason that companies with ESOPs have displayed a dynamism and vitality lacking in many others. An ownership stake in one's place of work is not only a reason for workers to help drive the company's success, it also inspires greater loyalty as workers consider themselves aligned with the fortunes of the business, and avoid adversarial dynamics that can emerge when employees are convinced that the interests of stockholders and corporate board members are at odds with their own. For workers in S corporation ESOP firms, what is good for ownership is good for them.

Employee Ownership as a Transition Tool to Keep Jobs Local

As the Ways and Means Committee contemplates pro-growth measures, ***we urge members to support tax policies that expand the availability of S corporation ESOPs, allowing more workers to own their businesses and benefit from the advantages that employee ownership holds***. Today there are practical limitations, however, that hinder this goal, including a lack of information about employee ownership as a transition option.

Ensuring business continuity in and of itself is a job-retaining play and creating employee-owners can help make businesses more powerful job engines. Alex Brill, CEO of Matrix Advisors, who has served as policy director and chief economist on the Ways and Means Committee staff, noted in his March 2017 [paper](#), *Employee Stock Ownership Plans as an Exit Strategy for Private Business Owners*, "For certain private business owners, a way to preserve a firm's continuity, foster employee commitment, and build lasting economic value in a community is to sell the business to its employees through an ESOP."

This builds on earlier Brill studies from 2012 and 2013 that found:

- **The number of S ESOPs and the level of active participation (number of employee-owners) have more than doubled since 2002.**
- **Employment among surveyed S ESOP firms increased more than 60% from 2001-2011, while the private sector as a whole had flat or negative growth in the same period. (2012)**
- **In the struggling manufacturing industry in particular, the S ESOP structure has buffered against economic adversity and job loss. (2012)**
- **S ESOPs have significantly expanded the pool of US workers who are saving for retirement, while also boosting company productivity – something that has greatly benefited their employee-owners. (2012)**

H.R. 2092

Toward that end, H.R. 2092 -- introduced in April by Committee members Dave Reichert and Ron Kind along with Reps. Pat Tiberi, Richard Neal, Erik Paulsen, Earl Blumenauer and Bill Pascrell -- would help to grow the number of private ESOP businesses in the United States, giving more workers the

opportunity to build savings, reduce wealth and wage inequality, and retire with dignity. The measure includes provisions to extend the gain-deferral provisions of Code section 1042 to sales of employer stock to S ESOPs, encourage the flow of bank capital to ESOP-owned S corporations, provide resources to small businesses contemplating making the transition to an ESOP, and ensure that SBA-certified small businesses do not lose their status by becoming employee owned. Last Congress' version of this legislation, H.R. 2096, had 96 bipartisan cosponsors (including 22 members of the Ways and Means Committee).

Economic Security for Employee-Owners

One of the clearest benefits of job stability and strong savings among workers is how they feel about their own economic security and the evidence also tells us there is a marked difference between ESOP employees and other workers, with ESOP employees expressing less worry and more confidence about their fiscal health. A [new survey](#) by John Zogby Strategies found that employees who work at private, employee-owned companies feel more financially secure and feel they have more job security than other workers, whose economic anxiety continues to grow by comparison. The survey benchmarked responses against the annual "Economic Anxiety Poll" put out by Marketplace/Edison Research. The survey also found these employee-owners feel financially stable enough that they worry less about being able to cover expenses – mortgage and rent payments, student loan costs or unexpected costs – than does the rest of the population.

Conclusion

Given the clear and compelling benefits to workers, communities, businesses and the national economy that are derived from S ESOPs, there is little doubt that a practical solution to the question at hand is to spur the creation of more S ESOPs and create more employee-owners. With that goal in mind, we look forward to working with Committee members to advance provisions from H.R. 2092 this year. We thank the Committee for its continued championship of employee ownership through the S ESOP model, and more broadly for its work on pro-growth policies for working Americans.

The Employee-Owned S Corporations of America ("ESCA") is the Washington, DC voice for employee-owned S corporations. ESCA's exclusive mission is to advance and protect S corporation ESOPs and the benefits they provide to the employees who own them. These companies have an important story to tell policymakers about the tremendous success of the S ESOP structure in generating long-term retirement savings for working Americans and their families. ESCA provides the vehicle and the voice for these efforts. ESCA represents employee-owners in every state in the nation.



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Statement for the Record

Hearing on How Tax Reform Will Grow Our Economy and Create Jobs across America

Committee on Ways and Means
U.S. House of Representatives

June 1, 2017

As the Committee seeks taxpayer and industry input on the important task of simplifying and reforming our tax code to generate jobs and economic growth, the Federation of Exchange Accommodators (“FEA”) appreciates this opportunity to demonstrate the benefits and need for retention of IRC Section 1031, in its present form, in any tax reform bill.

The House Republican Blueprint for Tax Reform proposes reduced tax rates and full, immediate expensing with unlimited loss carryforward for all investment and business-use tangible & intangible depreciable personal property assets, including real estate improvements, but not land. We understand that some policymakers believe that if these proposals are enacted, that §1031 like-kind exchanges will no longer be necessary. We disagree.

The Blueprint proposals, taken as a whole, do not provide equal benefits, and are not as comprehensive, as the benefits provided to both taxpayers and our economy by §1031 like-kind exchanges. Even with lower tax rates and immediate expensing, Section 1031 will still be necessary to remove friction from transactions and fill in the gaps.

At its core, IRC §1031 is a powerful economic stimulator that is grounded in sound tax policy. The non-recognition provision is premised on the requirement that the taxpayer demonstrates continuity of investment in qualifying replacement property with no intervening receipt of cash. There is no profit-taking, and at the conclusion of the exchange, the taxpayer is in the same tax position as if the relinquished asset was never sold.

Since 1921, Federal tax law under IRC §1031 has permitted a taxpayer to exchange business-use or investment assets for other like-kind business-use or investment assets without recognizing taxable gain on the sale of the old assets. Taxes which otherwise would be due if the transaction was structured as a sale are deferred. Qualifying assets include commercial, agricultural and rental real estate, aircraft, trucks, automobiles, trailers, containers, railcars, agricultural equipment, heavy equipment, livestock and other assets involved in a broad spectrum of industries, owned by an equally broad spectrum of taxpayers ranging from individuals of modest means and small businesses to large business entities.

Under current law, §1031 promotes capital formation and liquidity. A macro-economic impact study by Ernst & Young, and a micro-economic impact study on commercial real estate by Dr. David Ling and Dr. Milena Petrova, both published in 2015, concluded that Section 1031 removes the tax lock-in effect and permits taxpayers to make good business decisions without being impeded by negative tax consequences¹.

¹ *Economic Impact of Repealing Like-Kind Exchange Rules*, Ernst & Young (March 2015, Revised November 2015) available at <http://www.1031taxreform.com/1031economics/>; and *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate*, David C. Ling and Milena Petrova (March 2015, revised June 22, 2015), available at <http://www.1031taxreform.com/ling-petrova/>.

Like-kind exchanges stimulate economic activity and promote property improvements that benefit communities, increase property values and local tax revenues, improve neighborhoods, and generate a multitude of jobs ancillary to the exchange transactions. These studies quantified that restricting or eliminating like-kind exchanges would result in a decline in GDP of up to \$13.1 billion annually, reduce velocity in the economy and increase the cost of capital to taxpayers.² A 2016 Tax Foundation report estimated a significantly larger economic contraction of approximately \$18 billion per year.³

Like-kind exchanges benefit the economy in a myriad of ways. Commercial real estate owners, individuals, and businesses of all sizes use like-kind exchanges to trade up from a small rental to a larger apartment building, from a factory or office space that met yesterday's needs to a business facility that positions the business for tomorrow, and upgrade machinery, equipment or vehicles into newer assets that better meet current and future needs. The ability to take advantage of good business opportunities stimulates transactional activity that generates taxable revenue for brokers, lenders, appraisers, surveyors, inspectors, insurers, equipment dealers, manufacturers, suppliers, attorneys, accountants and more. This transactional velocity also creates opportunities for smaller businesses to acquire entry-level facilities and used equipment from which to launch and grow their fledgling businesses.

Farmers and ranchers use §1031 to preserve the value of their investments and agricultural businesses while they combine acreage, acquire higher grade land, or otherwise improve the quality of their operations. They rely on §1031 to defer depreciation recapture tax when they trade up to more efficient farm machinery and equipment. Farmers and ranchers trade dairy cows and breeding stock when they move their operations to a new location.

Immediate expensing does not remove the lock-in effect on a host of real estate owners. Given that improvements would be eligible for immediate expensing, but the value allocated to land would not be deductible, it is important to recognize that land values represent on average, approximately 30% of the value of commercial improved properties, and up to 100% of agricultural land investments. If these property owners are faced with reducing the value of their investments and life savings through capital gains tax when they sell and reinvest in other real estate, even with lower rates, they will likely hold onto these properties longer. The ability to use §1031 to defer gain recognition removes the lock-in effect, takes the government out of the decision-making process, and permits taxpayers to engage in opportunistic transactions that make good business and investment sense without fear of negative tax ramifications.

Repeal or restriction of like-kind exchanges would be especially troublesome for agricultural and commercial real estate investments in which the land value, relative to the value of improvements, is great. A taxpayer replacing low basis real estate would recognize substantial capital gains that would not be fully offset by the proposed expensing deduction for improvements on equal value replacement real estate if the improvements are minimal in value or non-existent, as in the case of agricultural land, or if the property is located in an area with high land to improvement ratios. Without additional cash to cover both the tax liability and the new investment, loss of §1031 would result in a government-induced shrinkage of agricultural and commercial real estate investment, retarding ability for growth as well as diminishing the net worth of farmers, ranchers, and real estate investors.

Like-kind exchanges make the economics work for conservation conveyances of environmentally sensitive lands that benefit our environment, improve water quality, mitigate erosion, preserve wildlife habitats, and create recreational green spaces for all Americans. Farmers, ranchers and other landowners reinvest sale proceeds from conservation conveyances through §1031 like-kind exchanges into more productive, less environmentally sensitive land. These socially beneficial conveyances are dependent upon the absence of negative tax consequences.

Many taxpayers benefitting from like-kind exchanges are not ultra-high net worth individuals or large corporations. These individual taxpayers do not have use for a large net operating loss carryforward

² Ernst & Young LLP, *Economic Impact* at (v) and Ling and Petrova, *Economic Impact*, at 6

³ *Options for Reforming America's Tax Code*, Tax Foundation (2016), p.79, available at <https://taxfoundation.org/options-reforming-americas-tax-code/>.

from the unused expense deduction for real estate improvements. They do not have sufficient related income to offset the expense, thus they would realize minimal benefit. These taxpayers would face a massive amount of depreciation recapture upon sale, for which they may not have sufficient liquidity, or may not have set aside enough cash to satisfy, creating further personal challenges, locking them in, and putting other wealth building options out of reach. The tax-deferral provisions of Section 1031 fill this gap by permitting full reinvestment of sales proceeds into like-kind property.

Retiring taxpayers benefit by exchanging their most valuable asset, their farm, ranch, or apartment building, for other real estate that doesn't require a 24/7/365 workday, without diminishing the value of their life savings. With a §1031 exchange, farmers and ranchers can downsize or divest their agricultural operations, landlords can eliminate the “3 Ts” of tenants, toilets and trash, and these retirees can reinvest in other income producing real estate, such as a storage unit facility, or a triple net leased commercial property. The loss of §1031 would result in a direct reduction of the retirement savings of these taxpayers whose work has provided food for our nation and affordable living space for other Americans.

Unlike the Blueprint, Section 1031 provides a mechanism for asset sales and replacement purchases that bridge 2 tax years. Absent §1031, taxpayers would be forced to acquire new assets prior to year-end, or be faced with recapture tax on the Year 1 sale and less equity available for the replacement purchase in Year 2. This would create a disincentive to engage in real estate and personal property transactions during the 4th quarter, resulting in tax-driven market distortions. Seasonal businesses in particular can benefit from exchanges in which assets are divested in late autumn and replaced in early spring, at the start of the new season, thereby eliminating off-season storage and debt-service expenses, without any tax-induced cash-flow impairment.

Retention of §1031 in present form eliminates potential expensing abuse. The proposal to fully expense real estate improvements in the year of acquisition, with an unlimited carryforward, provides a tremendous incentive at acquisition for a taxpayer to inflate the value of improvements, so as to maximize the write-off. Conversely, upon sale, there would be great incentive to minimize the value of the buildings and over-allocate value to the land, thus minimizing recapture tax on the improvements at ordinary income tax rates, and benefiting from lower capital gains tax rates on the land.

Appraising is not an exact science. There are different methodologies, and a considerable amount of subjectivity, particularly when there is a scarcity of market activity and relevant data upon which to rely. Given the multiple variables that can impact land and structure values, appraisals can vary widely. A taxpayer with a clear incentive could easily game the system to maximize tax benefit and minimize taxes owed on disposition. Section 1031 eliminates this conflict and simply encourages reinvestment of the full value.

Professional Qualified Intermediaries simplify like-kind exchanges and promote compliance with tax laws. Treasury Regulations provide rules and a safe harbor for taxpayers engaging in non-simultaneous exchanges under §1031 that involve different buyers and sellers.⁴ In these delayed, multiparty exchanges (which constitute the majority of like-kind exchanges), the taxpayer is prohibited from having receipt of or control over the sale proceeds from the relinquished property prior to receiving replacement property, or termination of the exchange.

The Qualified Intermediary (“QI”) is the independent third party that receives the sale proceeds from the relinquished property buyer, holds and safeguards the funds for the benefit of the taxpayer, and then disburses the funds to the seller of the replacement property. Although a QI occasionally takes title to the exchanged properties, typically the QI is only assigned into the chain of contracts, and the safe harbor treats the transaction, for tax purposes, as if the exchange occurs between the QI and the taxpayer. Agents, such as the taxpayer’s attorney, accountant, broker or employee, and parties related to the taxpayer, are disqualified from acting as a Qualified Intermediary.

⁴ 26 CFR 1.1031(k)-1

- Professional Qualified Intermediaries facilitate §1031 like-kind exchanges, for a nominal fee, by providing necessary documentation, and by holding, safeguarding and disbursing the exchange funds for qualifying like-kind replacement property.
- FEA member QIs are subject matter experts in §1031 exchanges. Our members serve as a valuable resource to taxpayers and their advisors, providing a simple, streamlined process, and promoting compliance with tax rules.
- Qualified Intermediaries do not act as brokers, deal makers or advisors to the taxpayer - doing so would disqualify them from serving as a QI.
- Qualified Intermediaries are subject to exchange facilitator laws in nine states.

Capital intensive businesses rely upon like-kind exchanges and affordable access to debt to build and expand. Both tax-deferral and interest deductibility are important economic drivers that stimulate transactional activity, capital investment and growth in the United States.

In summary, like-kind exchanges remove friction from business transactions and stimulate economic activity that would not otherwise benefit from the proposed Blueprint. Section 1031 facilitates opportunistic investment of capital and community improvement. Like-kind exchanges assist the recycling of real estate and other capital to its highest and best use in the marketplace, thereby creating value and improving economic conditions for local communities, rural and urban. Landowners and other businesses would be disadvantaged if they had neither the option of a tax deferred like-kind exchange nor expense deductions for asset acquisition and interest on related debt.

We are grateful for the opportunity to cooperatively work with you and your staff to provide productive, constructive, practical input toward achieving the goal of a fairer, simpler, pro-growth tax reform plan.

Sincerely,

Federation of Exchange Accommodators



May 18, 2017

Dear Members of the Ways and Means Committee:

We believe tax reform done right is the key to helping millions of Americans improve their lives – especially those who have been struggling to lift themselves out of poverty. On behalf of our members, hundreds of business and philanthropic leaders throughout the country, we write to thank you for your work on tax reform and express our commitment to this shared goal.

It shouldn't surprise anyone that [72 percent](#) of Americans feel that the “economy is rigged to advantage the rich and powerful.” It is. And there's no greater contributor to the rigged economy than the U.S. tax code. We want to work with you and the administration to fix these problems, eliminate special interest carve outs and loopholes, and help restore equity and fairness so that all Americans have the equal opportunity to succeed.

Ideal tax policy would raise enough revenue to fund the proper functions of government with limited market interference, and treat individuals and institutions equally in the process. But the U.S. tax code does just the opposite.

- It takes too much hard-earned money from ordinary Americans struggling to get by.
- It pits the least fortunate against the well-connected, who spend millions of dollars on lobbyists seeking special tax treatment and favors, instead of creating value through economic means.
- It distorts market signals that are essential to a free and innovative economy, one that grows and produces jobs and opportunities for all Americans.
- And it drains the U.S. economy of billions of dollars in tax law compliance costs that could be used for more productive purposes that lead to innovations and job creation.

With every change, complexity grows, the economy suffers, jobs and opportunities are lost, and our nation becomes a more entrenched two-tiered society.

We have a positive vision for a fairer, flatter, and simpler tax code, that is understood and respected by the American people, and unleashes growth and opportunity so all Americans can improve their lives – especially the least fortunate.

Our vision for tax reform follows five simple principles:

- 1. Simplicity:** Lower rates, fewer brackets, and the elimination of special loopholes, deductions, and exemptions will make tax compliance easier and more affordable.



America's byzantine tax policy, with the highest corporate statutory rates in the developed world, deters American business investments, stifles economic growth, and has caused America to lose [as many as 3 million jobs](#).

American workers and consumers are hurt by higher taxes, whether they are imposed on individuals or corporations. Most middle-class taxpayers, who take the standard deduction, do not benefit from the array of special deductions and credits, and high individual tax rates reduce badly needed take-home pay. Higher corporate tax rates reduce jobs and increase consumer prices.

Individuals and businesses waste [billions of dollars and billions of hours](#) complying with the code's complex and convoluted requirements. In 2016, tax code complexity cost American taxpayers and businesses [\\$409 billion dollars](#), and over [8.9 billion hours](#) in compliance time – time and money that could be put to more productive use.

- 2. Efficiency:** Broad-based, low-rate tax systems are the most efficient way for the government to collect revenue—causing as little disruption to the economy as possible.

Eliminating distortions allow people to make the best decisions about saving and investing for their families or businesses, rather than focusing on tax outcomes. And it allows businesses to focus on producing real value for their customers, rather than gaining at the expense of others through the political system.

- 3. Equitability:** Corporate welfare and special-interest handouts in the current tax code create an unfair, two-tier tax system and should be eliminated.

From 2002 to 2011, lobbyists [spent \\$28 billion](#) pleading with federal, state, and local governments for special treatment for their clients. When government picks favorites in our tax code, this leads to higher tax rates for everyone else. The U.S. government pays out almost [\\$100 billion per year in corporate welfare](#) – that's an average cost of almost \$900 per American family. The true cost to taxpayers is greater because the \$100 billion does not include the cost of preferential tax carve outs or trade restrictions.

In addition, tax expenditures, which include special exclusions, exemptions, deductions, credits, and preferential tax rates, are estimated by the [Congressional Budget Office](#) to exceed \$1.5 trillion in 2017.

- 4. Predictability:** Tax certainty is essential to a pro-growth tax system.

Our current tax system relies on short-term fixes to help businesses deal with extremely high tax rates. These tax extenders and the complex formulas for bringing foreign-earned income back home to the United States make it very difficult for businesses to plan long-term.



5. No Burden on Taxpayers: Comprehensive tax reform must be done without placing new burdens on the American people.

Government has a spending problem, not a revenue problem. Tax reform can and must be done without saddling new taxes on American consumers, whether in the form of a BAT, VAT, carbon tax, or other tax increase.

Freedom Partners Chamber of Commerce and our coalition allies hope to work closely with your committee to advance these principles and help unify Americans behind a pro-growth tax reform agenda that changes the nation's trajectory away from a two-tiered society, and brings opportunity back to those who are most in need.

Americans deserve a tax code that is simple, efficient, equitable, and predictable – without new burdens on taxpayers. If you can join us in championing these principles, we will help ensure that the American people will stand behind you in this important effort.

Sincerely,

A handwritten signature in black ink that reads "Nathan Nascimento".

Nathan Nascimento
Vice President of Policy,
Freedom Partners Chamber of Commerce



Statement of Adam Brandon

President, FreedomWorks

U.S. House of Representatives Committee on Ways and Means

“Hearing on How Tax Reform Will Grow Our Economy and Create Jobs”

Thursday, May 18, 2017

On behalf of FreedomWorks' community of more than 5 million grassroots activists, I would like to thank Chairman Brady and members of the committee for beginning their work on fundamental tax reform. This is an issue of tremendous importance to FreedomWorks and a moment that comes only once in a generation.

As the Chairman and the members of the committee know, the United States tax code has not been overhauled since 1986, with the passage of the Tax Reform Act, and that effort was years in the making. This Congress, however, must approach tax reform with a sense of urgency. The American people do not have years to wait. They need and expect action that will boost economic growth and provide opportunity and prosperity for all.

The United States' economy has not seen annual economic growth of 3 percent or higher since 2005. This is an indictment of the economic policies of the past eight years. It is, however, an opportunity for Congress to reverse this trend and promote policies that let Americans keep more of the money they earn and encourage investment.



The recovery from the “Great Recession” has been anemic. As the old axiom goes, “Those who fail to learn from history are doomed to repeat it.” Indeed, we have been down this road before.

During the Great Depression, President Franklin D. Roosevelt was able to get his economic agenda passed through Congress, establishing new agencies, programs, and regulations that greatly expanded the size and scope of government. Although President Roosevelt and his “New Deal” programs are heralded in the history books as ending the Depression, more recent academic research has put this assumption in doubt.¹

¹ Harold L. Cole and Lee E. Ohanian, *New Deal Policies and the Persistence of the Great Depression: A General Equilibrium Analysis*, The University of Chicago Press, August 2004 <http://www.jstor.org/stable/3555138>

“President Roosevelt believed that excessive competition was responsible for the Depression by reducing prices and wages, and by extension reducing employment and demand for goods and services,” said Harold L. Cole, then a professor of economics at the University of California-Los Angeles. “So he came up with a recovery package that would be unimaginable today, allowing businesses in every industry to collude without the threat of antitrust prosecution and workers to demand salaries about 25 percent above where they ought to have been, given market forces. The economy was poised for a beautiful recovery, but that recovery was stalled by these misguided policies.”²

The aggressive tax and regulatory approach taken by President Barack Obama and his administration hampered the recovery from the Great Recession. The administration ramped up regulation on the financial and energy sectors of the economy, created or increased taxes through the so-called “Affordable Care Act,”³ or ObamaCare, as most of us know it, and signed a \$620 billion tax increase in January 2013.⁴ The “fiscal cliff” deal included the addition of a seventh individual income tax rate, a significant increase in the estate tax, and an increase in the capital gains tax and dividends tax.

The tax and regulatory policies implemented by President Obama and his administration resulted in stale economic growth. Under ordinary circumstances, the economy would have been \$1.4 trillion larger and could have been \$2 trillion larger if the economy had grown at the same rate as it did during the recovery under President Ronald Reagan.⁵

Some believe that Congress should keep its approach on taxation simple and pass only a net tax cut. FreedomWorks, however, is focused on deficit neutrality, or budget neutrality, to ensure that changes to the tax rates are permanent. This was one of the flaws of the Economic Growth and Tax Relief Reconciliation Act of 2001, which expired after ten years. Moreover, it is imperative that Congress use this moment to simplify the tax code, making it less costly and time consuming for individuals, families, and businesses to file their tax returns.

As the committee begins its work on fundamental tax reform, FreedomWorks hopes that members will keep these broad and basic principles in mind.

Broaden the Tax Base: The approach Congress should take is: drain the swamp. The tax code is riddled with special interest tax breaks, deductions, and credits that reek of cronyism and put

² Meg Sullivan, “FDR’s policies prolonged Depression by 7 years, UCLA economists calculate,” UCLA Newsroom, August 10, 2004 <http://newsroom.ucla.edu/releases/FDR-s-Policies-Prolonged-Depression-5409><http://newsroom.ucla.edu/releases/FDR-s-Policies-Prolonged-Depression-5409>

³ John Kartch, “Full List of Obamacare Tax Hikes: Listed by Size of Tax Hike,” Americans for Tax Reform, June 29, 2012 <http://www.atr.org/full-list-obamacare-tax-hikes-listed-a7010>

⁴ Joseph Henchman, “Details of the Fiscal Cliff Tax Deal,” Tax Foundation, January 1, 2013 <https://taxfoundation.org/details-fiscal-cliff-tax-deal/>

⁵ Stephen Moore, “Obama’s \$2 Trillion Deficit,” Heritage Foundation, May 1, 2014 <http://www.heritage.org/budget-and-spending/commentary/obamas-2-trillion-deficit>

more of the tax burden on hardworking Americans and entrepreneurs. The foundation for a good and fair tax policy is a broad base, with as few deductions and tax credits as possible.

Ideally, Congress would increase the standard deduction for all taxpayers and keep in place few deductions; eliminating the mortgage interest deduction, the federal deduction for paid state and local tax, and most other deductions.

Lower and Consolidate Individual Tax Rates: The goal should be to take the projected revenue from broadening the tax base and use it to create a tax structure with as few brackets as possible, scrapping the current seven-tier tax bracket system created under the American Tax Relief Act in January 2013. Consolidating tax brackets will make the system easier to administer and promote fairness.

Provided rates are kept reasonably low, fewer burdensome tax brackets would also boost household incomes, putting more of the money that they earned into their pockets. This will give Americans more purchasing power, as well as more money to save, and create more opportunities for businesses to invest and expand, which will, in turn, create more jobs.

Reduce Corporate Tax and Investment Tax Rates: The United States' corporate income tax is the highest in the developed world, and, along with Washington's proclivity for regulation, is driving businesses overseas through offshoring and inversions. Congress should simplify the corporate tax code and reduce rates to encourage investment at home. Additionally, Congress must reduce the capital gains tax to encourage Americans to invest their dollars in the economy.

Simplify the Tax Code: Today, there are nearly 75,000 pages in the tax code, up from 26,300 in 1984. In 2016, Americans spent nearly 9 billion hours complying with the onerous tax code, at a cost of \$409 billion to the economy,⁶ which is greater than the gross domestic product of the state of Maryland.

Because Congress has failed to reform the tax code, pages have continued to be added, making tax season a dreaded time for Americans. Simplification of the tax code and reducing compliance burdens should be a top priority of any tax reform effort the 115th Congress undertakes. The tax system should be so easy to understand that Americans can file their return on the back of a postcard.

Repatriation of Overseas Cash: By some estimates, there is nearly \$2.5 trillion in profits overseas,⁷ money that could be invested right here in America. Because the United States'

⁶ Scott Hodge, "The Compliance Costs of IRS Regulations," Tax Foundation, June 15, 2016 <https://taxfoundation.org/compliance-costs-irs-regulations/>

⁷ Chelsea Dulaney, "Dollar to Benefit if \$2.5 Trillion in Cash Stashed Abroad Is Repatriated," Wall Street Journal, November 25, 2016 <https://www.wsj.com/articles/2-5-trillion-foreign-profit-stash-could-be-another-boon-for-u-s-dollar-1480096695>

corporate income tax is so burdensome, companies are holding these profits in friendlier climates. Even as Congress takes the important step of corporate income tax reform, lawmakers should incentivize the repatriation of these overseas profits to the United States with a special, low-rate tax holiday.

Budget-Neutrality, Not Revenue-Neutrality: Making tax reform revenue-neutral is the answer to the wrong question. If tax reform is attempted under budget reconciliation, Congress should seek to make the proposal budget-neutral. This ensures that tax reform will not increase the budget deficit. If changes to the tax code will lower revenues to the Treasury, Congress should seek to lower the deficit through cuts to outlays over the ten-year budget window.

Additionally, Congress should use this opportunity to repeal the estate and gift taxes, as well as the individual and corporate alternative minimum tax.

FreedomWorks and our community of activists hope that Congress will begin to move on fundamental tax reform in the coming weeks. After eight years of economically crippling policies, the 115th Congress has been presented with a generational moment to restore prosperity and opportunity for all Americans and achieve sustaining economic growth.



June 1, 2017

Chairman Brady and Ranking Member Neal:

Thank you for convening the full Ways and Means Committee hearing on May 18th -- *How Tax Reform Will Grow Our Economy and Create Jobs across America*.

As Congress considers tax reform, members of the Fuel Cell and Hydrogen Energy Association (FCHEA) have been greatly disadvantaged because of inequities in the existing code. As we note in the attached testimony, extending incentives for some technologies but not others, has distorted the marketplace and put the federal government in the position of picking winners and losers. We believe Congress should level the playing field, allowing all technologies to compete on their merits.

Contained in the testimony is information concerning H.R. 1090, *Technologies for Energy Security Act*. This bill, which enjoys broad bipartisan support, extends advanced energy technology investment tax credits that expired last year. H.R. 1090 aligns directly with the goals of the hearing to show how tax reform policies generate economic growth and create well-paying jobs for Americans.

- ✓ Over 10,000 Americans are directly employed by these energy industries, and thousands more Americans are employed in the supplier networks that serve them.
- ✓ H.R. 1090 is a transition rule that creates a level playing field by fully phasing out the Section 48 investment tax credit for all technologies over five years.
- ✓ Supporting this legislation will help ensure our global competitive edge and not cede our technological or workforce edge to foreign nations.
- ✓ These technologies support resiliency, reliability and energy security important to critical infrastructure and to keeping American businesses running in severe weather events or cyber-attacks.

At the conclusion of this testimony, please find a letter in support of HR 1090 signed by 19 trade associations and 43 companies. As the letter demonstrates, there is broad support for parity for technologies formally covered under the Sections 48 and 25D.

Our testimony also makes the case for parity for our vehicle and hydrogen infrastructure technologies. As it currently stands, the tax code provides incentives battery electric vehicles, but not fuel cell vehicles. This is unfortunate considering that Department of Energy analysis indicates that today, 16,000 jobs are linked to fuel cell vehicles and hydrogen. The same analysis offered a forward looking projection of more than 200,000 jobs once market penetration hit 20 percent of volume.

Thank you for your consideration, and we look forward to working with you on comprehensive tax reform that fosters economic growth and creates jobs.

**Statement of the Fuel Cell and Hydrogen Energy Association
House Committee on Ways and Means
Hearing on How Tax Reform Will Grow Our Economy and Create Jobs**

Chairman Brady, Ranking Member Neal, and Members of the Committee, thank you for the opportunity to submit written testimony to this committee. The Fuel Cell and Hydrogen Energy Association (FCHEA) applauds your efforts to examine the tax code and look for ways to reform the existing system in a way that leads to more jobs, economic growth and opportunities for all Americans.

The Fuel Cell and Hydrogen Energy Association is the national trade organization for the fuel cell and hydrogen energy industry. Our membership includes manufacturers; automotive companies; hydrogen producers and distributors; suppliers; government laboratories and agencies; and other end-users.

We often refer to fuel cell technology as the “all-of-the-above” technology, meaning it applies to stationary and distributed power generation, back-up power for telecommunications, material handling, and transportation, including passenger vehicles and buses. We utilize “all-of-the-above” fuels, because you can derive hydrogen from 100 percent domestic resources, including natural gas, biogas, to renewables such as solar and wind.

Our industry is well positioned to be a significant source of jobs and economic growth in the U.S. with the right policies in place. And while the applications I listed are very diverse, the single most important driver to this success rests on parity for our technologies in the tax code.

My testimony will focus on current and future jobs, ongoing investment in our technology, the case for parity and certainty, and a list of our legislative priorities.

Concerning jobs, FCHEA reviewed data from a subset of member companies that manufacture stationary and material handling equipment, just before the Section 48 ITC expired, more than 10,000 jobs can be attributed to this segment of the industry between manufacturers and suppliers.

Additional analysis spearheaded by the Department of Energy, noted 16,000 jobs attributed to fuel cell vehicles and hydrogen. The same analysis offered a forward looking projection of more than 200,000 jobs for fuel cell vehicle sales once market penetration hit 20 percent of volume.

In terms of investments, tens of billions of dollars have been committed to research and development, demonstrations, manufacturing plants and service facilities. These funds have overwhelmingly come from the private sector, with additional funding in the form of Department of Energy and/or state funds.

For example, the automobile industry alone has spent more than \$9 billion on fuel cell development, and today there are three fuel cell vehicle models on the road now with more expected.

Manufacturers of stationary and material handling fuel cell tout 15 manufacturing facilities in eight states across the country, with suppliers for the industry spread across 43 states.

The State of California, which has invested in stationary and fuel cell vehicles, has committed more than \$400 million for fuel cell and hydrogen systems.

And Honda and General Motors recently announced a notable manufacturing investment in Michigan, inking an \$85 million deal to manufacture fuel cells in the state by 2020.

While the jobs numbers are encouraging, investment in the technology remains and we are making impressive strides in early markets. However, the federal tax code is currently working against us by favoring competing technology platforms. Therefore, we are asking for tax parity for all our technologies.

Parity for our stationary and material handling fuel cell products covered by Section 48 is a well-known issue to members of the committee. In 2015, Congress provided long-term certainty exclusively for solar technology, while fuel cells and advanced energy technologies were allowed to expire at the end of 2016.

Congressman Reed, Meehan, and six other Ways and Means members have cosponsored H.R. 1090, which provides parity for these technologies with solar. If enacted, this would provide a phase-out of the ITC for fuel cells, and we feel it would serve as a good transition for larger reform efforts.

Fulfilling the spirit of H.R. 1090 will provide our manufacturers, who are located in the United States, with a chance to compete on a more level playing field with solar technology.

Since the ITC problem was created, fuel cell companies have or are planning to cut employee rolls. Reports and estimates range from 20 to 25 percent reduction in workforce. These same companies who are scaling back activity have reported that with the ITC in place, projections by these same companies anticipated hiring to increase between 20-40 percent.

Beyond hobbling domestic manufacturing, eroding confidence in the domestic market has increased pressure on these same companies to move overseas. This has been evidenced by recent attempts by Chinese companies and government officials approaching fuel cell manufacturers seeking to acquire greater access to the technology and our manufacturing knowhow.

Reinstating the Section 48 tax credits will shore up domestic markets, lead to profitability, and help the United States maintain its leadership in these technologies.

Parity for fuel cells also should be extended to credits for fuel cell vehicles and accompanying hydrogen infrastructure credits, found in Sections 30B and 30c of the tax code. These sections were also allowed to expire at the end of 2016.

The timing of the expiration is particularly inconvenient, as three automobile manufacturers now offer fuel cell vehicles for sale or lease. At the moment, these vehicles are being sold exclusively in California, but automobile companies are looking to the northeast and Mid-Atlantic states for new markets.

The expiration also created a situation where numerous vehicle manufacturers can offer two different electric vehicle platforms for sale, with one option eligible for a federal tax credit, and the other without a corresponding incentive.

The push to include fuel cell vehicles (FCVs) in their vehicle fleets comes in part as manufacturers are working to balance the need to comply with numerous state and federal mandates, while offering consumers vehicles that they want to purchase. The availability of fuel cell vehicles will give consumers more choices as they look for zero-emission options.

This committee can help states and consumers by providing incentives for all electric vehicles, including fuel cells. This could be accomplished by reinstating the expired credit (found in Section 30B), or by allowing fuel cell vehicles to qualify under Section 30D.

Finally, I would like to point out that the committee can aid in efforts to jumpstart investments in infrastructure. Our members strongly favor reinstating credits for hydrogen fueling stations. This involves reinstating Section 30C, and raising the cap from \$30,000, which was so prohibitively low, that compliance costs far outweighed the benefit of the credit.

Addressing this, and allowing for hydrogen infrastructure that supports material handling equipment to qualify, will allow the code to reflect Congressional intent, and help seed new stations.

Below I have provided the options in more detail for the committee's consideration:

1. Investment Tax Credit Parity - Sections 48, 25 D

- At the end of 2015, Congress extended the Section 48 Investment Tax Credit (ITC) exclusively for solar technologies. Fuel cells and other advanced energy technologies that have been eligible for ITC were not included in the extension provided by the Consolidated Appropriations Act of 2016. Congress should restore the inclusion of fuel cells in the ITC through the earliest available legislative vehicle. This will return fuel cells to parity with solar technology, and thereby help domestic manufacturers, prevent the unintended use of the tax code to pick technology winners, and recognize the contribution of industries that are providing resilient, efficient technologies.

2. Electric Vehicle Tax Credits – Reinstatement or Modification

- Option one simply reinstates the Section 30B credit for five years. Analysis by the Joint Committee on Taxation on a similar proposal introduced last Congress (which extended the 30B and 30C credits to 2025) shows that the cost of this to be de minimis.
- Option two would incorporate tax credits for fuel cell vehicles into Section 30D of the tax code which only incentivizes battery electric vehicles. The current lack of parity and uncertainty regarding zero emission vehicles is problematic for states and consumers. Some companies have suggested that the merger could be paired with an increase in the manufacturer's volume cap and imposing a sunset date where one currently does not exist.

3. The Alternative fuel vehicle refueling property credit – Modification of Section 30C of the IRS Code

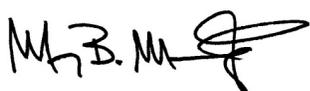
- The statute was intended to provide an incentive for new refueling infrastructure, including for hydrogen and natural gas vehicles. However, the credit was not workable since compliance costs are higher than the credit. Eliminating the cap and maintaining the 30% credit would allow the credit to operate as intended. Additionally, Congress should clarify through a legislative modification that the credit should also benefit hydrogen infrastructure for material handling equipment.

4. Technical Correction - Section 6426 of the IRS Code

- Section 6426 provided an excise tax credit only to retail sale of liquefied hydrogen. Reauthorization and a simple modification of the language to include sale of gaseous hydrogen for use onboard a vehicle, which is the pathway being considered by automobile manufacturers

and allows material handling equipment refueling to qualify, will provide the necessary framework intended by Congress.

We again want to thank you for taking our comments into consideration, and extend our gratitude to the Committee, the staff, and Congress for your past support. FCHEA strongly believes that the legislative proposals suggested are not only a benefit to the fuel cell and hydrogen industry, but to the American economy.



Morry B. Markowitz
President & Executive Director

Fuel Cell and Hydrogen Energy Association
1211 Connecticut Ave. NW, Suite 650
Washington, DC 20036
202-261-1331

FCHEA Members

- 3M
- Air Liquide
- Air Products and Chemicals
- Altery Systems
- American Honda Motor Company
- Anglo American Marketing Limited
- ARC: Hydrogen
- AREVA
- Black & Veatch
- Bloom Energy
- BMW of North America, Inc.
- California Air Resources Board
- California Fuel Cell Partnership
- Center for Hydrogen and Next Generation Energy
- Ceres Power
- Connecticut Hydrogen-Fuel Cell Coalition
- CSA Group
- Daimler
- Doosan Fuel Cell America
- Fuel Cell Seminar & Energy Exposition
- FuelCell Energy
- Fuji Electric
- GE Fuel Cell Systems
- General Motors
- Global Tungsten & Powders
- Gore Fuel Cell Technologies
- Hydrogenics
- Hyundai
- Idaho National Laboratory
- Intelligent Energy
- Johnson Matthey Fuel Cells
- LG Fuel Cell Systems Inc.
- McPhy Energy
- Methanol Institute
- myFC
- National Renewable Energy Laboratory
- Nebraska Public Power District
- NEL Hydrogen
- Nissan Technical Center North America
- Nuvera Fuel Cells
- Ohio Fuel Cell Coalition
- Pajarito Powder
- PDC Machines
- Plug Power
- Sandia National Laboratories
- Savannah River National Laboratories
- Shell Oil Company
- South Coast Air Quality Management District
- The Linde Group
- Toyota Motor North America
- Treadstone Technologies
- United Hydrogen
- Volkswagen Group of America

Text of letter of support for HR 1090

House Speaker Paul Ryan
H-232, The Capitol Building
Washington, D.C. 20515

Senate Majority Leader Mitch McConnell
S-230, The Capitol Building
Washington, D.C. 20510

House Minority Leader Nancy Pelosi
H-204, The Capitol Building
Washington, D.C. 20515

Senate Minority Leader Chuck Schumer
S-221, The Capitol Building
Washington, D.C. 20510

Dear Speaker, Senate Majority Leader, House Minority Leader and Senate Minority Leader:

We are writing in support of H.R. 1090, Technologies for Energy Security Act, which extends advanced energy technology investment tax credits that expired last year. An extension of the business Section 48c and residential Section 25D credits is essential to provide parity for all technologies in those sections of the tax code. These technologies incorporate an “All of the Above” energy strategy by utilizing clean, efficient natural gas and renewable technologies made in America.

As Congress considers tax reform many businesses that compete in this space are at a severe disadvantage because of inequity in the tax code. The ITC is critical to a range of advanced energy technologies such as fuel cells, geothermal, small wind, Combined Heat and Power (CHP), microturbines, and thermal energy that help expand and diversify the nation’s electricity supply and lower costs for consumers. Additionally, by phasing these tax credits out, this legislation could serve as a transition for tax reform.

Extending the credits for some technologies but not others has distorted the marketplace and put the federal government in the position of picking winners and losers. We believe Congress should level the playing field in the marketplace, allowing all the technologies to compete on their merits.

Moreover, the use of these technologies enhances energy independence and security, all the while strengthening the resilience and reliability of the U.S. power grid. They improve efficiency and reduce long-term costs, while increasing sustainability for homeowners, hospitals, universities, small businesses, as well as Fortune 500 companies. Advanced energy technology deployment drives innovation, business, job growth, economic activity, and manufacturing, much of it in rural America.

In order to avoid further serious market disruption and provide businesses, investors, and consumers with the ability to plan in the short- to mid-term, extending these credits should be a “must pass” item on the first available and appropriate legislative vehicle. Both the business and residential credits are essential to help ensure fair competition and access in the marketplace for clean energy solutions.

Thank you for your consideration.

Sincerely,

Advanced Energy Economy

AEE is a coalition of business using policy advocacy, analysis and education to bring about a prosperous economy based on secure, clean, affordable energy.

The Alliance for Industrial Efficiency

The Alliance for Industrial Efficiency is a diverse coalition of business, contractor, labor and environmental groups committed to advancing industrial efficiency through the use of combined heat and power (CHP) and waste heat to power (WHP).

American Farm Bureau Federation

AFBF is the unified national voice of agriculture, working through our grassroots organizations to enhance and strengthen the lives of rural Americans and to build strong, prosperous agricultural communities.

American Gas Association

The American Gas Association (AGA) represents companies delivering natural gas safely, reliably, and in an environmentally responsible way to help improve the quality of life for their customers every day. AGA's mission is to provide clear value to its membership and serve as the indispensable, leading voice and facilitator on its behalf in promoting the safe, reliable, and efficient delivery of natural gas to homes and businesses across the nation.

Air Conditioning Contractors of America

ACCA is a non-profit association whose membership includes more than 60,000 professionals and 4,000 businesses in the indoor environment and energy services community. We work together to promote professional contracting, energy efficiency, and healthy, comfortable indoor environments.

CHP Association

CHP Association (CHPA) brings together diverse market interests to promote the growth of clean, efficient local energy generation in the United States. It is a private, non-profit 501(c)6 trade association, originally formed in 1999 to promote the merits of combined heat and power (CHP) and to achieve public policy support for CHP.

Distributed Wind Energy Association

The Distributed Wind Energy Association (DWEA) is a collaborative group comprised of manufacturers, distributors, project developers, dealers, installers, and advocates, whose primary mission is to promote and foster all aspects of the distributed wind energy industry.

Fuel Cell & Hydrogen Energy Association

The Fuel Cell and Hydrogen Energy Association (FCHEA) is the trade association for the fuel cell and hydrogen energy industry, and is dedicated to the commercialization of fuel cells and hydrogen energy technologies. Fuel cells and hydrogen energy technologies deliver clean, reliable power to leading edge corporate, academic and public sector users.

Geothermal Exchange Organization

The Geothermal Exchange Organization (GEO) is The Voice of the Geothermal Heat Pump Industry in the United States. As a non-profit trade association, we promote the manufacture, design and installation of GeoExchange® systems—the most energy efficient and environmentally friendly heating and cooling technology in the world

International Code Council

The International Code Council (ICC) – The ICC is a U.S. not for profit organization which administers the development and maintenance of 15 model codes and 8 standards used to construct residential and commercial buildings in the U.S., including schools and hospitals. The ICC is dedicated to all aspects of building safety including fire prevention, plumbing and sanitation, property maintenance, energy efficiency and resilience. The mission of the ICC is to provide the highest quality codes, standards, products and services for all concerned with the safety and performance of the built environment.

International Ground Source Heat Pump Association

The International Ground Source Heat Pump Association (IGSHPA) is a non-profit, member-driven organization established in 1987 to advance ground source heat pump (GSHP) technology on local, state, national and international levels. Headquartered on the campus of Oklahoma State University in Stillwater, Oklahoma, IGSHPA utilizes state-of-the-art facilities for conducting GSHP system installation training and geothermal research. With its access to the most current advancements in the geothermal industry, IGSHPA is the ideal bridge between the latest technology and the people who benefit from these developments.

National Association of Home Builders

The National Association of Home Builders (NAHB) helps its members build communities. Each year, NAHB's members construct about 80% of the new homes built in the United States, both single-family and multifamily.

National Farmers Union

To advocate for the economic and social well-being, and quality of life of family farmers, ranchers, fishermen and consumers and their communities through education, cooperation and legislation. NFU advocates sustainable production of food, fiber, feed and fuel.

National Ground Water Association

NGWA is a not-for-profit professional society and trade association for the groundwater industry. Our members from all 50 states include some of the country's leading public and private sector groundwater scientists, engineers, water well contractors, manufacturers, and suppliers of groundwater-related products and services. The Association's vision is to be the leading community of groundwater professionals that promotes the responsible development, use and management of groundwater resources.

National Rural Electric Cooperative Association

NRECA is the national service organization for more than 900 not-for-profit rural electric cooperatives and public power districts providing retail electric service to more than 42 million consumers in 47 states and whose retail sales account for approximately 12 percent of total electricity sales in the United States.

Plumbing-Heating-Cooling-Contractors – National Association

The PHCC—National Association, formed in 1883, provides legislative advocacy, education, and training to more than 3,500 plumbing and HVACR businesses and 70,000 technicians. Members of PHCC have access to a wide variety of services designed to increase their professionalism, grow their business, and improve profitability.

The Sheet Metal & Air Conditioning Contractors' National Association (SMACNA) would like to sign on.

The Sheet Metal and Air Conditioning Contractors' National Association (SMACNA) is an international trade association representing 1,834 member firms in 103 chapters in throughout the United States, Canada, Australia, and Brazil.

Solar Rating and Certification Corporation

The SRCC™, is a member of the International Code Council® Family of Companies, whose primary purpose is to provide authoritative performance ratings, certifications and standards for renewable energy products, with the intention of protecting and providing guidance to consumers, incentive providers, government, and the industry.

TechNet

TechNet is a CEO-led organization representing both America's largest tech companies and most dynamic startups with an aim to educate government leaders on the importance of the growing technology industry and to promote a technology-led innovation ecosystem.

Companies endorsing H.R. 1090 "Technologies for Energy Security Act."

Aegis Renewable Energy - Waitsfield, VT
 Advent Technologies –Sacramento, CA
 Air Liquide - Houston, TX (Multiple Locations)
 Amberg Renewable Energy – Alberta, MN
 Ambor Structures, Inc. – St. Paul, MN
 Ameresco - Framingham , Massachusetts (Multiple Locations)
 Aztech Geothermal – Ballston Spa, New York
 Bergey Windpower Co - Norman, OK
 Bloom Energy - Newark, DE
 Carrier Corporation – Indianapolis, Indiana
 ClimateMaster, Inc. – Oklahoma City, Oklahoma

Comfortworks, Oklahoma City, OK
Doosan Fuel Cell America - South Windsor, CT
EarthLinked Technologies, Lakeland, FL
EcoSmart Solution, LLC – Austin, Texas
Enertech Global – Greenville, Illinois
Eocycle - Montreal (Quebec) Canada.
EWT Direct Wind – Multiple locations
Flow Center Products, Inc. – Crawfordsville, Indiana
Francis Renewable Energy – Tulsa, Oklahoma
Fuel Cell Energy
Geo Enterprises, Inc., Catoosa, OK
Geo-Flo Products Corporation – Bedford, Indiana
Hyster Yale Group
Johnson Matthey Fuel Cells, Inc. -
LG Fuel Systems Inc.
Linde
Major Heating & Air – Wheat Ridge, Colorado
Northern Power Systems - Barre, VT
Nuvera Fuel Cells
Ohio Fuel Cell Coalition
Pika Energy - Westbrook, ME
Plug Power - Latham, NY
Primus Windpower
Seminole Financial Services, LLC – Belleair Bluffs, FL
Skylands Renewable Energy, LLC - Hampton, New Jersey
Sono-Tek
The Stella Group, Ltd. - Washington, DC
Taurus of Texas – Austin, Texas
Treadstone
United Wind Inc. - Brooklyn, NY
WaterFurnace International – Fort Wayne, Indiana
Watt Fuel Cell - Mount Pleasant, PA

May 17, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing On How Tax Reform Will Grow Our Economy And Create Jobs

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

I am submitting this letter in regard to the House Ways and Means Committee's scheduled hearing on May 18th entitled "How Tax Reform Will Grow Our Economy and Create Jobs." I commend the work your committee has, and is, doing in exploring different ways in which pro-growth tax reform can be achieved and help further strengthen the American economy. As the committee considers myriad proposals and ideas for reforming the tax code, I want to stress the importance of preserving the full deductibility of interest on debt.

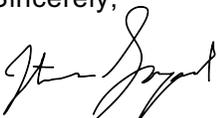
When it comes to reforming America's tax code, my motivation to preserve interest deductibility to promote growth and enhance my contribution to the economy is rooted in my first-hand experience of running the daily operations of Gaspard & Morgan Construction and Gaspard Properties. While there is certainly an important role for policymakers and policy thinkers in reforming the tax code, I also firmly believe that input from businesses is essential to setting the record straight on the practical implications of certain tax proposals. My support for maintaining full interest deductibility comes from the knowledge I have of how the tax code affects my ability to grow my construction and property investment businesses, create new jobs and strengthen my local economy.

Interest deductibility is a well-established, growth-promoting provision of the tax code that has been in existence for more than 100 years. Interest expense is a normal cost of doing business; and, for me, it provides a peace of mind as well as a sense of stability and predictability when business owners are guaranteed they will not be taxed on the cost of accessing capital and can have more flexibility when making important long-term financial decisions.

Companies like mine borrow in order finance expansions, purchase equipment and meet many other key obligations. Having the ability to deduct interest on such expenses gives business owners like me the certainty I need to make these decisions with confidence. It also allows my company to weather any shifts in demand.

In my view, maintaining full interest deductibility is essential for achieving the stated top priority of tax reform: allowing the U.S. economy to reach its full growth potential. As a business owner who has experienced first-hand what works and doesn't work in the tax code, I can tell you that full interest deductibility works.

Sincerely,



Jonathan Gaspard
President/Owner, Gaspard Morgan Construction, LLC
President/Owner, Gaspard Properties, LLC



The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1106 Longworth House Office Building
Washington, DC 20515

The Honorable Peter J. Raoskam
Subcommittee Chairman
House Tax Policy Subcommittee
1106 Longworth House Office Building
Washington, DC 20515

May 31, 2017

Dear Chairman Brady and Subcommittee Chairman Raoskam

GIIA submission: Hearing on how tax reform will grow our economy and create jobs across America

The Global Infrastructure Investor Association (“GIIA”) is pleased to submit comments to the House Committee on Ways and Means on how tax reform in relation to US infrastructure investment will grow the US economy and create jobs.

GIIA is a member-driven organization focused on promoting the role of private investment in infrastructure. Our association represents the leading global investors in the unlisted infrastructure industry and other parties that play an active role in the sector. Our members span six continents and manage more than \$400 billion in infrastructure assets globally, bringing economic growth, jobs, responsible stewardship and long term investment in sectors such as water and waste water, airports, ports, renewable energy, gas and oil pipelines, fiber, roads and rail.

U.S. infrastructure has been identified by the current Administration as a national priority and noting that the American Society of Civil Engineers (“ASCE”) most recently graded the current state of US infrastructure at D+ in the 2017 ASCE infrastructure report card, emphasizes that infrastructure has been underfunded and in need of urgent renewal.

The current state of U.S. infrastructure has a direct impact on the U.S. economy and job creation. As noted in the ASCE 2017 report, failure to close the US infrastructure spend gap will result in \$3.9 billion in losses to the US GDP and the loss of 2.5 million American jobs by 2025.¹ The Bipartisan Policy Center also acknowledged that infrastructure investment creates jobs and prosperity, and over the long term allows the economy to operate with maximum

¹ 2017 Infrastructure Report Card – A Comprehensive Assessment of America’s Infrastructure, America Society of Civil Engineers available at www.infrastructurereportcard.org/wp-content/uploads/2017/04/2017-IRC-Executive-Summary-FINAL-FINAL.pdf

efficiency.² This has also been emphasized by the Administration in its recent ‘Fact Sheet – 2018 Budget: Infrastructure Initiative’ which recognized that the current infrastructure system is not working and that the Nation’s infrastructure needs to be rebuilt and modernized to create jobs, maintain America’s economic competitiveness, and connect communities and people to more opportunities.

A key issue associated with private capital investment in US infrastructure has been the lack of investable projects, not a lack of private capital. Although US tax reform is not itself the solution to this problem, it does have a role to play in attracting and leveraging private investment. In particular, as consideration is given to the use of Federal funds to incentivize State and local governments to recycle capital into new infrastructure development and reduce reliance on additional government debt, US tax reform (including the perceived stability of the US Federal tax regime) can positively or negatively impact the success of such a program.

We submit for your consideration commentary on two key issues that would have a material impact on pricing for US infrastructure projects and, consequently, the funding requirements to pay for such projects:

- 1 Impact of the GOP Blueprint tax reform measures
- 2 Introduction of an infrastructure specific investment vehicle

Impact of the GOP Blueprint proposed tax reform measures

The 2016 GOP Blueprint proposed a number of US federal tax reform measures. Some of these will have a negative or positive impact on the US infrastructure investment sector and they are summarized in the table below.

Table 1 - GOP Blueprint illustrative impact on infrastructure sector

<i>GOP Blueprint measure</i>	<i>Positive</i>	<i>Negative</i>
Reduction in corporate tax rates	X	
Denial of deductions for net interest expense and the immediate deduction for business expenditure		X
Net operating losses: Indexation for inflation	X	
Net operating losses: Removal of carry forward limitation	X	
Net operating losses: 90% restriction on net operating loss offset		X
Elimination of the corporate Alternative Minimum Tax	X	

² *Bridging the Gap Together: A New Model to Modernize U.S. Infrastructure*, May 2016, Bipartisan Policy Center available at: <https://bipartisanpolicy.org/library/modernize-infrastructure/>

Large scale, long term infrastructure projects generate stable cash flows that typically support high leverage levels and are financed through stand-alone entities. Tax deductions are only able to be offset against revenue streams generated by that project. As such, the proposed denial of deductions for net interest expense and the upfront deductions for business investment costs, coupled with the 90% restriction on net operating loss offsets will have a disproportionately negative impact on after-tax returns to private capital equity investors in US infrastructure. In particular, as infrastructure projects are typically valued under a discounted cash flow model, the timing benefit of upfront deductions for capital expenditure does not offset the negative impact of the interest deductibility and NOL restrictions noted above.

Consequently, not only does this discriminate against the use of private capital, it will also have a flow-on impact on the pricing of projects, adversely affecting the costs to Governments and users.

Some of our members have undertaken sensitivity modelling on existing US infrastructure investments and the net impact of the Blueprint measures listed above is estimated at an immediate valuation reduction of 6% to 12%. For infrastructure investors who have made long term and significant investment decisions under the existing tax regime assumptions, this represents a significant value reduction, and has an adverse impact on investor confidence. Whilst grandfathering will assist in addressing the negative impact on existing investments, it does not alleviate the pricing impact on future infrastructure projects.

In relation to regulated assets such as energy and water utilities, our members have estimated that the impact of the net interest denial with the reduction in tax rate would have a negative 15-20% impact on current asset valuations. As tax is a business cost that is passed onto users through rate case negotiations, this would result in US tax reform increasing the electricity and water bills of US citizens, creating a drag on spending capacity.

Furthermore, beyond the direct tax impacts, changes relating to interest deductibility will have a negative impact on the cost of capital, which would in turn impact capital expenditure programs (especially where there is significant reliance on debt funding) critical to improving the essential services provided to the public. This not only reduces asset values, as noted above, but also US economic growth through lost opportunity in relation to research, trade, construction and employment generation. We submit that an exception or an “opt-in” mechanism be considered for infrastructure projects. Any such exception will need to be defined to avoid abuse and could potentially be done by reference to projects that are designated to be of “national economic benefit”. We also note that the “opt-in” mechanism is not inconsistent with that proposed in President Trump’s 2016 Tax Plan.

Creation of a US infrastructure investment vehicle

The US has created sector specific investment vehicles in the past, with the real estate sector having access to the Real Estate Investment Trust (“REIT”) and the oil and gas sector having access to the Master Limited Partnership (“MLP”). Given the need for US infrastructure development and the role of private capital, consideration should be given to the introduction of an investment vehicle for ownership of US infrastructure. Such a vehicle could be based on the REIT regime with appropriate modifications. The vehicle would not itself be subject to US federal tax provided it fully distributed its earnings on an annual basis and distributions of

earnings and capital gains to non-residents would be subject to a concessional final withholding tax rate.

In order to maximize the availability of private capital, such a vehicle would need to be attractive to both domestic and foreign institutional investors looking for stable, inflation-linked, long term investments. To be attractive, there would need to be no discrimination between the treatment of domestic and foreign investors, and the final withholding tax rate could be set at a level appropriate to compete globally for private capital investment. Such investments are particularly attractive to pension funds looking for investments to match their long term pension liabilities and would make US infrastructure competitive in attracting foreign capital.

In considering any specific vehicles or concessions for infrastructure investment, consideration will need to be given as to what types of infrastructure investment would qualify for these purposes and we submit that from a policy perspective, any such definition should be broad based and not narrowly defined.

Role of tax reform

As noted earlier, whilst US tax reform will not resolve the spending shortfall on infrastructure in the US, it can have a powerful positive impact on the pricing for such projects, facilitate the involvement of domestic and foreign private capital and reduce an excessive reliance on public financing for future projects.

* * * * *

We thank you for the opportunity to make this submission and look forward to being an active participant as tax reform moves forward to drive the US economy and US jobs.

Andrew Rose, CEO

June 1, 2017

The Honorable Kevin Brady, Chairman
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Richard Neal, Ranking Member
House Committee on Ways & Means
1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

The undersigned agricultural organizations urge your support for several tax provisions related to renewable energy and environmental mitigation as part of any broader tax reform plan taken up by Congress.

U.S. farmers and ranchers and the companies that process agricultural products provide food, feed, fiber and fuel for our nation and the world. Like all businesses, we must continue to innovate, establish new markets, and improve efficiency to remain viable and competitive in today's global market. Whether it is to help reduce regulatory compliance costs or to incentivize renewable energy and conservation benefits, there are a number of tax provisions that have been implemented or proposed for agricultural products and practices.

In recent years, regulators have applied increasing pressure on the agriculture sector to reduce output of nutrients like nitrogen and phosphorus to improve water quality in various watersheds around the country, from the Chesapeake Bay to the Great Lakes region. To help solve this problem, tax-writers in Congress have introduced bipartisan legislation to spur adoption and help cover the upfront capital costs of nutrient recovery technologies, as well as biogas systems that mitigate the environmental impacts of farming by transforming manure into stable fertilizer for crops, bedding for cows, and fuel and electricity for farms and nearby homes.

Tax incentives, such as the biodiesel tax credit, have also existed to support renewable energy and fuel derived from agricultural feedstocks, including animal fats. These renewable energy sources help diversify our fuel supply, establish new markets and add value to farm products, create jobs, and boost economic development, particularly in rural America. U.S. biodiesel producers have unused production capacity that stands ready to be utilized. Putting that capacity to work will encourage further market growth for agricultural products and create thousands of new jobs and billions of dollars in economic activity.

As you move forward with tax proposals, U.S. farmers and ranchers support the inclusion of these tax provisions that help our businesses meet regulatory requirements, provide conservation benefits and incentivize renewable energy production. Thank you for your continued efforts in

support of our nation's farmers and ranchers. We look forward to working with you as the process on tax reform continues.

Respectfully,

Agricultural & Food Transporters Conference
Agricultural Retailers Association
American Farm Bureau Federation
American Mushroom Institute
American Sheep Industry Association
American Soybean Association
American Sugarbeet Growers Association
Cobank
National Barley Growers Association
National Corn Growers Association
National Council of Farmer Cooperatives
National Milk Producers Federation
National Peach Council
National Pork Producers Council
National Renderers Association
Panhandle Peanut Growers Association
Southwest Council of Agribusiness
South East Dairy Farmers Association
United Egg Producers
United Fresh Produce Association
U.S. Canola Association
U.S. Rice Producers Association
U.S. Sweet Potato Council
USA Rice Federation
Western Growers
Western Peanut Growers Association
Western United Dairymen

June 1, 2017

The Honorable Kevin Brady, Chairman
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Richard Neal, Ranking Member
House Committee on Ways & Means
1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

On behalf of our nation's family farmers and ranchers, the undersigned groups would like to thank you for your efforts to reform the U.S. tax code in a meaningful way for individuals, corporations, and small businesses alike, including the 3.2 million farmers who generate food, fuel, and fiber for Americans and people around the world. With that in mind, we write today to express our concerns regarding the House Committee on Ways and Means blueprint proposal to eliminate the deduction for interest payments as a business expense.

Agricultural production is capital intensive. While financing requirements will vary among the different commodities, the majority of family-owned farming operations are heavily reliant on credit. Even for everyday business, agricultural producers utilize credit in the form of operating and inventory loans. According to the United States Department of Agriculture (USDA), net farm income in 2017 is forecast to decline for the fourth consecutive year by 8.7 percent to \$62.3 billion. In a weak farm economy, income is restricted to cover family farmers' living expenses and the repayment of debt. During tough times, producers are often forced to take on substantial annual interest expense. Interest paid on these loans should be deductible because interest is, and has historically been, considered a legitimate business expense.

In addition, family farmers continue to grow their operations in order to remain profitable. Equipment and land acquisition necessary for long-term expansion is only possible through financing. USDA predicts that in 2017, farm real estate debt will reach a historic high of \$240.7 billion, a 5.2 percent increase from 2016. Eliminating the interest deduction will place further financial stress on an already debt-burdened industry, and prevent producers from staying profitable in challenging economic times.

Finally, the need for debt financing is particularly important for the next generation of agricultural producers. Less than 2 percent of the U.S. population is directly employed in agriculture. Consistent with a 30-year trend, the average age of principal farm operators is 58, making farmers and ranchers among the oldest workers in the nation. As older producers exit the workforce, financing will be critically important for new and beginning farmers and ranchers looking to establish businesses. Eliminating interest deductions creates a significant barrier for the next generation.

As Congress works to enact comprehensive tax legislation, the positive reforms made should not be undermined by negative, unintended consequences as a result of eliminating the business interest deduction for agricultural entities. It is our hope that future legislative proposals do not ignore this important sector of the nation's economy, and that they will consider the unique utilization and importance of credit management across the entire agriculture sector.

Thank you for your continued efforts in support of our nation's agricultural producers. We look forward to working with you on this important issue.

Respectfully,

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Agricultural Retailers Association
American Farm Bureau Federation
American Mushroom Institute
American Sheep Industry Association
American Soybean Association
American Sugarbeet Growers Association
California Association of Winegrape Growers
Cobank
Farm Credit Council
National Barley Growers Association
National Cattlemen's Beef Association
National Corn Growers Association
National Cotton Council
National Council of Farmer Cooperatives
National Peach Council
National Pork Producers Council
National Potato Council
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The Honorable Richard Neal, Ranking Member
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1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

On behalf of our nation's family farmers and ranchers, the undersigned agricultural producer groups urge your support for maintaining the Section 199 deduction for domestic production activities income as part of any tax reform plan.

The Section 199 deduction was enacted as part of the American Jobs Creation Act of 2004 as a domestic production and jobs creation measure. The deduction applies to proceeds from agricultural or horticultural products that are manufactured, produced, grown, or extracted in the United States, including dairy, grains, fruits, nuts, soybeans, sugar beets, oil and gas refining, and livestock. Farmer-owned cooperatives are able to apply their wages to the calculation of the deduction, and then choose to pass it through to their farmer members or keep it at the cooperative level, making it extremely beneficial to both.

The Section 199 deduction is limited to the lesser of 9 percent of adjusted gross income or domestic production activities income or 50 percent of wages paid to produce such income. Reducing or eliminating the domestic activities deduction would result in a significant increase in taxable income for all farms that currently employ non-family labor. On the other hand, the benefit of the deduction would increase if agricultural producers were able to count non-cash wages paid, such as crop share payments of commodities.

The Section 199 deduction serves as both a domestic production and jobs creation incentive and has provided needed relief for producers in times when prices are depressed. Section 199 benefits are returned to the economy through job creation, increased spending on agricultural production, and increased spending in rural communities.

Thank you for your continued efforts in support of our nation's agricultural producers. We look forward to working with you on this important issue.

Respectfully,

Agricultural & Food Transporters Conference
Agricultural Retailers Association

American Farm Bureau Federation
American Mushroom Institute
American Sheep Industry Association
American Soybean Association
American Sugarbeet Growers Association
California Association of Winegrape Growers
Cobank
National Barley Growers Association
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The Honorable Richard Neal, Ranking Member
House Committee on Ways & Means
1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

On behalf of the nation's farmers and ranchers, the organizations listed below are writing today regarding one of our priorities for federal tax reform: a reduction in capital gains taxes.

Capital gains taxes have a significant impact on production agriculture and producers' long-term investments in land, breeding livestock and buildings. We believe a reduction of the tax rate on capital gains and assets indexed for inflation would enable producers to better respond to new market opportunities and facilitate the transfer of land to young and beginning farmers.

Taxation for capital gains upon the sale of farm assets creates a number of problems, particularly when an asset sale causes a sharp transitory spike in income that pushes farmers and ranchers into a higher than usual tax bracket. USDA has found that 40 percent of family farms have reported some capital gains or losses, compared to 13.6 percent for an average individual taxpayer.

Another problem is the "lock-in" effect where the higher the capital gains tax rate, the greater disincentive to sell property or alternatively to raise the asking price. In today's agriculture economy, starting a farm or ranch requires a large investment due to the capital-intensive nature of agri-business, with land and buildings typically accounting for 79 percent of farm and ranch assets. Given the barrier created by the capital gains tax, landowners are discouraged to sell, making it even more difficult for new farmers to acquire land and agriculture producers who want to purchase land to expand their business to include a son or daughter. This lose-lose scenario also interferes with capital that would otherwise spur new and more profitable investments.

At a time of heightened financial stress in our agriculture economy, it is more critical now for farmers and ranchers to have the flexibility to change their operations to respond to consumer demand in an increasingly dynamic market. Because of the capital gains taxes imposed when buildings, breeding livestock, farmland and agricultural conservation easements are sold, the higher the tax rate the more difficult it is for producers to cast off unneeded assets to generate revenue, upgrade their operations and adapt to changing markets.

As you continue your work on legislation to reform the tax code, we urge you to carefully consider our recommendations to address these concerns regarding the inadequacies and inefficiencies of current capital gains tax provisions. We acknowledge the extremely complex task of crafting legislation to adopt comprehensive tax reform and appreciate your support of America's farmers and ranchers.

Sincerely,

Agricultural & Food Transporters Conference
Agricultural Retailers Association
American Farm Bureau Federation
American Farmland Trust
American Mushroom Institute
American Sheep Industry Association
American Soybean Association
American Sugarbeet Growers Association
California Association of Winegrape Growers
Cobank
National Barley Growers Association
National Cattlemen's Beef Association
National Corn Growers Association
National Cotton Council
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1102 Longworth House Office Building
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The Honorable Richard Neal, Ranking Member
House Committee on Ways & Means
1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

America's farmers and ranchers rely on various tax code provisions to survive the constant financial and economic ups and downs that come with farming and ranching. The undersigned agricultural groups ask for your robust support of these critical provisions that ensure their long-term financial well-being.

Cash accounting allows farmers and ranchers to improve cash flow by recognizing income when it is received and recording expenses when they are paid. This provides the flexibility needed to plan for future business investments and in many cases provides guaranteed availability of agricultural inputs. Loss of cash accounting would create a situation where a farmer or rancher would have to pay taxes on income before receiving payment for sold commodities.

Like-kind exchanges help farmers and ranchers operate more efficient businesses by allowing them to defer taxes when they sell land, buildings, equipment, and livestock or purchase replacement property. Without like-kind exchanges some farmers and ranchers would need to incur debt in order to continue their farm or ranch businesses or, worse yet, delay mandatory improvements to maintain the financial viability of their farm or ranch business.

Farm and ranch businesses operate in a constant world of uncertainty with ongoing expenses and a fluctuating income. Income averaging, which permits revenue to be averaged over three years, allows farmers and ranchers to level out their tax liability and produces a more dependable and consistent revenue stream that aids financial management.

As Congress moves forward with its tax reform proposals and debate, we urge your support for these important tax provisions. Thank you for your continued efforts to support our nation's farmers and ranchers whose work allows us to enjoy the safest, most abundant and affordable food supply in the world. We look forward to working with you on these important issues.

Sincerely,

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Agricultural Retailers Association

American Mushroom Institute
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California Association of Winegrape Growers
Cobank
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U.S. Sweet Potato Council
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Western Peanut Growers Association
Western United Dairymen

Statement for the Record

Hearing on How Tax Reform Will Grow Our Economy and Create Jobs across America

Committee on Ways and Means
U.S. House of Representatives

June 1, 2017

As the House Committee on Ways and Means meets to consider how tax reform can create jobs, increase paychecks, and grow the economy, the 21 undersigned national real estate organizations appreciate the opportunity to share our views on tax reform and commercial real estate. While the comments below broadly represent the views and perspective of the real estate industry, individual property types or investment structures may have unique tax issues and policy concerns more appropriately addressed in separate communications.

OVERVIEW

Real estate is deeply interwoven in the U.S. economy and the American experience, touching every life, every day. Millions of Americans share in the ownership of the nation's real estate, and it is a major contributor to U.S. economic growth and prosperity. Real estate plays a central role in broad-based wealth creation and savings for investors large and small, from homeowners to retirees invested in real estate via their pension plans.

Commercial real estate provides the evolving physical spaces in which Americans work, shop, learn, live, pray, play, and heal. From retail centers to assisted living facilities, from multifamily housing to industrial property, transformations are underway in the "built environment." Investment in upgrading and improving U.S. commercial real estate is enhancing workplace productivity and improving the quality of life in our communities.

Among its vast economic contributions, the real estate industry is one of the leading job creators in the United States, employing over 13 million Americans—more than one in every 10 full-time U.S. workers—in a wide range of well-paying jobs. Real estate companies are engaged in a broad array of activities and services. This includes jobs in construction, planning, architecture, building maintenance, management, environmental consulting, leasing, brokerage, mortgage lending, accounting and legal services, agriculture, investment advising, interior design and more.

Commercial real estate encompasses many property types, from office buildings, warehouses, retail centers and regional shopping malls, to industrial properties, hotels, convenience stores, multifamily communities, medical centers, senior living facilities, gas stations, land and more. Conservatively estimated, the total value of U.S. commercial real estate in 2016 was between \$13.4 and \$15 trillion, a level that matches the market cap of domestic companies on the New York Stock Exchange. Investor-owned commercial properties account for about 90 percent of the total value, with the remainder being owner-occupied. Based on the latest data available from the Federal Reserve, U.S.

commercial real estate is leveraged conservatively with about \$4.2 trillion of commercial real estate debt.

Industry activity accounts for nearly one-quarter of taxes collected at all levels of government (this includes income, property and sales taxes). Taxes derived from real estate ownership and transfer represent the largest source — in some cases approximately 70% — of local tax revenues, helping to pay for schools, roads, law enforcement and other essential public services. Real estate provides a safe and stable investment for individuals across the country, and notably, retirees. Over \$370 billion is invested in real estate and real estate-backed investments by tax-exempt organizations (pension funds, foundations, educational endowments and charities).

Commercial real estate is a capital-intensive asset, meaning that income-producing buildings require constant infusions of capital for acquisition and construction needs, ongoing repairs and maintenance, and to address tenants' ever-changing technological requirements.

Today's commercial real estate markets are grounded in strong fundamentals, as indicated by vacancy rates near historic lows, positive growth of rents and stable net operating income. By most measures, commercial real estate conditions accurately reflect market supply and demand.¹ While certain policy reforms are clearly warranted (*i.e.*, removing unnecessary barriers to construction lending, addressing internet sales tax issue), sources of equity and debt capital are largely available for economically viable projects. A broad-based acceleration of economic growth through tax reform would boost real estate construction and development and spur job creation. However, Congress should be wary of changes that result in short-term, artificial stimulus and a burst of real estate investment that is ultimately unsustainable and counterproductive. In order to improve the economy's long-term trajectory, growth must be predicated on sound reforms that change underlying economic conditions.

TAX REFORM

The real estate industry agrees that tax reform is needed and overdue. We should restructure our nation's tax laws to unleash entrepreneurship, capital formation, and job creation. At the same time, comprehensive tax reform should be undertaken with caution, given the potential for tremendous economic dislocation. Tax policy changes that affect the owners, developers, investors and financiers of commercial real estate will have a significant impact on the U.S. economy, potentially in unforeseen ways.

We urge the Ways and Means Committee to be mindful of how proposed changes in commercial real estate taxation could dramatically affect not only real estate investment activities but also the health of the U.S. economy, job creation, retirement savings, lending institutions, pension funds, and, of course, local communities.

Positive reforms will spur job-creating activity. For example, tax reform that recognizes and rewards appropriate levels of risk taking will encourage productive construction and development activities, ensuring that real estate remains an engine of economic activity. Tax reform can also spur job

¹ The Real Estate Roundtable, *Sentiment Index: Second Quarter 2017* (May 5, 2017), available at: <http://www.rer.org/Q2-2017-RER-Sentiment-Index>.

creation, and assist the nation in achieving energy independence, by encouraging capital investments in innovative and energy-efficient construction of buildings and tenant spaces.

Alternatively, some reforms might unintentionally be counter-productive to long-term economic growth. Of major concern are proposals that could result in substantial losses in real estate values. Lower property values produce a cascade of negative economic impacts, affecting property owners' ability to obtain credit, reducing tax revenues collected by local governments and eroding the value of retirees' pension fund portfolios.

Thus, as much as we welcome a simpler, more rational tax code — and any associated improvements in U.S. competitiveness abroad — we continue to urge that comprehensive tax restructuring be undertaken with caution, given the potential for tremendous economic dislocation.

As history illustrates, the unintended consequences of tax reform can be disastrous for individual business sectors and the economy as a whole. A case in point is the Tax Reform Act of 1986, which ushered in a series of over-reaching and over-reactive policies — in some cases on a retroactive basis. Significant, negative policy changes applied to pre-existing investments. Taken together, these changes had a destabilizing effect on commercial real estate values, financial institutions, the federal government and state and local tax bases. It took years for the overall industry to regain its productive footing, and certain aspects of the economy never recovered.

We believe the four principles below should guide and inform your efforts to achieve a significant, pro-growth overhaul of the nation's tax code:

- Tax reform should encourage capital formation (from domestic and foreign sources) and appropriate risk-taking, while also providing stable, predictable, and permanent rules conducive to long-term investment;
- Tax reform should ensure that tax rules closely reflect the economics of the underlying transaction — avoiding either excessive marketplace incentives or disincentives that can distort the flow of capital investment;
- Tax reform should recognize that, in limited and narrow situations (*e.g.*, low-income housing and investment in economically challenged areas), tax incentives are needed to address market failures and encourage capital to flow toward socially desirable projects; and
- Tax reform should provide a well-designed transition regime that minimizes dislocation in real estate markets.

In short, rational taxation of real estate assets and entities will support job creation and facilitate sound, environmentally-responsible real estate investment and development, while also contributing to strong property values and well-served, livable communities.

***A BETTER WAY* – THE HOUSE REPUBLICAN TAX REFORM BLUEPRINT**

Last June, Chairman Brady, Speaker Ryan and the House Republican Conference put forward *A Better Way*, a bold tax reform proposal aimed at creating a modern tax code built for economic growth. The drafters made clear that this House Republican Tax Reform Blueprint (“Blueprint”) was

the “beginning of our conversation about how to fix our broken tax code.” Our industry has appreciated the open dialogue and opportunity to work constructively with Committee Members and staff to ensure that tax reform achieves its full potential.

We support the Blueprint’s underlying objectives, including the desire to reform the tax system to promote economic growth, capital formation, and job creation. The comments below are based on our current understanding of the Blueprint, as gathered from meetings and conversations with Members and staff. Many of these perspectives have been transmitted to the Committee, formally or informally, in recent weeks. Our views and input will continue to evolve as additional information is made available. The comments are offered in the spirit of support for the Ways and Means Committee’s tax reform effort, and they are aimed at ensuring the legislation successfully spurs economic growth without unintentionally discouraging entrepreneurship or creating unnecessary economic and market risks.

Cash flow taxation and real estate. The Blueprint would replace the existing system for taxing business income with a “destination-based, cash flow” tax system. Rather than taxing businesses on their net income, the Blueprint seeks to tax businesses on their net cash flow. For a domestic business, setting aside important aspects of the proposal that relate to cross-border transactions, the key conceptual change is that the full cost of a new investment would be recovered (deducted) immediately, rather than recovered (depreciated) over the economic life of the investment. The underlying expectation is that the shift to cash flow taxation will spur growth by reducing the tax burden on new investment.

The Blueprint proposes to deviate from cash flow taxation in two key ways that would have critical implications for real estate. First, land would not qualify for immediate expensing, only the value of structures. Second, businesses could not deduct currently their net interest expense. As a result, two major expenses associated with investing in real estate—the cost of the underlying land and the cost of borrowing capital to purchase the real estate—would be excluded from the basic architecture of the cash flow tax system.

- *Treatment of land.* Land represents a major share, on average roughly 30%, of the value of real estate. The Blueprint offers no express rationale for the exclusion of land from immediate expensing. The two suggestions offered informally to-date have been that land is a “non-wasting” asset and “we’re not making any more of it.” However, the actual economic life of an asset and its status as a manufactured good is irrelevant to a system that seeks to tax net cash flow. Under the Blueprint’s own terms, land should qualify for expensing. Denying taxpayers’ ability to expense land would create the very same economic distortions that the Blueprint is seeking to remove from the tax code. It would shift resources to other asset classes for reasons that are purely tax-motivated. In addition, it would create new geographic disparities and distortions based on the relative share of land in the cost of real estate.
- *Treatment of net interest expense.* Access to financing and credit is critical to the health of U.S. real estate and the overall economy. The ability to finance productive investment and entrepreneurial activity with borrowed capital has driven economic growth and job creation in the United States for generations. In both an income tax system and a cash flow tax system, business interest expense is appropriately deducted under the basic principle that interest is an ordinary and necessary business expense.

The Blueprint states that allowing both expensing and interest deductibility “would result in a tax subsidy for debt-financed investment.” The Blueprint “helps equalize the tax treatment of different types of financing” and “eliminates a tax-based incentive for businesses to increase their debt load beyond the amount dictated by normal business conditions.” The Blueprint suggests less leverage is inherently preferable, “A business sector that is leveraged beyond what is economically rational is more risky than a business sector with a more efficient debt-to-equity composition.”

Repealing or imposing limits on the deductibility of business interest would fundamentally change the underlying economics of business activity, including commercial real estate transactions. This could lead to fewer loans being refinanced, fewer new projects being developed, and fewer jobs being created. Legislation altering the tax treatment of existing debt could harm previously successful firms, pushing some close to the brink of insolvency or even into bankruptcy. Congress should preserve the current tax treatment of business interest. By increasing the cost of capital, tax limitations on business debt could dramatically reduce real estate investment, reducing property values across the country, and discouraging entrepreneurship and responsible risk-taking.

Like-kind exchanges. Under current law, section 1031 of the tax code ensures that taxpayers may defer the immediate recognition of capital gains when property is exchanged for property of a like kind. In order to qualify, a like-kind exchange transaction must involve property used in a trade or business, or held as an investment, and all proceeds (including equity and debt) from the relinquished property must be reinvested in the replacement property. Section 1031 is used by all sizes and types of real estate owners, including individuals, partnerships, LLCs, and corporations. While the Blueprint does not expressly address like-kind exchanges, we understand some policymakers view immediate expensing as a viable replacement for section 1031 of the tax code. We disagree.

Real estate like-kind exchanges generate broad economic and environmental benefits, and Section 1031 should be preserved without new limitations on the deferral of gains. Exchanges spur greater capital investment in long-lived, productive real estate assets and support job growth, while also contributing to critical land conservation efforts and facilitating the smooth functioning of the real estate market. Without Section 1031, many of these properties would languish underutilized and short of investment because of the tax burden that would apply to an outright sale. Recent academic research analyzing 18 years of like-kind exchange transactions found that they lead to greater capital expenditures, investment, and tax revenue while reducing the use of leverage and improving market liquidity.² Another study by EY concluded that new restrictions would increase the cost of capital, discourage entrepreneurship and risk taking, and slow the velocity of investment.³ As currently understood, the Blueprint would not fully replicate the benefits of section 1031, particularly to the extent that the land component of real estate remains ineligible for immediate expensing.

² Professors David C. Ling (Univ. Fla.) and Milena Petrova (Syracuse U.), *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate* (June 2015), available at: http://warrington.ufl.edu/departments/fire/docs/paper_Ling-Petrova_EconomicImpactOfRepealingOrLimitingSection1031.pdf.

³ EY, *Economic Impact of Repealing Like-Kind Exchange Rules* (Nov. 2015), available at: <http://www.1031taxreform.com/1031economics>.

State and local tax deduction. State and local taxes are the principal source of financing for schools, roads, law enforcement and other infrastructure and public services that help create strong, economically thriving communities. Throughout the country, real estate is the largest contributor to the local tax base. Most state and local taxes, including real estate taxes, are deductible from federal income. Eliminating the deductibility of state and local taxes could disrupt demand for commercial real estate in many parts of the country while raising taxes on millions of Americans. It would shift power away from local communities in favor of the federal government. The deductibility of state and local taxes is grounded in the Constitution, federalism, and states' rights. The state and local tax deduction prevents an erosion of local governance and decision-making by prohibiting the federal government from double-taxing amounts already taxed at the state and local level. The burden of the change will fall disproportionately on those regions that generate the most tax revenue for the federal government—and the reduced demand for commercial real estate in certain regions could lower property values and limit the ability of the industry to continue creating jobs and driving economic growth.

Blueprint impact on real estate investment and development. Economic modeling suggests that the proposed shift to cash flow taxation under the Blueprint would create different results for different taxpayers—even after all real estate has transitioned to the new regime. For investors with other income that can absorb the losses generated by immediate expensing, the Blueprint should increase after-tax returns. For others, as a general matter, the relative after-tax returns on new real estate investment, including construction, would depend heavily on the interest rate that applies to loss carryforwards. Under reasonable financial assumptions related to property costs, operating income, and project expenses, a loss carryforward interest rate of 5.0% would result in after-tax returns on real estate investment that are similar to current returns. In contrast, a loss carryforward interest rate equal to inflation would result in returns that are much lower than those under current law. As interest rates rise or debt-to-equity ratios increase, returns on real estate investment would decline further because of the change in the tax treatment of business interest.

Thus, under the Blueprint framework, the tax burden may fall disproportionately on entrepreneurs and small developers—those most likely to own properties in small and medium-sized markets—because they use greater leverage to finance their activities and lack the deep portfolio of assets to absorb the losses generated from expensing.

Moreover, depending on the structure of the transition rules, the Blueprint could result in substantially lower after-tax returns and reduced property values for existing real estate assets. The impact on existing properties is heavily dependent on the post-enactment treatment of tax basis, as well as the ongoing deductibility of interest on existing and refinanced real estate loans. The structure of any transition relief under the Blueprint is not yet clear.

Economic and market risks. In the past (1981-1986), the accelerated tax depreciation of structures contributed to unsustainable levels of uneconomic, tax-motivated real estate investment and construction. Tax-driven stimulation of real estate construction that is ungrounded in sound economic fundamentals, such as rental income and property appreciation expectations, creates imbalances and instability in real estate markets. The negative consequences could harm state and local communities (through reductions in state and local property tax revenue), the financial security of retirees (through pension investments tied to real estate), and the banking system (through the declining value of real estate on bank balance sheets and systemic risk to the financial system).

Most capital assets other than real estate structures already are recovered on an extremely accelerated schedule. Therefore, the economic risks associated with immediate expensing are largely unique to real estate. According to Treasury Department economists, nearly half of all capital investment by U.S. corporations is in 3-year and 5-year property.⁴ According to Goldman Sachs, under current tax policy, 70% of total capital investment is recovered within the first 18 months of use.⁵ In addition to its longer life, real estate differs from other fixed capital assets because it is more likely to be sold for a gain. The income it generates often is treated as passive. In short, the tax attributes of real estate diverge greatly from other forms of capital investment.

Lastly, the stock of existing real estate dwarfs in size all other depreciable capital assets. And unlike equipment and machinery, only about two percent of the stock is replaced with new construction annually. The large existing stock relative to new construction means that transitioning existing real estate into a cash flow tax system in a manner that treats current owners fairly and avoids severe market disruption and systemic risk would be extraordinarily expensive from the standpoint of lost revenue to the Treasury.

Going forward – addressing the challenges of real estate taxation under the House Blueprint.

In light of the unique status of real estate as a long-lived, fixed capital asset and the transition challenges generated by the large stock of existing properties, the Committee should consider excluding real estate from the basic Blueprint architecture of immediate expensing and interest non-deductibility. The Committee should preserve like-kind exchanges, an effective, time-tested tool that helps taxpayers internally mobilize capital to grow and expand their businesses and create jobs. Tax reform legislation could promote investment in manufacturing and other capital-intensive industries through a modified incentive that provides for permanent, immediate expensing of shorter-lived assets, such as equipment and machinery. Legislation could reduce the depreciation period for real estate to align more closely with its useful economic life, which is approximately 19 years, according to the Massachusetts Institute of Technology.⁶

Alternatively, if real estate is included in the cash flow tax system, it is critical that the House bill include carefully designed transition rules. The transition rules should ensure the new tax regime

⁴ James Mackie III & John Kitchen, *Slowing Depreciation in Corporate Tax Reform*, TAX NOTES (Apr. 29, 2013), available at: <http://www.taxnotes.com/tax-notes-today/budgets/slowng-depreciation-corporate-tax-reform/2013/04/30/f2p4> (behind paywall).

⁵ David Mericle & Dan Stuyven, *Corporate Tax Reform: Trading Interest Deductibility for Full Capex Expensing* (Goldman Sachs Economics Research, Nov. 30, 2016), available at: <http://static.politico.com/c3/34/c99de58745b29f77b027a0f848d9/goldman-sachs-analysis-of-net-interest-deductibility-and-expensing-provisions-of-tax-reform.pdf>.

⁶ Professor David Geltner and Sheharyar Bokhari, *Commercial Buildings Capital Consumption in the United States*, (MIT Center for Real Estate, Nov. 2015), available at: <https://mitcre.mit.edu/research-publications/commercial-building-capital-consumption-us>; Andrew B. Lyon & William A McBride, *Tax Policy Implications of New Measures of Building Depreciation*, TAX NOTES (June 20, 2016), available at: <https://www.pwc.com/us/en/tax-services/publications/assets/pwc-tax-implications-of-new-measures-of-building-depreciation.pdf>.

does not put the owners of existing real estate assets at an economic disadvantage compared to new construction and new investment; does not result in lower property values and new systemic economic risk; and does not create a lock-up of properties that distorts real estate commerce and undermines productive economic activity.

One approach to transition under consideration would grandfather current depreciation methods and schedules for existing assets. However, this approach would cement in law, for decades, two distinct tax systems for U.S. commercial real estate dependent on when the taxpayer acquired the property. This would result in two separate systems—one that is income-based for the \$15 trillion of existing real estate and one that is cash flow-based for future investment. In so doing, Congress risks creating a cascade of new market distortions with unknown and potentially dangerous consequences. It would violate a fundamental principle of good tax policy—treating similarly situated taxpayers the same. It could cause a lock-up of properties that reduces market liquidity, drags down property values, and prevents properties from transferring into the hands of owners that would upgrade and improve the real estate, creating jobs in the process.

In short, transition rules must address two powerful forces set in motion under the Blueprint—the loss of interest deductibility and the economic divergence that would result from the proposed acceleration of cost recovery for new investment. Both of these changes are challenges for the transition from one regime to the next.

In fairness to borrowers who made investment decisions in reliance on long-standing tax principles in place since the inception of our tax law, debt on existing real estate should be fully grandfathered for purposes of interest expense deductibility. This relief should extend to debt secured directly by real estate, as well as debt that is effectively backed by real estate, such as bonds issued by REITs. In addition, the transition rules should not discourage the refinancing of existing real estate debt, which accelerates reinvestment, economic activity, and job creation.

With respect to cost recovery, one viable option is to phase in immediate expensing over an extended period, while simultaneously accelerating the recovery of basis in existing assets. An alternative option would implement expensing immediately, but in contrast to the *American Business Competitiveness Act* (H.R. 4377, 114th Cong.), would ensure that current owners get full recognition of their tax basis when selling an existing asset, thus avoiding a “lump sum” tax on all existing real estate.

The importance of a well-designed transition regime cannot be overstated. The stock of existing commercial real estate is more than 12 times the size of total annual private investment in equipment and machinery. The risk of unintended consequences is real and past lessons should inform policymakers’ decisions. Congress should approach transition as a primary focus and not a secondary concern.

Other real estate issues in the Blueprint. There are several other areas where policy decisions in the legislative drafting of the Blueprint will have enormous consequences for commercial real estate activity. In brief:

- The 50% capital gains exclusion should fully cover individual gains from real estate investment, including real estate that is directly owned or owned through a pass-through entity;

- With respect to depreciation “recapture,” the tax law should recognize that a portion of the income received on the sale of real estate reflects the appreciation of the underlying land and is appropriately taxed at the reduced capital gains rate;
- The reduced tax rate on pass-through businesses should fully extend to partnerships, to distributions from REITs, and to other pass-through entities that generate real estate rental income;
- The new system should continue to encourage taxpayers to reinvest capital and earnings through provisions such as section 1031;
- In order to continue encouraging entrepreneurs and small developers to invest in U.S. real estate, the interest rate on loss carryforwards should include a real return that is sufficient to preserve the value of losses that cannot currently be used; and
- The character of real estate-related income, including carried interest, should continue to be determined at the partnership level and the new regime should continue to recognize that entrepreneurial risk-taking often involves more than just the contribution of capital.

FIRPTA Repeal. The punitive Foreign Investment in Real Property Tax Act (FIRPTA) regime subjects gains on foreign equity investment in U.S. real estate or infrastructure to a much higher tax burden than applies to a foreign investor purchasing a U.S. stock or bond, or an investment in any other asset class. In addition to the tax burden, the withholding and administrative filing requirements associated with FIRPTA are frequently cited by foreign taxpayers as principal reasons for avoiding the U.S. real estate market. FIRPTA is a major impediment to greater private investment in both U.S. real estate and infrastructure.

In 2015, the Ways and Means Committee, led by Chairman Brady and Rep. Joe Crowley (D-NY), along with Senators Mike Enzi (R-WY) and Robert Menendez (D-NJ) in the Senate, helped enact the most significant reforms of FIRPTA since its passage in 1980. The Committee should build on its success by repealing FIRPTA outright as part of tax reform. Unleashed by FIRPTA’s repeal, capital from abroad would create jobs by financing new real estate developments, as well as the upgrading and rehabilitation of existing buildings. Architects, engineers, construction firms, subcontractors, and others would be put to work building and improving commercial buildings and infrastructure.

* * *

Because commercial real estate is so ubiquitous, it is sometimes easy to overlook its positive connection to our nation. Commercial real estate is where America lives, works, shops, plays and invests. The right tax policy can help commercial real estate: create and maintain jobs, lift retirement savings for Americans, reduce energy consumption, and improve the quality of life in local communities.

We are fully committed to working with you and your colleagues to achieve a bold tax reform outcome that serves the overall economy and appreciate your consideration of these issues. We

appreciate your consideration of these comments and look forward to working with you, cooperatively, as tax reform moves forward.

Sincerely,

The Real Estate Roundtable
ADISA—Alternative & Direct Investment Securities Association
American Hotel & Lodging Association
American Institute of Architects
American Land Title Association
American Resort Development Association
American Seniors Housing Association
Appraisal Institute
Asian American Hotel Owners Association
The Building Owners and Managers Association (BOMA) International
CCIM Institute
Federation of Exchange Accommodators
Institute of Real Estate Management
International Council of Shopping Centers
IPA—Investment Program Association
Mortgage Bankers Association
NAIOP, the Commercial Real Estate Development Association
National Apartment Association
National Association of REALTORS®
National Multifamily Housing Council
REALTORS® Land Institute



May 18, 2017

Chairman Kevin Brady
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Chairman Peter Roskam
Subcommittee on Tax Policy
Committee on Ways & Means
Washington, DC 20515

RE: Comments on *How Tax Reform Will Grow Our Economy and Create Jobs Across America*

On behalf of Heating, Air-conditioning & Refrigeration Distributors International (HARDI), I write to offer comments on *How Tax Reform Will Grow Our Economy and Create Jobs Across America*. HARDI is the voice of nearly 1,000 member companies and 35,000 professionals worldwide in the HVACR industry. Our members provide the products that keep homes and businesses cool in the summer and comfortable in the winter. More than 80 percent of HARDI's distributor members are classified as small businesses, and our members help drive economic growth with more than \$35 billion in annual sales and 40,000 small business jobs supported.

HARDI member companies are faced with an increasingly complicated tax system that affects every aspect of business, including the products they sell, how their inventories are shipped and warehoused, and the benefits they are able to provide to employees. Given the impact that taxation has on businesses, Congress should focus on passing reforms that create certainty in the tax code so HARDI members can focus more on providing good-paying, quality jobs in every Congressional district.

We applaud your work to move the U.S. toward a commonsense tax system that works for all businesses. Many of the provisions of pro-growth tax reform will be helpful to HARDI including:

- Simplifying the tax code – Making the tax code simpler allows more people to understand how actions such as purchases can affect their tax liability. The added certainty of a simplified code lets HARDI members effectively plan for the future. Additionally, the usage of dynamic scoring will allow for changes in taxes and spending to be evaluated based on the predicted changes in behavior, not inaccurate changes in revenue and expense.
- Lowering tax rates on individuals and family businesses – Small businesses currently pay some of the highest taxes in the industrialized world. They are taxed at the individual tax rates that can be as high as 39 percent. The President's plan calls for the rate to be reduced to 15%. HARDI members believe that equity in the top pass-

through business tax rate and the corporate tax rate ensure competitiveness in the market. Furthermore, a decrease in the overall rates and reduction in special tax breaks would allow all industries to compete fairly. Of what tax breaks stay in place, the breaks need to be available across both pass-through and corporate tax structures.

- Full repeal of the federal estate and gift taxes – The nature of the distribution business requires our members to hold massive inventories in multiple warehouse locations. Upon a business owner’s death, they oftentimes exceed the estate tax threshold but lack the cash on hand to pay a 40 percent tax on their lifetime savings because their value is tied up in the family-business inventory. If a family cannot pay the death tax, they must fire workers, sell off machinery and parts of the business, or in the worst cases close the business entirely to pay death taxes. Many of our members are multigenerational family businesses that have had to grapple with the estate tax in the past and have been forced to hire lawyers and accountants to help them pass their businesses to the next generation. This is all money that could be used to reinvest in the business and the economy. According to the Tax Foundation, nearly 160,000 jobs could be created by repealing the death tax. Karen Madonia, a second generation HARDI member, testified before the Select Revenue Subcommittee on March 8, 2015 and described in her attached testimony why the estate tax hurts her family business.
- Immediate full expensing of HVAC equipment – As it currently stands now, commercial HVAC units must be depreciated over 39 years, which is significantly more than the units’ typical lifespan. Commercial building owners oftentimes choose to keep older, inefficient machines in service and pass on the higher energy costs rather than invest in new equipment. Congress voted to fix this problem in the 2015 PATH Act, which passed and was signed into law. The bill contained language to remove an exclusion from Section 179 expensing that prevented heating and air-conditioning units from qualifying. Responses from the IRS regarding their interpretation of this change make additional tax changes necessary. HARDI supports comprehensive tax reform that allows for the immediate expensing of HVAC equipment as was intended by Congress. We also support legislative efforts to create a real property exclusion for HVAC equipment which would codify immediate HVAC equipment expensing.
- Maintaining LIFO – Last In, First Out, or “LIFO” is a method of accounting that helps businesses, including many in HARDI’s membership, to determine both book income and tax liability. The LIFO method of valuing inventory has existed for three quarters of a century as a means of helping to protect businesses from inflation. Its repeal would be disastrous to supply chains in every industry.
- Parity between corporations and pass-through entities – Today, more than 50 percent of jobs are created by so-called “pass-through” businesses – sole proprietorships,

partnerships, limited liability companies and S corporations. Corporate-only tax reform would hurt the largest supplier of jobs. We encourage any comprehensive tax reform to fix both tax rates in such a way that does not benefit only one group. As a result of reforming the tax code, many HARDI members will be able to keep more of their hard-earned profits and use those funds to grow their companies, raise wages, hire new workers and invest in their communities.

Small businesses need a tax code that protects them and encourages them to grow and thrive in their communities. HARDI members are confident that your reform proposal will provide the tax environment they need to thrive, and we are excited to help you implement these pro-growth reforms. We look forward to working with you to create a business-friendly tax code that helps all businesses and individuals succeed in an expanding economy.

Sincerely,

Jon Melchi
Vice President, Government & External Affairs
HARDI
614-345-4328 (Office)

A LITTLE BIT ABOUT

HARDI

OUR TRADE ASSOCIATION HAS

NEARLY 1,000

MEMBER COMPANIES

OVER 475
ARE U.S. BASED
WHOLESALE
COMPANIES



OF MEMBERS ARE
CLASSIFIED AS
**SMALL
BUSINESSES**

THESE SMALL BUSINESSES
COLLECTIVELY EMPLOY

40,000



HARD-WORKING AMERICANS

HARDI MEMBERS HAVE OVER

35 BILLION

IN ANNUAL SALES

HARDI REPRESENTS AN ESTIMATED



OF U.S. WHOLESALE
DISTRIBUTION MARKET
OF HVACR EQUIPMENT,
SUPPLIES, AND CONTROLS

THERE IS A HARDI MEMBER IN



**EVERY
CONGRESSIONAL
STATE**

Testimony of

Karen Madonia

Chief Financial Officer
ILLCO, Inc. Aurora, IL

On Behalf of
Heating, Air-Conditioning and Refrigeration Distributors
International (HARDI)



Submitted to the
Subcommittee on Select Revenue Measures

Hearing on the
Burden of the Estate Tax on Family Businesses and Farms

B-318 Rayburn House Office Building
March 18, 2015

Chairman Reichert, Ranking Member Neal and Members of the Subcommittee on Select Revenue Measures, my name is Karen Madonia, and I am the Chief Financial Officer and next generation of Illco, Inc., a Chicago-area distributor of heating, ventilation, air-conditioning and refrigeration equipment, parts and supplies. Thank you for giving me the opportunity to talk about the estate tax and its effect on the many small family businesses that comprise the United States economy. This is an issue that is very close to my heart as my family is in the midst of our own generational transfer.

Let me provide you with some background: Illco was a very small company with only seven employees when my father purchased it back in 1973. At that time, my dad was only 32 years old, with a wife, three daughters and a mortgage, but he knew he wanted something more than just a job. He wanted to use his passion to create something permanent, to be in control of his own destiny. With help from my grandfather, my dad decided to take a risk and go into business for himself. A community bank took my grandfather's assets, my dad's assets and a guarantee from a vendor as collateral for a \$340,000 loan to purchase the company.

In those early years, my dad worked every job at Illco. During the day, he went to see customers and secure orders, then went back to the warehouse to pull and package them. The next day, he would make deliveries using my mom's station wagon before visiting more customers and taking more orders. Eventually, he was able to buy a truck and hire a driver, which left the station wagon free for my mom to pick up merchandise from Illco vendors while my sisters and I were at school. After the doors closed at 5:00, my dad would go to his office to perform both the accounts payable and accounts receivable functions. Every bit of profit he made got funneled back into the company so he could hire more people, buy more trucks and expand his inventory. My dad worked seven days a week, and most nights he did not get home until long after most people had finished their dinners. He had to give up any hobbies which took too much time away from his business, and our family vacations were mostly extended weekends because a week was simply too long for him to be away. Many weekends were spent entertaining customers, mostly over home-cooked meals, because that was the only way my parents could afford to wine and dine the people that were so necessary to the success of the business. But my dad's passion for the industry, his commitment to his employees, and his drive to grow his company empowered him to keep pushing even when interest rates hovered in the high teens during the late 1970's and early 1980's and things looked pretty ominous. Forty years later, he has a business with eight branches in three states, 97 employees and \$42,000,000 in revenue.

My sisters and I grew up understanding that if we wanted to be successful at anything, we had to work hard and stay focused on our goals. We are all proud to work alongside our dad now, and look forward to making our own mark on the family business in the coming years. There is also a generation behind us that is just beginning to consider career options. Perhaps some of them will join us...that is certainly my hope. But after years of listening to us struggle to figure out how to grow the business while navigating the estate tax waters, I imagine that all of them will think twice before making that leap.

For the last few years, I have come to Washington with our trade association, HARDI, to talk to Members of the House and Senate about the issues that are important to our companies and our

industry. Every year, estate tax is on the top of my list of topics to discuss. I personally find it fundamentally wrong to place a tax on death. If a person accumulates wealth through hard work, and if that person pays his fair share of taxes on income as it is earned, I do not understand how the government can justify taking a significant portion of what he has left simply because he opted to save and re-invest rather than consume. The United States has already benefited from that person's success because he has employed people who pay taxes, bought buildings on which he has paid property taxes and bought inventory and supplies from other companies, which can then afford to employ more people who pay taxes. He has created opportunity for the community as a whole while creating prosperity for himself. We all benefit when a small businessperson succeeds. To me, and probably to a large portion of the generation behind me, the estate tax serves as a tremendous entrepreneurial disincentive. Why work hard to build something substantial if it is likely to die when you do? Why not be just another worker, make enough money to live comfortably, and not worry about generating any more wealth than that? If even a small percentage of potential entrepreneurs decide not to turn their dreams into viable businesses because our tax policy discourages them from doing so, haven't we done a great disservice to our economy?

Proponents of the estate tax will tell you tell it prevents the concentrated accumulation of wealth in our country. They'll tell you that our nation needs to increase taxes on the "wealthy" because they need to pay their "fair share". On the surface, that's a pretty safe argument to make. It's easy to say the solution to our fiscal issues is to increase the burden on those who can afford it the most. But what's fair about paying taxes your whole life only to have to pay even more at death simply because you're leaving a business behind? What is always overlooked in these discussions is the effect of the estate tax on the small family business. In most cases, we're not talking about passing on bank accounts with multi-million dollar balances. We're talking about businesses where most of the net worth is tied up in inventory, accounts receivable, equipment and real estate. At Illco, for example, we carry an inventory valued at \$12,000,000 and accounts receivable of about \$5,000,000. Our inventory has to be high – we provide vital heating, air- conditioning and refrigeration parts and supplies to hospitals, schools, nursing homes and grocery stores. When the refrigeration system in a grocery store goes down, it needs to be repaired within hours or the food is lost. When the air conditioning system in a hospital doesn't work, patients cannot be appropriately cared for until air is circulating again. The parts and supplies that we sell must be on hand in order to facilitate quick repairs and replacements, which means that we must carry a heavy inventory. We also own five buildings and operate a fleet of twenty-four trucks, some of which cost upwards of \$250,000. After paying our taxes and making our annual profit sharing contribution to our employees, the income that's left is put right back into the company so we can continue to carry an extensive inventory, extend payment terms to our customers and maintain our fleet and our buildings. If something happened to my dad and we were left with a large estate tax bill, we would literally have to sell parts of the company in order to pay it. That would likely mean shutting down branches, laying off workers or liquidating inventory just to be able to pay a tax bill that only occurred because an owner died. Even worse, our company might have to be sold outright, which would likely mean that instead of our employees being part of our small business family, they would become part of a larger company that is beholden to Wall Street. That would not benefit them, and I would argue that it wouldn't benefit the economy as a whole either. Small businesses

employ over half of the nation's private sector workforce and create the vast majority of new jobs. With our economy in a relatively slow recovery, government should be encouraging us to grow and prosper. Instead, worry over the estate tax forces us to spend too much time and money focusing on things that have nothing to do with our businesses.

Over the last few years, my dad has spent countless hours and entirely too much money trying to figure out how his company can outlive him. Instead of focusing on growing his business so he can open more branches and employ more people, he has had to strategize about how to pass his company on to his kids without having to dismantle it. Most of our strategic management decisions, whether they are about day-to-day operations or opportunities to expand, involve consideration of the estate tax in one way or another. We have opted to maintain a large cash reserve as a precaution. Other companies choose to protect themselves by purchasing insurance. Either way, money that could be used to grow and create jobs is sitting on the sidelines. The estate tax is a huge roadblock to successful family businesses undergoing generational transfers. Think about that...perhaps the greatest challenge in transitioning a business from one generation to the next is our own tax code.

The United States has always been the land of opportunity. Small business owners take tremendous risk at great personal sacrifice, and they truly are the backbone of the American economy. No one is asking for it to be easy. In fact, my dad would probably be the first to tell you that working to overcome the challenges is the most rewarding part of owning your own business. But it shouldn't be the case that the thing that keeps you up at night is the worry that you may leave your kids with a huge tax burden when you die. I believe that most people would be proponents of an overhaul to our tax code. There probably are too many exemptions and loopholes that only upper income people can take advantage of, and those topics are worthy of a national conversation. But taxing the estates of successful entrepreneurs is punitive, and that is not the role that our tax code should play.

Two years ago, when Congress last addressed the issue of the estate tax, you gave the small business community some certainty by establishing an exemption and indexing it to inflation. While we still maintained that full repeal was the right answer, we appreciated that you understood that changing the rules on us every year made it impossible for us to properly plan for the future of our businesses. I respectfully ask that you again carefully consider all the ramifications of estate tax policy and then vote, once and for all, to permanently repeal the estate tax. Let's encourage families to create wealth by starting their own businesses, not threaten to take it away from them if the government thinks they have accumulated too much. Let's unleash the potential of those citizens willing to work hard and create something that will benefit all of us, not discourage their ambition through our tax code.

Thank you for the opportunity to share my family story with you. I would be happy to answer any questions that you may have.

To: the Honorable Members of the Ways and Means Committee of the United States Government

Re: Hearing on How Tax Reform Will Grow Our Economy and Create Jobs, May 18 2017, 10:00 a.m.

Today, as you discuss tax reforms intended to grow the economy and create jobs, please consider the tax plight of the thousands of small business owners such as myself who are operating within the legal constraints of our respective states, and who have created tens of thousands of jobs in manufacturing, packaging, sales, and assisted in the creation of even more jobs in ancillary products and services companies such as marketing, advertising, consulting, legal, tax, and transportation.

I'm talking about cannabis businesses and the billions we contribute to the economy each year.

H.R. 1810, the Small Business Tax Equity Act, is the number one issue for small business owners in this industry.

Please pass H.R. 1810 to help those of us who are struggling under the crushing weight of IRS Tax Code Section 280e, which currently has unfair tax consequences for businesses that are operating legally and within the guidelines of their respective states.

When H.R. 1810 passes, I will offer health care benefits, and I will increase wages for all of my existing 24 employees, I will add to my workforce of veterans, minorities, single mothers, and single fathers. I will further stimulate the economy by opening businesses in other industries and hiring even more people.

You don't have to support cannabis legalization to get behind H.R. 1810. If you believe in the fair treatment of small business owners in this country, if you believe in helping women business owners, if you believe in creating jobs and building the economy, then please show it by showing support for H.R. 1810 to exempt legally operating businesses from IRS tax code 280e.

Thank you.



Brian T. Castelli, President & CEO, Home Performance Coalition

Stephen Cowell, President, E4TheFuture

Tom Carter, Executive Director, Efficiency First

and

Larry Zarker, CEO, Building Performance Institute

House Committee on Ways and Means

Tax Incentives for Residential Energy Efficiency

May 30, 2017

As leaders in the residential energy efficiency industry, the Home Performance Coalition, E4TheFuture, Efficiency First, and the Building Performance Institute respectfully urge your support for residential energy efficiency tax incentives. These tax incentives are critical to reducing the upfront cost of energy efficiency improvements, thereby allowing more Americans access to the efficiency market, reduce monthly utility bills, and increase the health and safety of their homes. Energy efficiency is our nation's cleanest, most cost-effective energy resource, and energy efficiency incentives should be included in the tax code in a way that provides parity with other energy sources.

The Home Performance Coalition (HPC) is a national non-profit 501c3 organization that works with industry leaders in the home performance and weatherization industries to advance energy-efficient, healthy and safe homes retrofit policies, programs and standards through research, education, training and outreach.

E4TheFuture is non-profit 501c3 organization which collaborates with industry stakeholders to provide expert policy solutions, education, and advocacy to advance residential clean energy and energy efficiency solutions on the federal, state and local level.

Efficiency First (EF) is a national trade association with members across the country that unites the home performance workforce, building product manufacturers and related businesses and organizations in an effort to advance cost-effective energy efficiency solutions for residential customers to create jobs, boost the economy, and fight rising energy costs.

The Building Performance Institute (BPI) is the nation's premier building performance credentialing, quality assurance, and standards setting organization. Approved by the American

National Standards Institute, Inc. (ANSI) as an accredited developer of American National Standards and as a certifying body for personnel credentials, BPI develops technical standards and professional certifications that help raise the bar in home performance contracting.

As you know, America's homes and offices consume about 75% of all the national electricity and represent 40% of its total energy demand, thereby resulting in a significant impact on America's economy. The average homeowner spends approximately \$2,300 a year on energy bills, and a comprehensive whole-house energy efficiency upgrade will likely reduce this cost 20-25%.¹ To achieve these savings, however, the homeowner must pay for the upgrade measures (HVAC, insulation and air sealing, etc.) upfront. While most efficiency improvements more than pay for themselves over their lifetimes, these upfront costs remain a significant barrier for many homeowners. Tax incentives for residential energy efficiency projects help reduce the barrier of upfront costs, thereby allowing more Americans to enjoy the benefits of energy efficiency.

Previous tax reform proposals have focused primarily on energy production, largely ignoring the key role of energy efficiency – America's greatest energy resource. Only one tax provision provides an energy efficiency incentive for America's homeowners, 25C. While this legislation should be updated and improved, the very modest tax incentive has motivated many homeowners to do more to save energy. Furthermore, the high-efficiency products that qualify for the tax incentive, are largely made in America – spurring local job growth in manufacturing as well as installations. Businesses, investors, and consumers need stable, predictable federal tax policy to create jobs, invest capital, and deploy energy efficiency technologies. Energy efficiency tax incentives will help ensure that the United States does more with less (energy) to the betterment of our economy, national security, and environment. It should be noted that utilities also benefit greatly when energy efficiency is recognized as a resource – energy efficiency reduces utility costs over time (through avoided costs of generating capacity and ancillary services, avoided or deferred construction of additional transmission and distribution assets, etc.), which translates into reduced rates for customers.

Incentivizing energy performance also avoids “picking winners and losers” among resources. We support S. 1068, the “Clean Energy for America Act,” in that it provides an extension and update of the 25C tax code and also amends the provision to become performance based over time, allowing for both innovation and the acceleration of whole-house performance-based

¹ https://www.energystar.gov/index.cfm?c=home_improvement.hpwes_for_homeowners and <http://aceee.org/factsheet/homeefficiency-retrofit-program-feb-2009>.

retrofits. While we would like to see modest changes to this bill, we see this legislation as setting an excellent framework for tax reform.

Energy efficiency is more than just a way to reduce energy waste and save consumers and businesses money on their monthly utility bills - it is by far the largest sector in the U.S. clean economy. A recent report from E4TheFuture, entitled “Energy Efficiency Jobs in America,”² found that three out of every four clean energy jobs is an energy efficiency job, and as of 2015 the energy efficiency industry employed 1.9 million Americans. The report also found that most energy efficiency jobs are created by small businesses: of the 165,000 U.S. companies engaged in energy efficiency, 70% of them have 10 or fewer employees.

A significant portion of the energy efficiency jobs in the U.S. are in the residential sector, and forty percent of those jobs involve the installation of energy efficiency products. These are the contractors – the “boots on the ground” - installing energy efficiency products and technologies and working to reduce energy waste in homes and buildings across the country. These jobs are, by their very nature, inherently local and cannot be exported.

In addition to economic and jobs benefits, residential energy efficiency also plays a key role in public health. A U.S. Department of Energy report on the Weatherization Assistance Program³ found that home improvements focused on energy efficiency can improve indoor air quality, which reduces respiratory illness and sick days, and boosts mental alertness and productivity for both children and adults. A recent report from E4TheFuture, entitled “Occupant Health Benefits of Residential Energy Efficiency,”⁴ which reviews existing research on the link between resident health benefits and energy efficiency upgrades, also found that residential energy efficiency upgrades can produce significant improvements in asthma symptoms and help improve overall physical and mental health.

Given the importance of energy efficiency to job creation, health and safety, and energy security, it is vital that incentives to encourage and facilitate energy efficiency improvements in homes and buildings be included in the tax code. Specifically, we recommend that a system of “good”, “better” and “best” incentives be adopted for energy-saving retrofits for existing homes and commercial buildings. The incentives should be based on energy savings achieved

² https://e4thefuture.org/wp-content/uploads/2016/12/EnergyEfficiencyJobsInAmerica_FINAL.pdf

³ <https://energy.gov/eere/wipo/downloads/weatherization-assistance-program-national-evaluation>

⁴ <https://e4thefuture.org/occupant-health-benefits-of-residential-energy-efficiency/>

(performance-based), be technology neutral (any way to save energy counts) and phase out when specific market milestones are reached.

The Home Performance Coalition, E4TheFuture, Efficiency First, and the Building Performance Institute believe that energy efficiency is vital to our economic growth and international competitiveness. Energy efficiency improvements pay for themselves many times over and improve energy security, help Americans save money, and create more comfortable and safe homes and buildings. We strongly urge members of the committee to support energy efficiency incentives and include them in the tax code in a way that provides for parity with other energy sources. Thank you for providing this opportunity to submit testimony. We look forward to working with you.

Contact Information

Kara Saul Rinaldi
President and CEO, AnnDyl Policy Group
On behalf of HPC, E4TheFuture, Efficiency First, and BPI
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kara@anndyl.com



INDEPENDENT COMMUNITY
BANKERS of AMERICA®

May 18, 2017

Community Bank Principles for Tax Reform

On behalf of the more than 5,800 community banks represented by ICBA, we thank Chairman Brady, Ranking Member Neal, and members of the Ways and Means Committee for convening today's hearing on "How Tax Reform Will Grow Our Economy and Create Jobs." Tax reform is a critical and ambitious policy challenge. Done properly, it will strengthen our economy and spur job creation for a generation or more. We are strongly encouraged by the increasing momentum for change and are pleased to offer this statement for the record which describes community bank priorities in any tax reform legislation.

Lower Marginal Rates Needed for Individuals, Corporations, and Businesses

ICBA strongly supports tax rate relief for American individuals, corporations, and businesses. Significant tax relief will provide a much-needed boost to a sluggish economic recovery and possibly help stave off another recession by spurring consumer purchasing, business investment, and hiring. Rate relief must be a part of any tax reform package.

Preservation of the Business Interest Deduction is Vital

ICBA strongly opposes any limitation on the deduction for interest paid by business borrowers. Community banks have long enjoyed a strong partnership with America's small businesses and provide approximately half of all small business loans. Community bank credit is a critical – and frequently the only viable – source of capital for small businesses, which typically have very limited or no access to equity capital, especially in the early stages of their development. Moreover, community bank credit allows small business owners to invest and grow their businesses without diluting their control. Many small businesses are closely held to retain control over strategic decision making and direction. Outside equity capital would change the essential character of these businesses.

Eliminating the deduction for net interest expense amounts to double taxation of interest. Interest would be paid from taxable income and taxed a second time as income to the recipient. This would make community bank credit significantly more expensive and thus less available to thousands of small businesses.

The taxation of interest on business borrowing would represent a dramatic change in longstanding U.S. tax policy, the consequences of which are unknown. Community bankers across the country are seriously concerned with the practical, real world implications. In addition to impact on borrowers, the proposal also represents a threat to the ongoing viability of thousands of community banks that specialize in small business lending, having been priced out of consumer lending by tax-subsidized credit unions and lacking the scale to lend to larger businesses.

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Parity in the Taxation of Different Entity Forms

Over 2,000 community banks, approximately one third of the total, are organized under Subchapter S of the tax code. Under current law, the pass-through income of Subchapter S banks is taxed at the top individual rate of 43.4 percent including Obamacare taxes, while corporate income is taxed at a top rate of 35 percent. ICBA has long held the view that rate parity, which would ensure that one business form is not disadvantaged relative to another, should be an important goal of tax policy. ICBA strongly supports the Main Street Fairness Act (H.R. 116), introduced by Rep. Vern Buchanan, which would create rate parity and ensure that it is preserved under any future rate changes.

Strengthen the Subchapter S Business Model

Any reforms to the tax code should not only preserve the Subchapter S model but strengthen it as well. In particular, Subchapter S banks need new options to satisfy higher demands for capital from their regulators. ICBA-supported bills include the Capital Access for Small Business Banks Act (H.R. 2339), introduced by Rep. Kenny Marchant, which would raise the shareholder limit for Subchapter S banks from 100 to 500 and allow Subchapter S banks to issue preferred shares.

The S Corporation Modernization Act (H.R. 1696), introduced by Reps. Dave Reichert and Ron Kind, and its Senate counterpart, S. 711, introduced by Senators John Thune and Ben Cardin, would, among other provisions, allow Individual Retirement Accounts (IRAs) to invest in S corporation shares. A version of S. 711 was amended to the Retirement Enhancement and Savings Act of 2016, which passed the Finance Committee in September 2016 by a vote of 26 to 0.

The legislation noted above would allow Subchapter S banks to meet regulators' persistent demands for higher capital levels. ICBA urges their inclusion in any tax reform legislation.

Expand Access to Credit with Tax Incentives for Targeted Community Bank Lending

Carefully designed tax incentives for community bank lending would lower credit costs for targeted borrowers and help community banks diversify their loan portfolios and comply with the Community Reinvestment Act. For example, ICBA strongly supports the Enhancing Credit Opportunities in Rural America Act of 2016 (H.R. 2205), introduced by Rep. Lynn Jenkins, which would provide that interest earned on loans secured by agricultural real estate is tax exempt. This exemption would also apply to interest earned on a mortgage secured by a single-family home that is the principal residence of the borrower, provided the home is located in a rural area with a population of 2,500 or less. ICBA believes that a similar tax incentive should be extended to other types of community bank lending, including loans to low-to-middle income individuals and small businesses.

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Parity in Taxation of Financial Services Providers

Many of today's tax-exempt credit unions and Farm Credit System (FCS) lenders are multi-billion dollar entities competing against much smaller, taxpaying community banks. There are over 250 credit unions with assets over \$1 billion. The largest holds approximately \$75 billion in assets. The largest FCS lender is \$91 billion, and collectively the FCS holds nearly one quarter trillion-dollars in assets and, as a government sponsored enterprise (GSE), enjoys massive tax and funding subsidies.

The National Credit Union Administration's new, highly permissive (and, we believe, illegal) rules will allow credit unions to further expand into commercial lending and effectively remove any meaningful limit on their field of membership. These new rules will further blur the distinction between credit unions and community banks, as would proposals to allow credit unions to raise supplemental capital and thereby cease being member-owned entities. Many community banks that serve urban and suburban areas have already been squeezed out of consumer lending by tax-subsidized credit unions. Now, community bank commercial lending is also under threat. FCS lenders pose a similar threat to agricultural community banks.

The problem gets worse every year as credit unions and FCS lenders continue to leverage their tax exemption to expand. What's more, since 2012 11 banks have been purchased by credit unions. With more deals reportedly in the works, this alarming trend should be addressed before it strengthens and becomes a real threat to the tax base. Tax reform presents a once-in-a-generation opportunity to correct a historic injustice in the taxation of financial services providers. Credit unions and FCS lenders are becoming the equivalent of banks and should be taxed equivalently.

Repeal Estate Tax

ICBA supports full, permanent repeal of the estate tax as a threat to the intergenerational transfer of many community banks and small businesses served by community banks.

Many community banks have been held and operated within families for as many as four generations. This close family and cross-generational association is critical to the identity, the business model, and the competitive advantage of community banks in an evolving financial system in which it is becoming more challenging for them to preserve their independence.

The estate tax jeopardizes the succession of community banks from generation to generation. A family estate should never be forced to sell its interest in a community bank to pay a transfer tax. Forced sales of once family-owned community banks to other community banks or, frequently, to larger regional or national banks, coupled with a recent surge in regulatory burden, accelerate the current trend toward consolidation in the banking sector. Consolidation reduces competition and results in fewer product offerings, lower rates on deposits, higher rates on loans and higher fees.

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The loss of widely-used discounts for minority interests in a business and for lack of marketability would only increase estate tax liability and exacerbate consolidation. In this regard, ICBA urges the Treasury Department to withdraw its proposed regulations under Section 2704 of the tax code, which would effectively end the use of such discounts.¹ Notwithstanding the status of these proposed regulations, ICBA's preferred solution is full repeal of the estate tax. We urge you to use tax reform to accomplish this long held goal.

Preserve Exemption for Municipal Bond Interest

Community banks are proud to support their communities by investing in state and local government debt. In this regard, ICBA urges you to preserve the current law tax exemption for interest earned on municipal debt. The loss of curtailment of this important exemption would depress municipal bond pricing for all investors, raise borrowing costs for state and local governments, and reduce resources for vital public services and infrastructure.

Opposition to New Commercial Bank Taxes

ICBA has consistently opposed new taxes or fees specifically targeting the commercial banking sector or their customers. In our view, tax policy should be neutral and not target a specific industry sector. Sector-specific taxes distort the market and generate counterproductive outcomes. Even when such taxes exempt community banks, they set a troubling precedent: Once the tax code is opened up to target a specific sector it is difficult to contain the size, scope, and broader application of the tax.

Closing

Thank you again for convening this hearing and for your commitment to growth-oriented tax reform. ICBA looks forward to continuing to work with the committee as tax reform advances.

¹ See ICBA's comment letter at <http://www.icba.org/docs/default-source/public/letters-to-regulators/2016/cl110216.pdf?sfvrsn=0>.

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May 25, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
1106 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

The Industrial Minerals Association – North America (IMA-NA) applauds Congress for its recognition that the current tax system in the United States is in need of serious changes. However, as you are looking at how tax reform can grow our country's economy and create jobs, IMA-NA cautions the Committee against eliminating the percentage depletion deduction. The percentage depletion deduction is not a credit; it is not a subsidy; and, it is not a handout. This deduction is a form of depreciation that makes the development and production of industrial minerals economical. Without this provision in the tax code, it is likely that the domestic production of industrial minerals would decline substantially.

IMA-NA represents the industrial minerals industry in North America. Industrial minerals are the raw material feedstock for the manufacturing sector. Without industrial minerals, production of homes, cars, glass, electronics, ceramics, and virtually any other product would not be possible. Industrial minerals are found throughout the United States. According to the United States Geological Survey (USGS), in 2016 the industrial minerals sector of the mining industry provided over 150,000 direct jobs and produced minerals valued at \$51.6 billion. The data from the USGS also shows that our country is relying on foreign sources for an increasing share of these minerals. Industrial minerals are low margin products that require significant financial commitments to long-term projects where the resource itself is depleted over time.

The percentage depletion deduction is essential to our member companies and their business models. It allows companies to invest in land they need for future mineral reserves in order to keep their businesses sustainable. The percentage depletion deduction also is reinvested in the form of capital expenditures or other growth-oriented investments. Most importantly, the deduction allows companies to hire and retain more employees each year than they otherwise would be able.

The USGS keeps track of the nation's mineral dependency. Over the years, the level of dependency on foreign nations for minerals vital to the manufacturing sector has risen dramatically. The United States is largely reliant on nations such as China and Russia for these essential raw materials for manufacturing. Without the percentage depletion deduction in our country's tax code, we will only see our reliance on foreign nations for minerals increase as it become uneconomical for our members to do business. This will lead to job losses and hurt not just our industry, but the manufacturing sector as well.

Without the percentage depletion deduction in place, we would likely see manufacturers in the United States become even more dependent on foreign sources of minerals, and potentially locate their facilities closer to those mineral sources rather than in the United States to save on the high transportation costs. Merely reducing the corporate tax rate or allowing for expensing would do little to offset the loss of eliminating the percentage depletion deduction for our member companies. Maintaining a strong natural resources production sector and limiting our dependence on foreign production is critical to the growth of the U.S. economy and growing jobs. Eliminating the deduction ultimately would result in increased raw materials costs for manufacturers, increased product costs for consumers, and a loss of American jobs in all sectors of our economy.

Thank you for allowing us to comment on your tax reform efforts and its possible effects on our industry. The IMA-NA looks forward to working with you and the Committee throughout this process.

Sincerely,

A handwritten signature in black ink that reads "Mark G. Ellis". The signature is written in a cursive, flowing style.

Mark G. Ellis
President



INSURED RETIREMENT INSTITUTE

IRI SUPPORTS PRO-GROWTH TAX REFORM THAT PROTECTS & ENHANCES RETIREMENT SAVINGS

With 10,000 Americans retiring every day until 2030, increased longevity, escalating post-retirement health and long-term care costs, retirement security could become a national crisis if we don't take it seriously enough and protect and build on what's working. The approach outlined below will advance tax reform goals and help Americans achieve the secure, dignified retirement they deserve.

I. TAX REFORM SHOULD PROTECT AND PRESERVE CURRENT TAX-DEFERRED RETIREMENT SAVINGS INCENTIVES AND DIVERSE TYPES AND STRUCTURES OF RETIREMENT PLANS

Key role in providing for retirement needs

- 75 to 85 percent of Baby Boomers, Gen-Xers, individual annuity owners and households with defined contribution plans say current incentives are important to their retirement savings.
- 685,000 private-sector retirement plans cover 89.9 million participants and provide \$650 billion in annual benefits according to the latest Department of Labor data (September 2016).
- 75 million American families rely on annuities and other life insurers' products for peace of mind, long-term savings, and guarantee of lifetime income and receive annual benefits of \$179.6 billion.

Important role in job-creation and economic growth

- The insurance industry, annuities and other insurers' products generate 2.5 million U.S. jobs, invest \$5.9 trillion (90 percent of industry assets) in our economy and hold 20 percent of all U.S. corporate bonds.
- Annuities, employer-provided retirement plans and IRAs currently (September 2016) produce \$25 trillion of retirement assets and account for 34 percent of all U.S. household assets.
- 71 percent of U.S. pension assets are invested in equities and bonds, predominantly from the U.S.

Keeping 401(k), 403(b) and 457(b) plans is important - consolidation is harmful, but simplification is helpful

- It is important to retain 401(k), 403(b) and 457(b) defined contribution plans to meet particular needs of employees in private, church, governmental, educational and nonprofit sectors. Diversity, choice and flexible plan design help maximize savings. Employee confusion is not a problem. Each employee simply decides whether to participate in the defined contribution plan his or her employer offers.
- Consolidation (e.g., having just 401(k) plans) is harmful because it takes away important benefits from many employees and increases complexity and costs. 403(b) and 457(b) plans cover many nonprofit employees, teachers, police, fire and safety workers and can provide helpful features; e.g.,: 1) Lack of early withdrawal penalty tax; 2) Favorable catch-up provisions; and 3) Tailored compensation standards and nondiscrimination rules.
- Simplification is helpful because it either broadens the application of helpful provisions or makes positive changes for all types of plans. Examples include: 1) Conform harsher plan withdraw rules of 457(b) plans to those that now apply to 401(k) and 403(b) plans; and 2) Coordinate, streamline and allow for electronic delivery of overlapping, sometimes confusing participant notices.

Expanding the role of Roth accounts is harmful

- Retirement security is too important to risk as a short-term expedient to pay for unrelated tax cuts – a reason some cite for considering a greater role for Roth accounts. Roth accounts likely do not increase long-term revenue due to tax-exempt withdrawals. Deferred taxes from annuities, employer plans and IRAs increase revenue as a share of GDP between 2016 and 2046 according to a 2016 Congressional Budget Office report.
- Greater role of Roth could decrease retirement savings significantly. 75 to 85 percent of key groups say tax-deferred incentives for annuities, employer plans and IRAs are important to their retirement savings. These incentives come when people need them most – during their working lives when income, taxes and expenses are highest. The economic values of distant Roth benefits from conditional tax-exempt distributions are difficult to discern and require a great deal of speculation about what effective tax rate individual taxpayers will face, often decades into the future.
- Roth will not motivate the broad base of retirement savers as well as current incentives. While Roth has appeal to some segments, for most, when required to forego current consumption and conveniences, Roth's distant, speculative future benefits will not motivate retirement saving nearly as well as the immediate, clear benefits of current tax-deferred saving incentives. Roth IRAs have been available for almost 20 years, but Roth IRAs hold less than 10 percent of the total of all IRA assets. In addition, 54.8 percent of 401(k) plans offer Roth, but only 20.1 percent of contributing participants of those plans make any Roth contributions.
- Other developments could magnify risks. If pre-tax incentives play a greater future role in health care – as some have proposed – and there is an increased role of Roth accounts, the combined impact could greatly lessen retirement savings when the need is growing dramatically.

II. TAX REFORM SHOULD BUILD ON WHAT IS WORKING BY ENACTING RETIREMENT SECURITY ENHANCEMENTS WITH BI-PARTISAN SUPPORT AND MODEST REVENUE COST

The first four of these common sense enhancements were approved by Senate Finance Committee on September 21, 2016 on a bipartisan 26-0 vote as part of the *Retirement Enhancement Savings Act of 2016*.

- **Multiple Employer Plans:** Remove regulatory barriers that currently prevent many small and start-up businesses from offering retirement plans and encouraging them to offer lifetime income options in these plans.
- **Annuity Selection Rules:** Clarify employer fiduciary responsibility to enable businesses to offer lifetime income options in retirement plans without fear of legal liability.
- **Annuity Portability:** Enable portability with a technical fix to prevent employees who invest in lifetime income options through an employer plan from losing these benefits if the employer changes record-keepers or annuity providers.
- **Lifetime Income Estimates:** Require lifetime income estimates on workers' benefit statements to encourage workers to save appropriately by showing the amount of monthly income their nest egg will generate in retirement.
- **Automatic Enrollment:** Broaden coverage by encouraging employers to auto-enroll workers who lack access to employer-provided plans into IRAs, auto-IRAs or other plans with employer tax credits to defray set-up costs.
- **Default Savings Rates:** Enhance retirement security by increasing the default savings rate of participants who are automatically enrolled from three to six percent and the limit on participants' auto-escalation savings rate to 15 percent.



INSURED RETIREMENT INSTITUTE

IRI INPUT ON TAX REFORM ON PERTINENT INSURER ISSUES

IRI member companies, annuities, employer-provided plans and IRAs make key contributions to retirement security and the economy

- IRI member companies include major insurers, asset managers, and broker-dealers/distributors that account for 95 percent of annuity assets in the United States, with more than 150,000 financial professionals serving over 22.5 million households in communities across the country.
- Annuities, employer-provided retirement plans and IRAs currently (September 2016) produce \$25 trillion of retirement assets and account for 34 percent of all U.S. household assets. 71 percent of U.S. pension assets are invested in equities and bonds, predominantly from the U.S.
- The insurance industry, annuities and other insurers' products generate 2.5 million U.S. jobs, invest \$5.9 trillion (90 percent of industry assets) in our economy and hold 20 percent of all U.S. corporate bonds. 75 million American families rely on annuities and other life insurers' products for peace of mind, long-term savings, and guarantee of lifetime income and receive annual benefits of \$179.6 billion.

Fair, equitable taxes on insurers help minimize price and maximize benefits for annuities and other products

- It is important that tax provisions be applied on a fair and consistent basis to insurance companies as compared to other entities in order to facilitate the ability of insurers to minimize the costs and maximize the benefits of annuities and other important retirement security products. We urge that 2017 tax reform continue avoid tax reform provisions proposed in 2014, which would have unfairly increased net taxes on the life insurance industry by 26 percent (e.g., reduced deductions for reserves, dividends received, deferred acquisition costs) compared to a one percent proposed net tax increase for all other industries.

IRI input on Blueprint company tax proposals (expensing of capital expenditures and net interest rules) and support for repeal of harmful consolidated return restrictions

- The 2016 House Republican Tax Reform Task Force Blueprint (Blueprint) set forth business tax proposals allowing immediate deductions for capital expenses and restricting net interest deductions.
- It is consistent with the Blueprint's concept of allowing immediate deductions for capital expenses to eliminate the current rules requiring insurers to capitalize and amortize so-called deferred acquisition costs, or "DAC", for commission payments over a period of 10 years. Other types of entities typically can deduct such expenses in the year they are paid.
- We urge the Blueprint's proposed net interest expense limitation be applied similarly to life insurance company affiliated groups and non-insurance affiliated groups. This can be accomplished by considering the interest expense and interest income of all affiliated members despite current consolidated return restrictions imposed only on insurer-affiliated groups (see below).
- Current law on consolidated returns adversely restricts life insurance company group members from joining a consolidated group that includes non-life insurance companies. In practice, the rules also complicate and negatively impact how insurers conduct activities such as mergers, acquisitions and raising capital. We support repealing restrictions on life insurance company affiliated groups, putting them on equal footing with non-insurance groups.

23 May 2017

May 18th Hearing on How Tax Reform Will Grow Our Economy and Create Jobs

From: James DiCampli
5327 Fayette Street
Houston, Texas 77056
Ph: 713 870 - 7182

Subject: Public Submission for the Record

Representing: Self (not written or appearing for any persons and/or organizations).

Key tenets of tax reform should fundamentally include a significant corporate-tax-rate cut, immediate expensing for new equipment, and the repatriation of offshore cash.

In recent articles (Houston Business Journal and self-published on [LinkedIn](#)), I observed that sub-par economic growth and wage stagnation is largely due to low business investment and productivity, in part, because the U.S. corporate tax structure impedes business revenue and earnings growth. We need to revise the tax code and fiscal policies that enhance U.S. competitiveness and enables higher economic growth.

Subsequently, during the House Ways and Means Committee hearings last week, there seemed to be bi-partisan support for tax reform. Taxes consume corporate profits that could go to capital reinvestment, job training, wage growth, or

shareholder dividends. But a key sticking point is how to maintain a deficit-neutral revenue balance if the corporate tax rate is reduced. The debate on Capitol Hill currently revolves around the border adjustment tax. Let me provide some context.

The political aim of tax reform is to lower the rate and broaden the base, and thereby enable growth while not adding to the national debt. Lower rates mean less revenue for the Treasury. Eliminating tax breaks (deductions) would offset lost revenue. Striking the balance is the challenge, which is difficult pending specific deductions tied to a business segment. Capital depreciation and the R&D credit are two examples favored by manufacturing entities.

Another way to make up revenue is a border adjustment tax, the focus of the current debate. With a border adjustment, the U.S. would tax imports (or disallow tax deductions), similar to value added taxes or border adjustment schemes used by most other countries. Examples were cited during the hearings. The European Union imposes a value added tax (VAT) that runs 17% – 27% of the price of a good or service consumed in the EU. Goods which are sold for export or services which are sold to customers abroad are not subject to VAT. This generates revenue for the EU and provides a cost advantage over imports. So why not adopt a VAT in the U.S. and join the ~160 countries that impose a similar tax? The border adjustment is generally opposed by those businesses that rely on imports, for example, retailers who sell imported electronics, clothes, etc. Such a tax could disproportionately impact lower income households by driving up the costs of everyday goods. Easing-in such a tax over a period would lessen the impact, and international exchange rates would likely adjust - a stronger dollar would lower the cost of imports. Still, the concept has detractors in the House.

If the border adjustment is not palatable, there remains the mathematical option. Enable growth, business profits rise, and increased tax revenue follows. Treasury Secretary Steven Mnuchin told the Senate Banking Committee his belief that tax reform will lead to an estimated a 3 percent growth rate by 2021. The difference between less-than 2 percent growth and 3 percent growth is well over \$3 trillion in additional revenue per the CBO. Achievable? Yes. Over the last 70 years, government statistics show GDP Growth Rate in the United States averaged 3.21 percent. The last ten years have seen an average 1.3 percent. Excluding the economic downturn of 2008-2009 (negative GDP), growth still only achieved 2.2 percent. We need to get back to consistent >3% growth rates.

The current tax code encourages the import of foreign-made goods while penalizing products made in and exported from America. It also encourages companies to keep foreign profits overseas instead of investing those earnings in their U.S. facilities. Washington must fix this. We need a tax system that supports American workers and encourages businesses to invest in the U.S. I am optimistic both sides of the aisle can come to a consensus on striking the balance and enable pro-growth tax policies. This should fundamentally include a significant corporate-tax-rate cut, immediate expensing for new equipment, and the repatriation of offshore cash.

Signed

James DiCampli



**Statement of Kristine Lucius, Executive Vice President
The Leadership Conference on Civil and Human Rights**

Hearing on “How Tax Reform Will Grow Our Economy and Create Jobs”

**Committee on Ways and Means
United States House of Representatives
May 18, 2017**

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Policy and Enforcement
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Michael Lieberman
Anti-Defamation League
President & CEO
Vanita Gupta

Chairman Brady, Ranking Member Neal, and members of the Committee: thank you for holding a hearing on “How Tax Reform Will Grow Our Economy and Create Jobs.” On behalf of The Leadership Conference on Civil and Human Rights, I am pleased to provide this written statement for inclusion in the record.

The Leadership Conference on Civil and Human Rights is the nation's oldest and most diverse coalition of civil and human rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, The Leadership Conference seeks to further the goal of equality under law through legislative advocacy and public education. The Leadership Conference provides a powerful unified voice for the various constituencies of the coalition and is charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States. Through advocacy and outreach to targeted constituencies, The Leadership Conference works toward the goals of a more open and just society - an America that is as good as its ideals.

Invoking the words of Dr. Martin Luther King, Jr., civil rights hero and icon Representative John Lewis powerfully reminded us during the hearing that “[w]e may have all come on different ships, but we’re in the same boat now.” The Leadership Conference shares the belief that our economy and tax system must work for all of us, not just the wealthy few, as we work together to ensure economic security for all Americans. Fairness can and should animate the structure and incentives created within our tax system as Congress undertakes tax reform.

The Leadership Conference has long believed that civil and human rights are inextricably linked to economic security. From the passage of the Universal Declaration of Human Rights in 1948 to the March on Washington for Jobs and Freedom in 1963, the economic security of all Americans has long been a priority of the civil and human rights community.

Today our nation faces troubling income inequality and a staggering racial wealth gap. We believe that any kind of changes to the tax system must help close those gaps, not exacerbate them. According to the Economic Policy Institute, the “[a]verage wealth for White families is seven times higher than average wealth for Black families. Worse still, median White



wealth (wealth for the family in the exact middle of the overall distribution—wealthier than half of all families and less-wealthy than half) is *12 times* higher than median Black wealth.”¹ And in 2013, the Federal Reserve’s Survey of Consumer Finances found that the median White family possessed 10 times the wealth of the median Latino family.² In order to truly be tax *reform*, and not simply a tax giveaway to those already well off, tax legislation at its core must be fair and not regressive, helping to lift up working people and families of every race, color, and creed across our nation.

Much of the focus on tax reform and of this hearing has centered around cutting the corporate tax rate. Many seem to believe that the corporate tax rate of 35 percent is too high, and that it stifles investment. This is a centerpiece of the Trump Administration’s approach to taxes. The truth however is that most companies pay far less than the 35 percent statutory rate because of a myriad of tax loopholes. The U.S. Treasury Department has found that the average effective tax rate for corporations is in fact 23 percent.³ Moreover, today corporate taxes are the source of only \$1 out of \$9 of federal revenue. According to Americans For Tax Fairness, 65 years ago \$1 out of every \$3 in federal revenue came from corporate taxes.⁴

The one-page tax plan the Trump Administration released on April 26 was light on details, but a few things were clear. In addition to slashing the corporate tax rate, the tax plan would reduce the number of individual income tax brackets to three, likely reducing federal revenue. It also proposes eliminating the estate tax and the alternative minimum tax, both of which predominantly aid only the wealthy. After the presidential election, now-Treasury Secretary Steven Mnuchin asserted that “there would be no absolute tax cut for the upper class.”⁵ We will hold both the Trump Administration and Congress to this promise.

Why is a civil and human rights coalition concerned about tax reform? Because we are deeply concerned in the ability of the federal government to be able to invest in our people and communities. When policymakers starve the federal government of tax revenue, we are unable to make critical investments in education, affordable housing, healthcare, and infrastructure in underserved communities throughout our nation. And when policymakers starve the federal government of tax revenues in ways that further benefit millionaires, billionaires, and wealthy corporations at the expense of working families, our nation suffers and income inequality worsens.

¹ Jones, Janelle, “The racial wealth gap: How African-Americans have been shortchanged out of the materials to build wealth.” *Economic Policy Institute blog*. Feb. 13, 2017. <http://www.epi.org/blog/the-racial-wealth-gap-how-african-americans-have-been-shortchanged-out-of-the-materials-to-build-wealth/>

² Florido, Adrian. “Black, Latino Two-Parent Families Have Half The Wealth Of White Single Parents.” *Code Switch blog*. Feb. 8, 2017. <http://www.npr.org/sections/codeswitch/2017/02/08/514105689/black-latino-two-parent-families-have-half-the-wealth-of-white-single-parents>

³ Faler, Brian. “Why corporate tax reform is so messy.” *Politico.com*. May 31, 2017. <https://www.politico.com/tax/story/2017/05/tax-reform-messy-157465>

⁴ “The Six Worst Features of Donald Trump’s Tax Plan.” *Americans For Tax Fairness*. Nov. 28, 2016. <https://americansfortaxfairness.org/the-six-worst-features-of-donald-trumps-tax-plan/>

⁵ Cohen, Patricia, “Treasury Nominee Vows No Tax Cut for Rich. Math Says the Opposite.” *New York Times*. Feb. 9, 2017. <https://www.nytimes.com/2017/02/09/business/economy/mnuchin-rule-tax-cut.html>



This is not simply unjust and immoral, it also does not make economic sense. Those who say that private investment in the United States is lower than it should be often turn to cutting tax rates as the key to spurring investment. However, they fail to take into account the larger picture in their analysis. Private investment in our nation is low in part because consumer demand is low. Over the last several decades, wages have stagnated. For low income people, things have been particularly hard. The federal minimum wage has for the last 10 years remained at \$7.25 an hour. Today, one in every three jobholders—41.7 million people—earns under \$12 per hour, which is just above the poverty line for a family of four.⁶ Working people must be paid fairly for the work that they do. And when they are paid fairly, these same hardworking Americans will have increased purchasing power, stimulating investment.

Tax “reforms” that lead to disinvestment in our communities or that are not coupled with other growth inducing policies like raising the minimum wage are destined to fall short in stimulating economic growth.

When the least among us succeed, those who have the most among us succeed. This basic principle should animate the Committee on Ways and Means as you deliberate on changes to tax policy in our nation.

Thank you for the opportunity to submit this statement for the record.

⁶ Economic Policy Institute and Oxfam America. "Few Rewards: An Agenda to Give America's Working Poor a Raise." Washington DC and Boston MA. 2016.
<https://www.oxfamamerica.org/explore/research-publications/few-rewards/>

May 17, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing On How Tax Reform Will Grow Our Economy And Create Jobs

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

I am submitting this letter ahead of the House Ways and Means Committee's scheduled hearing on May 18th entitled "How Tax Reform Will Grow Our Economy and Create Jobs." I commend the work your committee is doing in exploring different ways in which pro-growth tax reform can be achieved and help further strengthen the American economy. As the committee considers myriad proposals and ideas for reforming the tax code, I want to stress the importance of preserving the full deductibility of interest on debt.

When it comes to reforming America's tax code, my motivation to preserve interest deductibility to promote growth and enhance my contribution to the economy is rooted in my first-hand experience of running the daily operations of Leading Pointe Strategies, LLC. While there is certainly an important role for policymakers and policy thinkers in reforming the tax code, I also firmly believe that input from businesses is essential to setting the record straight on the practical implications of certain tax proposals. My support for maintaining full interest deductibility comes from the knowledge I have of how the tax code affects my ability to grow my business, create new jobs, and strengthen the local economy. Most businesses use debt in one way or another to grow and create new opportunity. My business takes comfort in the predictability of the deduction and the elimination of this deduction would make me less likely to take the risk of using debt to grow my business in the future.

Interest deductibility is a well-established, growth-promoting provision of the tax code that has been in existence for more than 100 years. Interest expense is a normal cost of doing business; and, for me, it provides a peace of mind as well as a sense of stability and predictability when business owners are guaranteed they will not be taxed on the cost of accessing capital and can have more flexibility when making important long-term financial decisions.

Companies like mine borrow in order finance expansions, purchase equipment, and meet other key obligations. Having the ability to deduct interest on such expenses gives me the certainty I need to make these decisions with confidence. It also allows my company to weather any shifts in demand.

In my view, maintaining full interest deductibility is essential for achieving the stated top priority of tax reform: allowing the U.S. economy to reach its full growth potential. As a business owner who has experienced first-hand what works and doesn't work in the tax code, I can tell you that full interest deductibility works.



Tom Willis
President
Leading Pointe Strategies, LLC

May 31, 2017

The Honorable Kevin Brady
Chairman
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
House Ways and Means Committee
1139E Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Brady and Ranking Member Neal:

In connection with the House Ways and Means Committee's recent hearing on *How Tax Reform Will Grow Our Economy and Create Jobs*, we are submitting as a statement for the record the attached letter urging you to preserve the current availability of like-kind exchange treatment as part of any business tax reform. Thank you for your consideration and your leadership on these important issues.

Sincerely,

The Like-Kind Exchange Stakeholder Coalition

THE LIKE-KIND EXCHANGE STAKEHOLDER COALITION

November 29, 2016

Mr. Jim Carter
Tax Policy Lead
Presidential Transition
1800 F Street NW
Washington, DC 20006

Dear Mr. Carter:

As you consider ways to create jobs, grow the economy, and raise wages through tax reform, we strongly urge that current law be retained regarding like-kind exchanges under section 1031 of the Internal Revenue Code (“Code”). We further encourage retention of the current unlimited amount of gain deferral.

Like-kind exchanges are integral to the efficient operation and ongoing vitality of thousands of American businesses, which in turn strengthen the U.S. economy and create jobs. Like-kind exchanges allow taxpayers to exchange their property for more productive like-kind property, to diversify or consolidate holdings, and to transition to meet changing business needs. Specifically, section 1031 provides that taxpayers do not immediately recognize a gain or loss when they exchange assets for “like-kind” property that will be used in their trade or business. They do immediately recognize gain, however, to the extent that cash or other “boot” is received. Importantly, like-kind exchanges are similar to other non-recognition and tax deferral provisions in the Code because they result in no change to the economic position of the taxpayer.

Since 1921, like-kind exchanges have encouraged capital investment in the U.S. by allowing funds to be reinvested back into the enterprise, which is the very reason section 1031 was enacted in the first place. This continuity of investment not only benefits the companies making the like-kind exchanges, but also suppliers, manufacturers, and others facilitating them. Like-kind exchanges ensure both the best use of real estate and a new and used personal property market that significantly benefits start-ups and small businesses. Eliminating like-kind exchanges or restricting their use would have a contraction effect on our economy by increasing the cost of capital, slowing the rate of investment, increasing asset holding periods and reducing transactional activity.

A 2015 macroeconomic analysis by Ernst & Young found that either repeal or limitation of like-kind exchanges could lead to a decline in U.S. GDP of up to \$13.1 billion annually.¹ The Ernst & Young study quantified the benefit of like-kind exchanges to the U.S. economy by recognizing that the exchange transaction is a catalyst for a broad stream of economic activity involving businesses and service providers that are ancillary to the exchange transaction, such as brokers, appraisers, insurers, lenders, contractors, manufacturers, etc. A 2016 report by the Tax

¹ *Economic Impact of Repealing Like-Kind Exchange Rules*, ERNST & YOUNG (March 2015, Revised November 2015), at (iii), available at <http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf>.

Foundation estimated even greater economic contraction – a loss of 0.10% of GDP, equivalent to \$18 billion annually.²

Companies in a wide range of industries, business structures, and sizes rely on the like-kind exchange provision of the Code. These businesses—which include real estate, construction, agricultural, transportation, farm / heavy equipment / vehicle rental, leasing and manufacturing—provide essential products and services to U.S. consumers and are an integral part of our economy.

A microeconomic study by researchers at the University of Florida and Syracuse University, focused on commercial real estate, supports that without like-kind exchanges, businesses and entrepreneurs would have less incentive and ability to make real estate and other capital investments.³ The immediate recognition of a gain upon the disposition of property being replaced would impair cash flow and could make it uneconomical to replace that asset. This study further found that taxpayers engaged in a like-kind exchange make significantly greater investments in replacement property than non-exchanging buyers.

Both studies support that jobs are created through the greater investment, capital expenditures and transactional velocity that are associated with exchange properties. A \$1 million limitation of gain deferral per year, as proposed by the Administration⁴, would be particularly harmful to the economic stream generated by like-kind exchanges of commercial real estate, agricultural land, and vehicle / equipment leasing. These properties and businesses generate substantial gains due to the size and value of the properties or the volume of depreciated assets that are exchanged. A limitation on deferral would have the same negative impacts as repeal of section 1031 on these larger exchanges. Transfers of large shopping centers, office complexes, multifamily properties or hotel properties generate economic activity and taxable revenue for architects, brokers, leasing agents, contractors, decorators, suppliers, attorneys, accountants, title and property / casualty insurers, marketing agents, appraisers, surveyors, lenders, exchange facilitators and more. Similarly, high volume equipment rental and leasing provides jobs for rental and leasing agents, dealers, manufacturers, after-market outfitters, banks, servicing agents, and provides inventories of affordable used assets for small businesses and taxpayers of modest means. Turnover of assets is key to all of this economic activity.

In summary, there is strong economic rationale, supported by recent analytical research, for the like-kind exchange provision's nearly 100-year existence in the Code. Limitation or repeal of section 1031 would deter and, in many cases, prohibit continued and new real estate and capital investment. These adverse effects on the U.S. economy would likely not be offset by lower tax rates. Finally, like-kind exchanges promote uniformly agreed upon tax reform goals such as economic growth, job creation and increased competitiveness.

² *Options for Reforming America's Tax Code*, Tax Foundation (June, 2016) at p79, available at <http://taxfoundation.org/article/options-reforming-americas-tax-code>.

³ David Ling and Milena Petrova, *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate* (March 2015, revised June 2015), at 5, available at <http://www.1031taxreform.com/wp-content/uploads/Ling-Petrova-Economic-Impact-of-Repealing-or-Limiting-Section-1031-in-Real-Estate.pdf>.

⁴ *General Explanations of the Administration's Fiscal Year 2017 Revenue Proposals*, at 107, available at <https://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2017.pdf>.

Thank you for your consideration of this important matter.

Sincerely,

Air Conditioning Contractors of America
American Car Rental Association
American Rental Association
American Seniors Housing Association
American Truck Dealers
American Trucking Associations
Associated Equipment Distributors
Associated General Contractors of America
Avis Budget Group, Inc.
Building Owners and Managers Association (BOMA) International
C.R. England, Inc.
Equipment Leasing and Finance Association
Federation of Exchange Accommodators
International Council of Shopping Centers
NAIOP, the Commercial Real Estate Development Association
National Apartment Association
National Association of Home Builders
National Association of Real Estate Investment Trusts
National Association of REALTORS®
National Automobile Dealers Association
National Business Aviation Association
National Multifamily Housing Council
National Ready Mixed Concrete Association
National Stone, Sand and Gravel Association
Truck Renting and Leasing Association

May 17, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways and Means
United States House
1102 Longworth House Office Building
Washington, D.C. 20515

RE: Hearing On How Tax Reform Will Grow Our Economy And Create Jobs

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

I am submitting this letter ahead of the House Ways and Means Committee's scheduled hearing on May 18th entitled "How Tax Reform Will Grow Our Economy and Create Jobs." I'd like to thank the committee for the work you're doing in exploring different ways in which pro-growth tax reform can be achieved and help further strengthen the American economy. As the committee considers myriad proposals and ideas for reforming the tax code, I want to stress the importance of preserving the full deductibility of interest on debt.

Our organization plays a significant role in contributing to one of Louisiana and nation's most important economic engines- it's infrastructure. When it comes to reforming America's tax code, we believe that preserving interest deductibility is crucial to promoting growth and enhancing our contribution to the economy. While there is certainly a key role for policymakers and policy thinkers in reforming the tax code, I also firmly believe that input from businesses is essential to setting the record straight on the practical implications of certain tax proposals.

Interest deductibility is a well-established, growth-promoting provision of the tax code that has been in existence for more than 100 years. Interest expense is a normal cost of doing business; and, for many of our businesses, it provides a peace-of-mind as well as a sense of stability and predictability when business owners are guaranteed they will not be taxed on the cost of accessing capital and can have more flexibility when making important long-term financial decisions.

Our member companies borrow in order finance expansions, purchase equipment, and meet other key obligations of building the state's roadways. Having the ability to deduct interest on such expenses gives them the certainty they need to make these decisions with confidence. It also allows us to weather any shifts in demand.

Maintaining full interest deductibility is essential for achieving the stated top priority of tax reform: allowing the U.S. and our state's economy to reach its full growth potential. We appreciate your consideration in this matter and look forward to debate ahead on reforming our nation's tax structure.

Sincerely,



Erich Ponti
Executive Director
Louisiana Asphalt Pavement Association

June 1, 2017

STATEMENT FOR THE

UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS

ON BEHALF OF:

Missouri Health and Educational Facilities Authority (MoHEFA)

The Missouri Health and Educational Facilities Authority (MoHEFA) respectfully submits this statement to the House Committee on Ways and Means for the hearing on “How Tax Reform Will Grow Our Economy and Create Jobs” held on May 18, 2017. MoHEFA is an issuer of tax-exempt bonds for dozens of not-for-profit and governmental health and educational facilities throughout Missouri including hospitals, clinics, medical research organizations, long-term care facilities, universities, colleges, elementary and secondary schools and other educational entities.

We respectfully urge Congress to protect and maintain tax-exempt bond financing, including qualified 501(c)(3) private-activity bonds, which is necessary for the missions and continued financial health of the hospitals, colleges, universities, and other charitable organizations and which promotes critical infrastructure and economic development throughout Missouri. Low-cost access to capital helps keep these institutions strong, enabling them to keep infrastructure expenditures low so that they can efficiently fulfill their mission and focus on the work they do for the public good— making our lives, our economy, and our nation stronger.

One of the many ways the federal government invests in human capital and innovation in the United States is by granting tax-exempt status to these health and educational institutions whose services provide a wide range of societal benefits. Hospitals, colleges, and universities are economic mainstays, providing stability and job growth in communities.

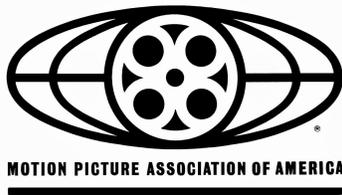
Tax-exempt bond financing available to these institutions provides access to the capital markets at reduced cost which in turn reduces the cost of the health and educational services they provide. In general, for institutional borrowers, the interest rate on tax-exempt bonds is significantly lower than on taxable bonds, thus creating beneficial financial terms. The lower interest rates create significant savings by lowering the financing cost of multi-million dollar construction projects, often financed over a 30-year period. The lower financing cost allows hospitals and health care institutions to keep charges lower than would be the case if taxable financing was used.

We believe elimination of, or a cap on, the income tax exemption of tax-exempt bond interest, or even a partial tax, will cause investors to demand higher returns, again leading to higher costs for health and educational services.

A study conducted recently in Missouri by IHS Markit Economics determined the following economic impact with respect to MoHEFA's bond issuance activity from 2007 through 2016:

- Average annual bond issuance for new projects of \$562 million
- These financings supported 6691 jobs annually
- This included \$362 million in labor and \$473 million in GDP annually
- The issuance activity created long term economic value through the completed projects and the resulting reduction of health and educational costs
- Health care and education is the second largest employment sector in Missouri accounting for 16% of employment in the state
- Had these projects not been completed Missouri could have lost another 2967 construction jobs
- MoHEFA's financings provide low-cost options for capital projects when needed most and even in challenging economic times

Missouri's fine health and educational institutions depend on tax-exempt bonds as their primary method of financing the capital projects so vital to performing their missions. We respectfully urge Congress to continue to support readily accessible and cost effective tax-exempt bond financing, including qualified 501(c)(3) private-activity bonds to ensure the financial stability of health and educational institutions in Missouri and across the United States.



May 23, 2017

The Honorable Kevin Brady
Chairman
House Ways and Means Committee

The Honorable Richard Neal
Ranking Member
House Ways and Means Committee

Re: Hearing on How Tax Reform Will Grow the Economy and Create Jobs

Dear Chairman Brady and Ranking Member Neal:

The MPAA and its member companies are very appreciative of the efforts by the Committee to examine and improve our tax system and are pleased to submit our comments for the hearing record. We believe tax reform similar to the Blueprint that lowers corporate rates and modernizes our international tax system is essential to promote job and wage growth, and enhance the ability of U.S. businesses to compete and succeed in the global economy.

Our industry is an important economic force in the United States, employing nearly 2 million people and generating \$134 billion in wages in 2015. As one of our country's most successful products, U.S. film and television production consistently garners a positive balance of trade with virtually every country to which we export, generating an overall \$13.3 billion trade surplus in 2015.

However, with each passing year, we are becoming more susceptible (and sensitive) to foreign competition. Many of our major trading partners are actively promoting growth in film and other IP production, through tax incentives and other subsidies. Also, recent technological advances have made film production more highly mobile than ever before. We believe the U.S. must act quickly or risk losing film and other IP development and the associated well-paying jobs to other countries.

The business environment in the United States offers numerous advantages, but our outdated tax system is unnecessarily holding us back. Our worldwide tax system, combined with high corporate tax rates, is an outlier among developed countries and has a number of adverse economic consequences. It impedes growth, blocks reinvestment of foreign earnings, diverts other investment capital overseas, and causes our companies to be less competitive in foreign markets.

While our corporate and international tax system has remained static for the past three decades, other countries have aggressively sought to attract investment by modernizing their tax systems through significantly lower statutory tax rates, adoption of territorial tax regimes, and use of targeted tax incentives and innovation box regimes to attract IP production and ownership overseas. Moreover, the Modified Nexus Approach in the OECD BEPS project will now require that companies shift IP development activities and jobs to foreign countries to take advantage of these incentives. If the United States fails to respond, we are concerned these actions by the OECD and other highly developed economies will pose a threat to U.S. jobs and tax revenue.

Consequently, we are encouraged that the Committee is focused on responding to these challenges by improving our tax system, and are extremely grateful for your leadership on these issues. We strongly support the Committee's ongoing efforts to reduce the U.S. corporate tax rate significantly and to modernize our international tax system in order to increase domestic job growth, level the competitive playing field for U.S. businesses, and encourage the creation and ownership of films and other IP in the United States. We look forward to working with the Committee to help you successfully achieve these goals.

Please contact Patrick Kilcur (202) 378-9175 if you have any questions or need anything else from us. We look forward to working with the Committee members and the staff on these important issues.

Sincerely,

Joanna McIntosh
Executive Vice President, Global Public Policy and External
Affairs

cc:
Members of the House Committee on Ways and Means

Comments of the
Municipal Bonds for America Coalition
to the
U.S. House Ways and Means Committee
Hearing on How Tax Reform Will Grow Our
Economy and Create Jobs
(Submitted May 22, 2017)

The Municipal Bonds for America Coalition¹ (MBFA) appreciates the opportunity to comment on how reform of the federal income tax system may affect the economy and employment. MBFA is a non-partisan stakeholder coalition including municipal bond issuers, state and local government officials, and regional broker dealers working together to explain the many benefits of municipal bonds. We strongly believe that the more than 100-year old tax exemption of municipal bond interest has allowed state and local governments to build and maintain vital infrastructure projects at the lowest cost. State and local governments use municipal bonds to finance roads, bridges, schools, hospitals, airports, sewers, affordable housing, utilities, and other public projects. These investments make commerce possible and our communities livable.

In the last decade alone, state and local governments have made approximately \$2 trillion in bond-financed infrastructure investments.² State and local governments build nearly three-quarters of the nation's core infrastructure, utilizing low-cost borrowing in the tax-exempt bond market to provide a large majority of the financing. As a result, to ensure that tax reform grows our economy and creates jobs, it is vital that it not impose an unprecedented federal tax – in any form – on these investments.

Bonds Build America

State and local governments have issued tax-exempt municipal bonds for more than 200 years to finance construction and maintenance of public facilities and infrastructure. Interest paid on a municipal bond is generally exempt from federal income tax, just as interest paid on Treasury bonds is exempt from state and local tax. Capital investments financed with municipal bonds build communities and grow our economies. In 2015, state and local governments issued roughly \$400 billion in municipal bonds. Of those issuances: about \$85 billion financed repair and construction of primary and secondary schools; \$39 billion financed investments in community colleges, colleges, and universities; \$50 billion financed investments in roads, bridges, ports, airports, mass transit, and other transportation facilities; \$38 billion financed water and sewer investments; \$27 billion financed hospitals

¹ A full list of MBFA coalition members joining in these comments are listed, along with contact information for the MBFA, at the end of these comments.

² "Bond Buyer Thomson Reuters 2016 yearbook," Feb. 2016.

and clinics; and \$18 billion financed electric power utilities. These bonds also financed bridge repairs, convention centers, police and fire stations, solid waste facilities, seaports, flood control, libraries, and museums. These are the investments that make commerce possible and our communities strong and livable.

One type of municipal bond is a qualified activity bond (also known as a private activity bond, a qualified facility bond, or Alternative Minimum Tax bond), which is used to finance certain qualifying public-private projects or other qualifying uses. These bonds allow state and local governments to join with the private sector to best achieve project and program goals. In 2015, about \$8 billion of these bonds were issued to finance transportation-related investments (airport terminals, toll roads and bridges, ports and the like). Another \$6.7 billion financed affordable rental housing properties, and \$4.6 billion financed affordable mortgages for working families. In addition, \$700 million helped finance state and local government student loan programs. Qualified activity bonds also provide critical financing to non-profit hospitals and schools (\$1 billion in financing to non-profit schools alone), and support community and economic development – with roughly \$250 million in industrial development, farm, and related bonds issued in 2015. Qualified activity bonds are exempt from federal income tax, but can be subject to the alternative minimum tax (AMT).³

There is overwhelming consensus that for the foreseeable future there will be substantial and sustained demand for the sorts of infrastructure investments financed with municipal bonds. A failure to make these investments could have significant negative economic consequences. The American Society of Civil Engineers estimates that by 2025 insufficient infrastructure investments will lead to a \$3.9 trillion decline in GDP; \$7 trillion in lost business sales; and 2.5 million in lost jobs.⁴

Policymakers are looking for innovative ways to finance these investments, or to spur investments by privatizing some of these public facilities. These could be helpful at the margin – a complement to bond-financed projects. However, policymakers should not lose sight of the fact that state and local governments financed approximately \$2 trillion in new infrastructure investments in the last decade and will invest \$2 trillion to \$3 trillion more over the next decade. They did so with the support of state and local residents (roughly 82 percent of bond referenda in the last election were approved) and while controlling overall debt (in real dollars and as a percentage of GDP, state and local debt borrowing has actually declined in the last decade).⁵

No Better Alternative

³ Qualified hospital facility, 501(c)(3), residential rental, and mortgage revenue bonds are private activity bonds, but are not subject to the AMT.

⁴ American Society of Civil Engineers., *Infrastructure Report Card*, (pg. 4). 2017.

⁵ Board of Governors of the Federal Reserve System, Data Download Program, <https://www.federalreserve.gov/datadownload/Choose.aspx?rel=Z.1> (providing access to historic state and local financial data from the Financial Accounts of the United States reports (Table L. 107, State and Local Governments)); OFFICE OF MANAGEMENT AND BUDGET, “Budget of the U.S. Government, Fiscal Year 2017, Historical Tables” (Feb. 9, 2016)(providing figures for annual Gross Domestic Product(GDP) and GDP (Chained) Price Index).

It is a given that a tax on municipal bond interest will increase state and local borrowing costs. That would mean state and local governments making fewer investments for much needed infrastructure and/or passing these higher costs onto state and local residents.

Alternatives to tax-exempt bond financing exist, but each has substantial shortcomings—predominantly increased borrowing costs, increased complexity, and a lack of access to capital for smaller issuers. In the case of public-private partnerships, where a for-profit company operates or maintains a project after construction is completed, the ability to provide an ongoing equity-like rate of return to the company’s investors or partners must be considered, as well. While alternatives could supplement tax-exempt bond financing, they do not replace bond financing.

Similarly, some suggest that a surtax on bond interest could raise revenue for the federal government without increasing the interest rate demanded by bond buyers and impose additional taxes on the wealthy. Such a surtax (or “cap”) would reduce the value of *all* bonds in the secondary market by as much as \$200 billion.⁶ About half of this loss would fall on households with income of *less* than \$250,000.⁷ It would also disproportionately hurt seniors. About three-fifths of bond interest paid to individuals is paid to those aged 65 years and older, and 84 percent is paid to those aged 55 and older.⁸

This cap/surtax would also increase the cost of borrowing when state and local governments seek to issue a new bond. Investors will demand a higher rate of return:

- To accommodate this new surtax;
- To reflect the bond’s loss of value in the secondary markets; and
- To compensate for the risk that Congress will expand the tax to hit more bondholders, increase the tax rate imposed, or both.

The real-world example of qualified activity bonds, most of which are subject to the AMT, proves this point. The AMT is, effectively, a surtax beyond the regular income tax that is paid by taxpayers above a certain minimum income level—similar to the “cap” or limits being proposed by some lawmakers for municipal bonds. And, in fact, a qualified activity bond typically costs issuers as much as 50 basis points (0.5 percentage points) more in interest rates than a similarly rated municipal bond. Take, for example, Dallas/Fort Worth International Airport, which under tax law must use qualified activity bonds to finance its massive Terminal Improvement Project. The qualified activity bonds (subject to the AMT) financing \$3.1 billion of this project are costing \$268 million more than if they’d been issued as fully tax-exempt municipal bonds. And yet, the Treasury derives no benefit, because investors who actually pay the AMT avoid these bonds.

Conclusion

MBFA strongly encourages the Committee to support tax-exempt municipal bonds, including qualified activity

⁶ Michael Kaske, Tax Cap Threatens \$200 billion Muni Loss, Citigroup Says, Bloomberg, Dec. 7, 2012 (reporting analysis that limiting the tax value of the exclusion for municipal bond interest will reduce the value of existing bonds in the secondary market); Brian Chappatta, Tax-Status Threat Fuels Worst Losses Since Whitney: Muni Credit, Bloomberg, Dec. 21, 2012.

⁷ Internal Revenue Service, Statistics of Income—2012: Individual Income Tax Returns, (Publication 1304 (Rev. 08-2014)) at 40 (2012) (showing that 48 percent of bond interest paid to individuals is paid to households with income of \$250,000 or less).

⁸ Id. at 73.

bonds. The investments financed with these bonds have a proven track record to help our economy grow and create jobs. Conversely, a tax – in whole or in part – on these investments would hurt economic growth and job creation.

Municipal Bonds for America coalition members joining in these comments include:

African American Mayors Association

American Public Power Association

Bond Dealers of America

Capital Edge

Council of Development Finance Agencies

Court Street Group

Education Finance Council

Investment Company Institute

Large Public Power Company

National Council of State Housing Agencies

National Development Council

National League of Cities

National Water Resources Association



Statement for Record

Dave P. Tenny

President and CEO, National Alliance of Forest Owners

House Ways and Means Hearing – May 18, 2017

How Tax Reform Will Grow Our Economy and Create Jobs

I'd like to take this opportunity to mention the critical role that private working forests play in our rural economies. Many rural communities are located in heavily forested states where the forest products sector suffered historic economic setbacks during the Great Recession. In these communities forestry and forest products manufacturing have historically been a primary source of good paying jobs that provide lumber, paper, packaging, energy and more than 5,000 other economically valuable products.

The economic importance of these forests is evident from the 2.4 million domestic jobs supported and \$280 billion in value generated across a supply chain that includes foresters, loggers, truckers, mill workers, equipment suppliers, service providers, and many others. Most working forests – over seventy percent nationally – are privately owned by families, small and large businesses and an increasingly broad array of Americans who invest in forest ownership through investment vehicles such as pension and mutual funds. The economic value derived from working forests is directly connected to a 50% increase in overall tree volume domestically over the past 60 years – because markets for forest products provide an incentive to keep working forests as forests. In turn, increased volume in forest products has enabled the United States to meet much of our domestic demand for wood products.

The economic growth and opportunity fostered by private working forests is rooted in tax policies that recognize the unique, capital-intensive, long-term nature of timberland stewardship. These tax policies encourage sound management practices and investments that keep forestlands and the economy they support productive for generations to come. By ensuring tax reform recognizes the policies that make working forests strong, we secure a bright future for the rural families, individuals, and communities that rely on them.

Timber is an attractive investment opportunity featuring a non-volatile asset, a hedge against inflation, and access to significant long-term yield. Unlike stocks, investments in forests provide unique built-in, biologic growth that is immune from market volatility. That is one reason why public and private pension funds maintain sizable investments in timberlands through timberland investment management organizations (TIMOs) and publicly traded timberland real estate investment trusts (REITs). Working forests are a part of most Americans' retirement portfolios.

We urge Congress to recognize the long-term capital investments and risks associated with forest ownership and management by ensuring the federal tax code continues to encourage long-term investment in private forests. Provisions that ensure the continued capital gains treatment of timber revenue, the deductibility of timber growing and reforestation costs, and the treatment of timberland as real property are critical to the health of working forests and rural communities.



May 18, 2017

Chairman Kevin Brady
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Chairman Peter Roskam
Subcommittee on Tax Policy
Committee on Ways & Means
Washington, DC 20515

RE: Written comments for the hearing entitled: *How Tax Reform Will Grow Our Economy and Create Jobs Across America*

On behalf of National Association of Electrical Distributors (NAED) I write to offer comments on the future of comprehensive tax reform. NAED is a trade association for the \$70+ billion electrical distribution industry. Through networking, education, research, and benchmarking, NAED helps electrical distributors increase profitability and improve the channel. NAED represents more than 600 manufacturers and distributors of electrical products across the country. Our members are companies of all sizes - from small and mid-sized independents to large regional and national chains.

NAED members have been faced with an increasingly complicated tax code and remain steadfast proponents of comprehensive tax reform. Broadly speaking, our members want reform that simplifies the tax code, eliminates double taxation, and lowers rates on businesses. Our team plans to look closely at the legislative language of all tax reform proposals offered in Congress. We will be pushing for key principles including:

- Fairness for pass through entities – Currently, business tax rates for small companies can reach as high as 39.6 percent, which are some of the highest in the world. A high business tax rate not only makes companies less competitive, but also serves as a burden on employees by depressing wages. The vast majority of NAED members operate as pass through entities. NAED members support reducing the top marginal tax rate for all businesses in an equitable manner that does not give an advantage to either corporations or pass-through businesses. If tax rates can be reduced, NAED members will be able to keep more of their hard-earned profits and grow their companies, raise wages, hire new workers, and invest in their communities.
- Full business expensing - Currently, business owners must depreciate capital goods over many years when they purchase new equipment which disincentives new investment. Large purchases like delivery trucks or fork-lifts currently take years to depreciate. The change to full business expensing would create an incentive for companies of all sizes to invest in new equipment. Allowing capital purchases to be deducted from business income would make it easier for our members to purchase the equipment and tools they need to expand.

- Repeal of the estate tax – NAED members typically own multiple warehouses and millions of dollars in inventory. A typical NAED member business is valued at nearly \$30 million. When a business owner dies, the large stockpiles of necessary electrical components and assets often put the business well over the estate tax threshold. The electrical wholesale industry is rapidly consolidating. One of the primary drivers of this consolidation is the estate tax. Several of our multi-generational family businesses have already incurred significant setbacks from the estate tax. Any business that is planning for the next generation must hire lawyers and accountants in order to minimize the damage from the death tax. Money that NAED members currently spend in tax compliance would be better used to reinvest in their businesses.

NAED members are encouraged by steps taken this Congress to improve the regulatory and tax landscape for small businesses. Now is the time to take the next step by passing a complete overhaul of the antiquated tax code. Tax reform should help our members focus less on tax compliance and more on supplying the electrical equipment needed to build America. We look forward to reviewing the details of all tax reform plans offered in Congress.

Statement for the Record

Submitted by

**The National Association of Energy Service Companies
1615 M Street, NW
Suite 800
Washington, DC 20036**

For

The House Ways and Means Committee

**Hearing on How Tax Reform Will
Grow Our Economy and Create Jobs**

May 18, 2017

NAESCO is the leading national trade association of the energy services industry. During the last thirty years, NAESCO member companies have delivered thousands of energy efficiency, renewable energy, demand response, distributed generation and combined heat and power projects across the United States and around the globe. Nationally, NAESCO member companies have delivered \$50 billion in projects that have produced \$55 billion in guaranteed and verified energy savings, which repay the cost of the projects and provide positive economic impacts to local communities.

NAESCO supports the Committee's efforts to reform the tax code, and believes any reform must reflect the important relationship between the public policy goal of reducing waste through the reduction of energy consumption and tax policy. Of particular importance to NAESCO's members is the continuation of the §179D deduction for commercial energy efficient property, which delivers demonstrated and widespread benefits to the U.S. economy.

Reducing waste and costs through the reduction of energy consumption by using the §179D tax deduction for efficient lighting, HVAC, and building envelope improvements, has proved to be an important public policy initiative and should remain a critical element of our nation's energy strategy. Tax incentives promoting energy efficiency, such as §179D, are a critical tool in advancing the country's budget deficit reduction, energy efficiency, and national security goals and result in a high value impact to taxpayers.

The §179D deduction enables accelerated cost recovery of energy efficiency investments made by commercial building owners, provides economic benefits of the deduction to government owned buildings, and assists designers of efficiency systems to develop advanced technologies that, when implemented, reduce energy waste. It does not reward the taxpayer simply for making an investment; rather, the deduction requires the achievement of verifiable reductions in energy usage. In its rules implementing this section of the code, the Internal Revenue Service requires inspection and testing of the energy efficiency (EE) project by qualified individuals to ensure the project qualifies for the deduction.

§179D advances our nation's energy policy priorities in a prudent and cost effective manner:

- **Economic Value:** Utilizing the §179D deduction creates additional economic value for building owners and has contributed to the increased use of energy efficient building design strategies resulting in the retrofit of energy inefficient aging buildings, many with significant deferred maintenance problems. In addition, the dollars saved on energy costs by businesses through efficiency improvements can be reinvested in areas that produce greater economic activity.
- **Job Creation:** §179D serves as an engine of economic growth that generates job creation in a variety of industry sectors. The incremental energy efficiency projects enabled by the availability of this tax deduction create and sustain more jobs in the construction,

engineering, manufacturing, and design sectors and reduce the need for investment in new energy supplies and production.

- **Encourages Efficiency Improvements to Building Stock:** The §179D deduction encourages energy efficiency improvements to aging commercial building stock, which otherwise may be neglected, by allowing for accelerated cost recovery of energy efficiency investments. Without §179D, energy efficiency retrofits are depreciated over a longer period of time as capital expenses. Even with full expensing provided for in the House Republican Blueprint on Tax reform, §179D is necessary to provide an incentive for projects to be implemented in government owned buildings that do not receive the direct benefit of full expensing. The benefit provided to the governmental entity from passing the deduction through to the energy service company delivering the energy efficiency retrofit allows for additional efficiency improvements to be provided and savings generated on behalf of the government entity at the same first cost.
- **Saves Energy and Reduces Emissions:** The acceleration of energy efficient building design and retrofits of inefficient aging buildings generates deep savings in building energy costs, significantly reduces energy demand, generates budgetary cost savings, and lowers the emissions of greenhouse gases – all of which benefit the nation’s energy security and infrastructure improvement priorities. In terms of value, efficiency is a far more cost effective means of meeting energy demand than is the generation of a new unit of energy particularly energy generated and delivered during peak usage periods.
- **Technology Driver:** The §179D deduction rewards achievement of significant energy savings regardless of the technology used to achieve those savings and places a premium on implementation of more sophisticated technologies. The incentive supports the modernization of aging U.S. building stock and enhances the overall performance of our nation’s building infrastructure.

Repealing the tax incentive for energy efficient commercial property undermines the significant advancements made to date in modernizing our nation’s building stock. In fact, the expiration of the deduction in December 2014, its retroactive reinstatement in December 2015, and its expiration in December 2016 have resulted in tremendous uncertainty on the part of commercial building owners, as well as the energy services companies and other industry providers whose businesses are directly tied to developing and implementing efficiency retrofits. Additionally, removing the only incentive that provides accelerated treatment for commercial efficiency property could result in a strong disincentive to invest in efficiency improvements. The tax code allows commercial businesses the ability to immediately deduct money spent on energy consumption (utility bills) as an ordinary and necessary business expense, while without §179D the cost of efficiency improvements would be depreciated over many years. This asymmetry in the tax code is successfully addressed through the 179D deduction. Eliminating the 179D provision brings back the economic bias in favor of higher energy costs created by, in many cases, the wasteful use of energy that could have been avoided through the use of energy efficient technologies.

An analysis by Regional Economic Models, Inc. (REMI), released in May 2017, provides evidence of the benefits to the U.S. economy provided by §179D. The report shows that a long-term extension of §179D would support up to 40,749 jobs annually and contribute almost \$3.9 billion annually to national gross domestic product (“GDP”), as well as over \$3.1 billion annually towards national personal income. Should Congress enact changes to §179D (such as those proposed in S. 2189 from the 113th Congress) that aim to strengthen and modernize the deduction, REMI forecasts 76,529 jobs would be supported and nearly \$7.4 billion added to the GDP.

According to the report, “Section 179D promotes the proper allocation of incentives in the real estate development process. A key challenge to realizing the benefits of energy-efficient improvements is that the associated cost savings flow to building occupants, not developers. By helping offset the cost of energy efficient investments, Section 179D allows building owners to share in the incentive to install energy-efficient improvements that help their occupants save money on electricity, water, and climate control costs.”¹

In short, we strongly believe §179D should remain a permanent component of a reformed tax code. Importantly, §179D compliments the goals of tax reform by delivering economic growth, job creation, and enhanced economic competitiveness. If near-term enactment of comprehensive tax reform is not expected to be forthcoming, we strongly support an immediate, multi-year extension of §179D. An extension of §179D will provide needed certainty to the commercial and government building markets as well as the energy services company industry, and retain in the tax code the provision directed specifically at stimulating energy savings through investments in efficiency retrofits in the commercial building sector. Any discussion of a reformed tax code and energy tax policy is incomplete without a robust consideration of the positive budgetary impact of energy efficiency, and prudent and effective efficiency incentives – such as §179D – belong permanently in a reformed tax code.

¹ Analysis of Proposals to Enhance and Extend the Section 179D Energy Efficient Commercial Buildings Tax Deduction, Prepared by Regional Economic Models, Inc. (REMI) May 2017, Page 4

Introduction to NAESCO

The National Association of Energy Service Companies proudly celebrates 33 years of leadership in promoting, developing, and advocating for the central role of energy efficiency as part of a comprehensive national energy agenda. NAESCO and its member organizations maintain a firm belief in the economic and environmental benefits of the widespread use of energy efficiency and embrace ethical market behavior as a core value.

Advocacy Voice

NAESCO represents every facet of the energy services industry and actively advocates for the cost effective delivery of comprehensive energy services to all end user market segments. The Association places a high priority on making the Association a home for the broadest spectrum of market participants which gives our advocacy voice additional resonance. Through its robust advocacy program, NAESCO has been a key catalyst in creating, among federal and state lawmakers, regulators, and energy program managers, a continuing commitment to developing and implementing energy efficiency solutions.

Opening New Markets for Energy Services

On behalf of its membership, NAESCO works to help open new markets for energy services. NAESCO has focused during the last three decades on reaching out to end users by directly promoting the value of energy efficiency to customers in all market segments through its seminars, workshops, training programs, and conferences; publication of case studies, guidebooks, customer manuals, and original research; and the compilation and dissemination of aggregate industry data drawing upon the project database created and maintained by NAESCO and the Lawrence Berkeley National Laboratory. NAESCO also works collaboratively with allied trade groups, policy groups and customer representatives to accelerate market development and growth.

Promoting Industry Best Practices

NAESCO sponsors a rigorous accreditation program for ESCOs, Energy Service Providers and Energy Efficiency Contractors to recognize management capabilities, outstanding project experience, ethical business practices, and overall commitment to providing customers with comprehensive and successful energy solutions. NAESCO has ethical guidelines in place and has created an industry ombudsman to provide a transparent protocol for the review of ethical issues that may arise.

Nationally, NAESCO member company projects have produced:

- \$50 billion in projects paid from savings
- \$55 billion in savings – guaranteed and verified
- 450,000 person-years of direct employment
- \$33 billion of infrastructure improvements in public facilities
- 450 million tons of CO₂ savings at no additional cost

Most of these projects are Energy Savings Performance Contracts (ESPC), which don't require new taxes, because they re-purpose the money that a customer is currently spending on wasted energy into a payment stream for the energy-saving capital improvements.



National Association of Insurance
and Financial Advisors

STATEMENT ON BEHALF OF
THE NATIONAL ASSOCIATION OF INSURANCE
AND FINANCIAL ADVISORS (NAIFA)
HEARING ON “HOW TAX REFORM WILL GROW
OUR ECONOMY AND CREATE JOBS”
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

MAY 18, 2017

Introduction

On behalf of The National Association of Insurance and Financial Advisors (NAIFA)¹ I appreciate the opportunity to submit testimony for the hearing referenced above pertaining to the development of tax reform legislation for consideration by the Ways and Means Committee and the House of Representatives. The Better Way Tax Reform Blueprint (Blueprint) released last summer and President Trump’s tax reform plan released last month provide helpful frameworks, but do not yet include much of the key detail that will need to be filled-in before enactment of the first major tax reform since 1986.

NAIFA’s overarching concern is that as Congress considers tax reform, it must not make it more difficult or expensive for families to build their own financial safety nets. Americans need public policy that continues to encourage them to plan ahead, protect their families’ financial security and adequately save for retirement. Well-prepared families will have adequate retirement savings accounts, life insurance, medical insurance, and guaranteed income annuities to supplement social security benefits. With the strain on federal entitlement programs as well as on state and local programs, tax reform must not create new obstacles for families planning for their long-term financial needs.

With ten thousand people reaching retirement age every day, it is important that public policy incentivizes and encourages families to save and plan for retirement. Current retirement savings options, that are working well, should be preserved. And, it is important for Congress to ensure that families and workers can continue to protect against the risks of dying too soon or outliving

¹ **About NAIFA:** Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation’s oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA’s mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

their savings. Life insurance and annuity products can help minimize these risks and are necessary to obtaining financial and retirement security.

Insurance products and employer-provided benefits help Americans provide financial protection and security for themselves and their loved ones. Whether it is the economic loss from dying prematurely, becoming ill or disabled, or outliving savings in retirement, most families do not have the resources to manage these risks on their own.

Life Insurance

Life insurance products are unique in their ability to successfully and affordably transfer risk from the individual to a larger pool of savers or insureds. Policy benefits paid at the death of a breadwinner help families avoid the hardship of lost income. Sometimes life insurance can be a back-up savings source to be used in emergencies. Annuities pay a guaranteed, steady stream of income, protecting individuals from outliving their assets and can be purchased both in a qualified retirement plan or held personally. Disability income insurance protects workers' income by replacing a portion of their earnings if they cannot work due to accident or illness. Whether people seek protection and security products on their own or as part of a group with the assistance of their employer, our nation's tax system should not discourage these actions.

Life insurance and retirement savings products are taxed appropriately under current law. The savings that build up in life insurance and annuities do not escape taxation; they are taxed at ordinary income rates when policyholders make a withdrawal from their annuity or cash in their policy if protection is no longer needed. Additionally, life insurance and annuity owners pay premiums with after-tax dollars.

While 70 percent of American households rely on life insurance protection, 41 percent believe they do not own enough.² Changing the tax treatment of life insurance products may result in less protection for families that currently have these products, and little or no coverage for those still needing protection.

NAIFA is pleased to note that neither the Blueprint nor President Trump's tax reform plan includes any proposal to change the tax treatment of life insurance or annuity products, and believes that is appropriate.

Retirement Savings

Nearly 90 million Americans rely on a private sector plan such as a 401(k) defined contribution or defined benefit plan to save for retirement³ and 42.5 million households own IRAs.⁴ Seventy-five million American families rely on annuities or other life insurance products for long term

² "Facts of Life and Annuities 2016 Update," *Life Insurance Marketing and Research Association (LIMRA)*, 2016

³ U.S. Department of Labor Employee Benefits Security Administration, *Private Pension Plan Bulletin, Abstract of 2014 Form 5500 Annual Report* (September 2016).

⁴ "ICI Research Perspective," *Investment Company Institute (ICI)*, 2017, available at <https://www.ici.org/pdf/per23-01.pdf>

financial security.⁵ Unfortunately, Baby Boomers and GenXers are projected to have a retirement income deficit of \$4.3 trillion and roughly 44 percent will lack adequate retirement income for basic expenses.⁶

NAIFA believes that tax reform should preserve the tax treatment of retirement savings options under current law. In particular, NAIFA believes that Congress should not eliminate or limit the current ability to contribute tax-deferred amounts to 401(k), IRA, and other retirement plans. While these pre-tax retirement plan contributions do not give rise to immediate tax, they are fully taxed (along with any growth) when an individual draws them down in retirement.

NAIFA is concerned that proposals, such as those included in former Chairman Dave Camp's 2014 tax reform plan, to limit tax-deferred contributions and, instead direct taxpayers to Roth-type accounts, would create a disincentive to saving for retirement. Current tax-deferred retirement options give taxpayers a current tax saving when making a retirement plan contribution. Roth accounts, by contrast, provide no immediate tax incentive to prioritize long-term retirement savings over consumption. For many taxpayers with competing priorities, such as purchasing a home or saving for college for their children, the Roth option would not provide sufficient incentive to save for retirement.

Limiting retirement savings options to Roth-type accounts would also have significant adverse effects on employer-sponsored retirement plans. Roth accounts (including in 401(k) plans) do not permit employer-matching contributions except into a pre-tax account. If plans are "all-ROTH" there would not be employer matching contributions to retirement plans, and therefore employees would have significantly less incentive to make their own contributions. Moreover, without the ability to make pre-tax retirement plan matching contributions, many closely-held business owners may decide that it is easier to not offer a retirement plan at all. The behavioral response of employers and workers to limiting retirement savings to Roth-type options will lead to significantly less retirement readiness on the part of Americans.

Some have suggested that rather than limit current tax-deferred savings options, Congress might expand the attractiveness of Roth retirement savings options. NAIFA believes such an approach could be beneficial.

NAIFA is pleased that Trump Administration officials have clarified that the President's tax reform plan appropriately preserves the current tax treatment of retirement savings. NAIFA believes it would be helpful to provide a similar clarification with respect to the Blueprint.

Treatment of Pass-through Businesses

Both the Blueprint and President Trump's tax reform plan would provide a reduced tax rate for pass-through business income taxed directly to the business owner. Under the Blueprint the tax rate would be 25%, while it would be 15% under President Trump's plan. As the Blueprint

⁵ American Council of Life Insurers, 2016 Life Insurer's Fact Book

⁶ Employee Benefit Research Institute, *EBRI Notes: Retirement Income Adequacy for Boomers and Gen-Xers: Evidence from the 2012 EBRI Retirement Security Projection Model*.

notes, “Millions of small and closely held businesses are organized as pass-through entities – such as partnerships and S corporations – that are taxed under the individual rate structure rather than at the corporate rate. These businesses often compete directly with businesses that are subject to the corporate tax, with the differential in tax treatment creating potential distortions and inequities.” The vast majority of NAIFA members (some 86%) do business in pass-through form. Accordingly, NAIFA supports proposals to preserve competitiveness by ensuring that the tax rate on pass-through business income is no higher than the rate on corporate income.

Conclusion

NAIFA thanks you for the opportunity to submit testimony for today’s hearing. In order to ensure families and workers have a secure financial future Americans need a tax system that reinforces and builds on the proven savings and retirement plan structures. Whether Congress considers a comprehensive approach to tax reform or something more concise, new policies should not disrupt the current tax treatment of insurance products that protect against financial risks through the use of life, disability income, health and long-term care insurance and provide guaranteed income for life through annuities.



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**Written Testimony of the National Biodiesel Board
Submitted to the Ways and Means Committee
How Tax Reform Will Grow Our Economy and Create Jobs
May 18, 2017**

The National Biodiesel Board (NBB) is pleased to submit written testimony to the committee regarding the role of the biodiesel tax incentive in the continued growth of our industry and the resulting benefits for American competitiveness, job creation and the environment. NBB is the U.S. trade association representing the biodiesel and renewable diesel industries, including producers, feedstock suppliers and fuel distributors since 1992.

Biodiesel is a renewable, low-carbon diesel replacement fuel made from a diverse mix of resources, including recycled cooking oil, animal fats and agricultural oils such as soybean, camelina and canola oil. Based on the performance requirements established by the Energy Independence and Security Act, the U.S. Environmental Protection Agency (EPA) has determined that domestically produced biodiesel is an “advanced biofuel”— meaning it reduces greenhouse gas emissions by at least 50 percent when compared to petroleum diesel. Biodiesel is the nation’s first domestically produced, commercially available advanced biofuel. It meets a strict fuel specification set forth by ASTM International—the official U.S. fuel-certification organization. Biodiesel is primarily used in blends of 5 percent to 20 percent and does not require special fuel pumps or engine modifications. In fact, the majority of automobile manufacturers support biodiesel blends up to 20 percent in their engine warranties.

History has shown that well-crafted and efficient tax incentives can be powerful policy mechanisms to create jobs, achieve the nation’s energy objectives and leverage private sector investment to promote the deployment and utilization of new energy resources here in the United States. This is certainly the case with the tax credit for biodiesel.

We support H.R. 2383, the American Renewable Fuel and Job Creation Act of 2017, introduced by U.S. Reps. Kristi Noem (R-S.D.) and Bill Pascrell (D-N.J.). This bipartisan biodiesel tax credit bill would convert the blender’s credit for biodiesel to a \$1-per-gallon production credit for fuels produced in the United States for three years. The bill provides an additional 10-cent-per-gallon credit for small U.S. biodiesel producers.

The biodiesel tax incentive has played a key role in stimulating growth in the U.S. biodiesel industry, helping biodiesel become the leading EPA-designated advanced biofuel in the nation. Without question, the biodiesel tax incentive has stimulated production. In 2004, prior to the enactment of federal tax incentives, our industry produced 25 million gallons. When the incentives were first implemented in 2005, the United States produced roughly 112 million gallons; last year, domestic production increased up to 2.9 billion gallons.

By making biodiesel more cost-competitive with petroleum diesel, the \$1-per-gallon credit creates jobs, strengthens U.S. energy security, reduces harmful emissions, diversifies the fuels market and lowers costs to consumers. Nonetheless, Congress has allowed the incentive to expire repeatedly in recent years, most recently on Dec. 31, 2016.

The biodiesel industry deserves predictable federal tax policy to continue attracting investment, developing infrastructure and creating jobs. We hear routinely from biodiesel producers who have tremendous capacity for growth and want to expand but who struggle to gain financing for new projects because of the uncertainty around the tax incentive. While traditional oil incentives are written permanently into the tax code, the biodiesel incentive has repeatedly expired, severely disrupting producers' access to capital, as well as their ability to hire and expand. The expiration of the tax incentive has effectively amounted to a tax increase on the U.S. biodiesel industry—hampering job growth and stunting investment.

We believe the public policy benefits of continuing the tax incentive are clear, including:

- *Job Creation and Economic Benefits:* With biodiesel plants nationwide—from California to Iowa to North Carolina—the biodiesel industry already is supporting some 64,400 jobs, \$11.42 billion in economic impact and \$2.54 billion in wages paid. In many rural areas of the country, biodiesel plants are a driving force of the local economy.
- *U.S. Competitiveness:* Biodiesel already is one of the most diverse fuels in the world, produced using everything from soybean oil to animal tallow to used cooking grease. Industry demand for less expensive, reliable sources of fats and oils is simulating—and often financing—promising research on next-generation feedstocks. The development of these new technologies is critical to our global competitiveness.
- *Energy Security:* Biodiesel is diversifying our fuel supplies so that we're not so vulnerable to global oil markets that are heavily influenced by unstable regions of the world and global events beyond our control. Despite increased domestic oil production, consumers will remain vulnerable to volatile international oil prices without diversity and competition in the fuels market.

- *Improving Air Quality and the Environment:* The EPA has recognized biodiesel's environmental benefits by classifying it as an advanced biofuel. According to the EPA, biodiesel reduces greenhouse gas emissions by 57 percent to 86 percent when compared to petroleum diesel. In addition, biodiesel dramatically reduces most major air pollutants and take wastes out of landfills as well as the nation's waterways. Substituting higher amounts of biodiesel for traditional diesel fuel is the simplest, most effective way to immediately reduce emissions.

In recent years, a version of the tax incentive was approved without objection by the Senate Finance Committee that reforms the incentive to a domestic production credit, ending a practice where growing volumes of imported fuel are eligible for the credit simply by being blended in the United States. Subsidizing foreign production is obviously not the intent of Congress, and we should close this loophole by reforming the credit to focus on domestic production. The reform would:

- *Stop Subsidizing Foreign Manufacturing:* U.S. tax dollars and energy policy should be—and typically are—aimed at incentivizing domestic production, not foreign production. The current structure of the biodiesel tax incentive as a blender's credit increasingly allows foreign producers to access the credit if their fuel is blended in the United States. Importantly, reforming the credit to a production credit instead of a blender's credit would not block imported biodiesel from entering the U.S. market. In fact, significant imports would likely continue coming to the U.S. and receiving incentives under the Renewable Fuel Standard (RFS) and California's Low Carbon Fuel Standard.
- *Create Jobs Here at Home:* There is more than enough U.S. production capacity to meet U.S. demand. With significant underutilized capacity in the domestic industry, biodiesel producers across the country are waiting for the right policy signals to expand production. With most of the U.S. plants running at only 65 percent capacity, the industry is more than capable of meeting robust requirements under the RFS and would create jobs as production expands.
- *Save Taxpayer Dollars:* Biodiesel imports to the United States have grown sharply in recent years, largely as a result of the tax credit. According to the Joint Committee on Taxation, this reform would save U.S. taxpayers roughly \$90 million.

- *Streamline IRS Administration and Reduce Potential for Tax Fraud:* Today, thousands of blenders are registered to blend biodiesel, creating a decentralized system that is difficult for the Internal Revenue Service (IRS) to administer. However, fewer than 200 companies are producing biodiesel and renewable diesel today. This reform would significantly streamline administration of the credit and avoid fraud or abuse by sharply narrowing the number of potential claimants for the credit.
- *Continue to Lower the Cost of Diesel Fuel for Consumers:* The \$1-per-gallon production tax credit would be passed down through the biodiesel value chain throughout the distribution system, ultimately decreasing costs for retail consumers. Biodiesel producers and blenders already structure transactions with the value of the credit “baked into” the sale. The producer’s credit would have the same value as the historical blender’s credit, and blenders would continue to benefit.
- *Strengthen the Bioheat® Market:* The U.S. biodiesel industry has invested millions of dollars and spent years to help build the Bioheat® market, particularly in the Northeast, where biodiesel is increasingly blended into home heating oil to create a cleaner product. This reform will strengthen that market by continuing to grow a strong domestic biodiesel industry with regional production nationwide. The value of the tax credit will be the same for Bioheat® under a producer’s credit. The credit would be negotiated and shared throughout the distribution chain just as it is under a blender’s structure, and the reform will ensure that Bioheat® blenders incur no new tax liability.

In conclusion, NBB would like to emphasize that the biodiesel tax incentive has helped achieve the desired goal of expanding domestic production of American energy resources and jobs here at home. In turn, the increased use of biodiesel has helped the United States realize economic, global competitiveness and environmental benefits. These benefits, however, will be jeopardized without long-term reinstatement of the biodiesel producers tax incentive in the Code to stimulate U.S. biodiesel production and job growth.

Thank you again for the opportunity to submit this testimony. NBB would be pleased to serve as a technical resource on the industry as the committee moves forward with its deliberations. Should you have any questions regarding our comments, please don’t hesitate to contact NBB Vice President of Federal Affairs Anne Steckel at 202-737-8801.

**Statement of the
National Council of State Housing Agencies
to the House Ways and Means Committee
in Response to its Hearing on
How Tax Reform Will Grow Our Economy and Create Jobs
June 1, 2017**

On behalf of our Housing Finance Agency (HFA) members, the National Council of State Housing Agencies (NCSHA) appreciates this opportunity to provide comments to the Ways and Means Committee on how the Committee can further strengthen proven housing resources—specifically the Low Income Housing Tax Credit (Housing Credit) and tax-exempt private activity Housing Bonds (Housing Bonds)—to help grow the economy, create jobs, and improve the lives of households across the nation. These critical programs, which HFAs administer in virtually every state, are essential to our nation’s ability to develop affordable rental housing and provide homeownership opportunities to people of modest means.

NCSHA is a nonprofit, nonpartisan organization created by the nation’s state HFAs more than 40 years ago to coordinate and leverage their federal advocacy efforts for affordable housing. HFAs are governmental and quasi-governmental, nonprofit agencies created by their jurisdictions to address the full spectrum of housing need, from homelessness to homeownership. HFAs effectively employ the Housing Credit and Housing Bonds, entrusted by Congress to state administration, to advance their common public-purpose mission of providing affordable housing to the people of their jurisdictions who need it. These indispensable financing tools contribute more significantly to HFA efforts to create housing, community, and economic opportunity than any other federal housing resources.

Affordable Housing: A Vital Part of a Pro-Growth Tax Code

Congress is embarking upon one of the most significant and challenging endeavors of recent decades—reform of the federal tax code. NCSHA understands there is bipartisan agreement that the current system is outdated, overly complicated, and not optimally structured to promote economic growth. We supports the Committee’s plan to examine all aspects of the current code as it seeks to reform the tax system.

The use of the tax code to provide affordable housing—both through the production and preservation of affordable rental properties with the Housing Credit and multifamily Housing Bonds and through the provision of lower-cost mortgages for working families with single-family Housing Bonds (under the Mortgage Revenue Bond (MRB) and Mortgage Credit Certificate (MCC) programs)—has been one of the singular successes of the current system. Since the Housing Credit’s establishment in the Tax Reform Act of 1986, it has financed roughly 3 million affordable rental homes for low-income families, seniors, veterans, and those with special needs.

Approximately 40 percent of those rental homes rely on financing from multifamily Housing Bonds and would not exist were it not for those bonds. HFAs finance still more affordable rental housing with multifamily Housing Bonds alone.

Using MRBs, state HFAs have helped over 3.1 million working families purchase a home for the first time. HFAs typically help about 75,000 families achieve this milestone each year. MRBs represent about the only hope for creditworthy families with modest incomes and limited resources to achieve homeownership. Moreover, they allow HFAs to serve as constant, reliable sources of flexible, affordable mortgage money for lower-income first-time home buyers, anchoring the first-time home buyer market.

The Housing Credit and Housing Bond programs are highly successful public-private partnerships that combine state HFAs' sophisticated underwriting, asset management, and oversight capacity with private sector expertise and investment. Without question, the Housing Credit and Housing Bonds are the most effective means of targeting limited affordable housing resources to the people and places that need them, while transferring risk to private sector investors.

Most importantly, the Housing Credit and Housing Bond programs make immeasurable investments in people and places. They transform lives by creating quality and sustainable living environments that lift up families; help children thrive; support seniors, people with special needs, and veterans; and permanently house persons experiencing homelessness. They contribute to community revitalization by inspiring business growth, infrastructure advances, transportation solutions, and much more.

These programs also have an enormous impact on local economies through the creation of jobs and generation of tax revenue. The Housing Credit supports approximately \$3.5 billion in federal, state, and local taxes; \$9.1 billion in wages and business income; and 95,700 jobs across various U.S. industries every year. The National Association of Home Builders estimates that in its first year, a typical 100-unit Housing Credit property on average provides \$8.7 million in additional wages for local workers and business profits; creates \$3.3 million in additional federal, state, and local tax revenue; and supports 116 jobs.

Housing Bonds also have a profound economic impact. According to models formulated by the National Association of Home Builders and the National Association of REALTORS®, in the 10-year period from 2006 to 2015, state HFA MRB homeownership programs generated almost 50,000 jobs annually. Multifamily Housing Bonds also spur important economic growth. Over the same period of time, state construction and rehabilitation of apartments financed with HFA multifamily Housing Bonds generated approximately 27,000 jobs and added over \$2 billion to GDP annually on average

The Growing Housing Need Exacts an Economic Toll

Unfortunately, while the Housing Credit and Housing Bond programs are extraordinarily successful, the resources devoted to them are woefully insufficient to meet the nation's affordable housing need, which is great and growing. In fact, we are losing ground in this battle as needs grow and resources shrink at rapid rates.

Currently, 40 million U.S. households—more than one in three—pay an excessive share of their income for housing. The crisis is most acute for those earning the least. Of those households with incomes of \$15,000 or less annually—approximately equivalent to working full-time at the minimum wage—four in five pay more than 30 percent of their income for housing. Two-thirds pay over 50 percent. This leaves little money left over for other critical necessities like food, transportation, childcare, healthcare, and utilities.

The housing crisis affects both homeowners and renters. For many low- and moderate-income borrowers, purchasing a home is by far their best opportunity to build up savings, yet these families face significant challenges as they seek to achieve homeownership. Even as the housing market strengthens, many creditworthy home buyers, especially first-time buyers, struggle to obtain mortgages they can afford. According to the National Association of REALTORS®, first-time home buyers accounted for just 30 percent of all home sales in the past three months, compared to the historical average of 40 percent.

As more and more people turn to the rental market, they find a severe shortage of affordable homes. Those available to extremely low-income (ELI) households, those earning 30 percent or less of Area Median Income (AMI), are especially scarce. Since 2000, the rental housing shortfall for ELI renters—measured as the gap between the number of ELI renters and the number of units available and affordable to them—has grown by 57 percent. The rental shortage is exacerbated as hundreds of thousands of new renter households enter the market each year, while the nation loses countless affordable units from the housing stock due to conversion to market rate rentals or condominiums, demolition, or obsolescence.

The success of affordable housing programs is most easily measured by the number of units created and preserved each year and the number of households served. But, these metrics do not begin to measure the impact affordable housing has on those families and the economic benefits it brings to society at large. Conversely, without affordable housing, everyone suffers.

Affordable housing is the foundation of an economically vibrant country. Housing stability creates better health outcomes, improves children's school performance, and can help low-income individuals gain employment and keep their jobs. The Housing Credit and Housing Bonds provide families with greater economic stability and more discretionary income than low-income families who are unable to access subsidized housing. This allows them to allocate more

money to other needs, such as health care and food, and gives them the ability to pay down debt and save for education, retirement, or unexpected needs.

Homelessness and hypermobility suffered by unassisted low-income families have dire consequences for children's educational attainment. Numerous studies show that children who move frequently—as they often must without stable housing—are more likely to drop out of school, repeat grades, perform poorly, or have numerous school absences compared to those with stable housing.

Affordable housing also can promote economic mobility. A recent Harvard University study, *The Equality of Opportunity Project*, found that moving younger children from a high-poverty neighborhood to a more integrated, lower poverty neighborhood improves their chances of going to college, lowers their risk of becoming a single parent, and increases their expected income as an adult by as much as 30 percent. Housing production programs, such as the Credit and Bonds, which build and preserve affordable housing in lower-poverty neighborhoods, are critical to achieving these results.

Affordable housing located near transportation and areas with employment opportunities provides low-income households with better access to work, which increases their financial stability and may help them eventually achieve independence from government assistance. It also provides employers in those areas with needed labor.

Preserve, Expand, and Strengthen the Housing Credit

As you consider changes to the current tax structure, NCSHA urges you to use this opportunity to build on what works, not only by preserving the Housing Credit and Housing Bond programs, but also by expanding Housing Credit resources so that we can better address the nation's severe affordable rental housing shortage, and by enacting policy modifications to strengthen this already successful program.

Earlier this year, senior Ways and Means Committee member Pat Tiberi (R-OH) and Committee Ranking Member Richard Neal (D-MA) introduced H.R. 1661, the Affordable Housing Credit Improvement Act. NCSHA strongly supports this legislation, which would improve program flexibility, simplify requirements, support the preservation of existing affordable housing, and facilitate Housing Credit development in challenging markets and for hard-to-reach populations.

In particular, NCSHA supports provisions of this legislation that would strengthen the bond-financed portion of the Housing Credit program; amend the Housing Credit income limits to allow for income averaging, thus allowing low-income families earning up to 80 percent of AMI access to Credit properties, while improving affordability for ELI households; provide parity in Housing Credit income rules for rural properties; simplify complex program rules, such as the

Housing Credit student rule; and establish a state-determined basis boost of up to 50 percent for units in Housing Credit properties reserved for ELI households.

Already, the Affordable Housing Credit Improvement Act has drawn wide bipartisan support, with more than half of Ways and Means Committee members cosponsoring the bill. We urge you to prioritize this important legislation in any tax reform proposal the Committee considers.

Moreover, we urge you to also expand Housing Credit resources. We know that Congress faces extraordinary pressure as it directs limited federal resources to so many priorities. However, we strongly believe that investing new resources in the Housing Credit makes sense, even in this time of budget austerity. Senate Finance Committee Chairman Orrin Hatch (R-UT) and Finance Committee member Maria Cantwell (D-WA) have sponsored legislation which would make the same improvements called for in the Tiberi-Neal bill, but also increase Housing Credit authority by 50 percent, phased in over a five-year period. Their bill, too, has strong bipartisan support in that chamber.

Each year, state Housing Credit allocating agencies receive applications requesting nearly three times more Housing Credit resources than agencies have to allocate. Yet even this does not quantify the extent to which demand for affordable rental housing outstrips the supply of Credits, as many developers with worthwhile projects do not even bother applying because the competition for Credit is so fierce.

State Housing Credit allocating agencies face difficult choices—not just whether to direct their limited Credit resources to preservation as opposed to new construction, but also whether to commit them to rural rather than urban areas or to neighborhood revitalization rather than to projects in high-opportunity areas. Agencies must balance whether to finance supportive housing for persons experiencing homelessness against assisted living for the elderly, housing for needy families, and projects for veterans—all of which serve populations with serious housing and service needs. And, in recent years, the federal government has turned to the Housing Credit time and again to achieve federal priorities such as transforming the nation’s public housing through the Rental Assistance Demonstration program and producing housing for persons with disabilities in conjunction with the Section 811 program. Housing Credit authority is simply inadequate to fund all of the worthy developments that are so needed.

Preserve the Tax-Exempt Private Activity Housing Bond Program

For decades, the Housing Bond program—multifamily bonds for financing affordable rental housing and the MRB and MCC programs for financing affordable first-time, modest home purchases—has been an essential and successful tool in our affordable housing efforts. While these bonds are private activity bonds (PAB), Congress deemed that the affordable housing they make possible is worthy of a tax exemption, not just because of the direct housing benefits these

bonds provide but also because of the positive effects the housing opportunities they create have more broadly on families, communities, and the economy.

In recent years, a few tax reform proposals have been advanced, both in Congress and from outside experts, which would eliminate the tax-deduction for interest on PABs while maintaining the exemption for other municipal bonds. This would be a mistake, and would drastically set back our efforts to provide affordable housing to those in need.

While it is true PABs provide direct financing to private entities, the bonds fulfill a very important public purpose that the market is often unable to meet. This is certainly the case of Housing Bonds. In addition to affordable housing, PABs support many other critical public priorities such as financing for airport renovations, sewage facilities, public power, and affordable student loans. Simply put, repealing or limiting the tax-exemption for PABs would severely hamper state and local governments' efforts to support affordable housing and other locally determined priorities.

The Housing Bond market, like many financial markets, has not fully recovered from the financial, housing, and broader economic crises of recent years. The historically low interest rates we have experienced during the recovery have hampered further the Housing bond market by greatly reducing the Housing Bond tax-exempt interest rate advantage. However, interest rates now are beginning to rebound and are likely to continue to climb. As we enter a more typical interest rate environment, the tax-exemption afforded to Housing Bonds will be even more critical to helping lower income home buyers purchase their first homes. Already, the market for Housing Bonds has strengthened. The most recent available data shows that in just one year— from 2013 to 2014—state HFA bond issuance jumped by 39 percent, as demand for tax exempt bond-financed housing grew.

Streamline and Simplify the Housing Bond Program

NCSHA recommends Congress take a few modest steps to make the highly successful Housing Bond program even more effective. With tax reform, Congress has the opportunity to further strengthen Housing Bonds by making low or no cost changes to eliminate outdated rules and to give states more flexibility to respond to their unique needs and circumstances. For example, within the MRB program, the purchase price limit is no longer needed, as the income limits Congress later imposed much more effectively control the price of homes MRB borrowers can purchase. The considerable resources HUD and Treasury expend coming up with the purchase price limits annually could be deployed elsewhere.

In addition, the MRB home improvement loan program, especially important now given the repair needs of foreclosed properties and the home maintenance families were forced to defer during the recession, would be much more useful if Congress increases its loan limit of \$15,000 by an amount at least adequate to reflect the rise in construction costs since it was first established

in 1980 and indexes that limit to keep up with construction cost inflation annually. We also encourage Congress, as it did on a temporary basis from 2008 through 2010, to allow state HFAs to use MRBs for refinancing, so state HFAs can help otherwise qualified borrowers.

In addition, we urge you to adopt proposals that would improve investor interest in the Housing Bond program. For example, NCSHA supports exempting interest earned on refunding Housing Bonds from the Alternative Minimum Tax. Conversely, we urge you to resist proposals that would undermine investor interest in Housing Bonds, such as limiting the value of the municipal bond interest deduction to a lower tax rate, as this would greatly diminish the value of Housing Bonds investments and, consequently, investor interest in them.

We also have several suggestions for simplifying the MCC program, which the tax code provides as an alternative to MRBs and which states utilize more when the Housing Bond rate advantage is limited, as it has been in recent years. MCCs help lower-income families afford homeownership by allowing first-time home buyers who meet the MRB program's income requirements to claim a dollar-for-dollar tax credit for a portion of the mortgage interest they pay each year, up to \$2,000. Specifically, we urge you to simplify the MCC calculation; permit HFAs to recycle MCCs, as you allow them to recycle Housing Bonds; provide HFAs the flexibility to shorten the MCC term and/or "front load" its benefits; eliminate the \$2,000 annual credit cap on MCC benefits; and provide HFAs the flexibility to structure the MCC assistance to respond to diverse home buyer needs. We would be happy to provide further detail on any of these proposals.

Thank you for your commendable efforts to promote a pro-growth, simplified tax code. NCSHA and our HFA members are pleased to have this opportunity to demonstrate to you the effectiveness of the Housing Credit and Housing Bond programs and provide to you our proposals for program improvements. We stand ready to assist you further with your evaluation in any way we can.



National Grocers Association

Dear Chairman Brady, Ranking Member Neal, and Members of the Committee:

The National Grocers Association (NGA) appreciates this opportunity to submit for the record the following comments for the House Ways and Means Committee’s hearing: “How Tax Reform Will Grow Our Economy and Create Jobs.” Tax reform is essential for moving the country forward and providing an economic boost to help Main Street businesses such as independent supermarkets thrive. We applaud the efforts of the House Republican Leadership and of Ways and Means Committee Chairman Kevin Brady to advance tax reform by holding this hearing.

NGA is the national trade association representing the retail and wholesale grocers that comprise the independent channel of the food distribution industry. An independent retailer is a privately owned or controlled food retail company operating a variety of formats. Most independent operators are serviced by wholesale distributors, while others may be partially or fully self-distributing. Some independents are publicly traded, but with controlling shares held by the family and others are employee owned. Independents are the true “entrepreneurs” of the grocery industry and dedicated to their customers, associates, and communities. The independent supermarket channel is accountable for close to 1% of the nation's overall economy and is responsible for generating \$131 billion in sales, 944,000 jobs, \$30 billion in wages, and \$27 billion in taxes.

NGA sees great promise in the possibility of reform to help Main Street businesses grow. NGA wants to be helpful in achieving tax reform, but there are priorities that NGA is not willing to compromise to achieve lower rates.

THE NEED FOR RATE PARITY

	Privately-held C-Corporation	Pass-Through Entity
Gross Income	\$100	\$100
COGS	\$90	\$90
S&A	\$8	\$8
Net Profit	\$2	\$2
Tax Rate 20%	\$.40	--
Tax Rate 25%	--	\$.50
After Tax Income	\$1.6	\$1.5

NGA members are comprised of both pass-through entities and C-Corporations. The House GOP Blueprint fails a critical test of providing parity between various legal structures—namely pass-through entities verses C-Corporations.

Under the House GOP Blueprint, C-Corporations would pay a top tax rate of 20 percent. Pass-through entities would pay a top tax rate on “active business income” of 25 percent, but could face a higher top rate when other factors are figured in.

The rate difference of five-percentage points or possibly more is troubling. This difference creates incentives for businesses to choose one legal form instead of another. The government should not be in the business of picking winners and losers based on legal formation. A business owner should choose the legal form that makes most sense for his business.

It is likely that in a geographic area there will be two independent supermarkets competing against each other, where one retailer is setup as a C-Corporation and the other is organized for tax purposes as a pass-through entity. The difference of having a significantly lower tax rate between the two different types of entities could create a significant advantage in favor of the C-Corporation (see chart above). The C-Corporation will have more cash flow than its pass-through entity competitor. If the topline number in the chart is changed to \$10 million or \$100 million, the difference between the two businesses entities is magnified and the inequities becomes rapidly apparent.

In addition to the inequity issue, there is a misconception on Capitol Hill that all C-Corporations pay a second layer of tax. The C-Corporation pays once at the corporate level and shareholders pay a tax when dividends are paid. There is a misconception about how NGA C-Corporations operate. NGA C-Corporations are privately-held or closely-held corporations. The owners are the shareholders, and there is not the pressure one would see with a publicly traded corporation to return dividends to shareholders. In fact, in a survey conducted by NGA, the majority of NGA member C-Corporations do not pay dividends. Instead these corporations reinvest their earnings back into the business.

INTEREST EXPENSE DEDUCTION

The House GOP proposal would allow businesses to deduct interest expense against interest income, with any net interest expense not being deductible but being carried forward indefinitely to use against future net interest income.

Independent food retailers and wholesalers rely on loans from banks and other lending institutions to help finance their businesses. Independent retailers and wholesalers also issue debt. They do not issue equity to grow their businesses. Part of the calculus of taking out a loan or issuing debt is the ability to deduct the interest. Being unable to deduct the interest expense from a loan would hurt the ability of NGA member companies to grow.

The most obvious area where this would hurt NGA members is in the operations side of the business—for instance, to make payroll or hire an employee. A NGA survey showed that 80 percent of NGA members incur debt in connection with operating their business. Independent retail and wholesale food businesses are committed to providing the best value to their customers. Making interest expense non-deductible increases the cost of capital. Higher costs of capital will squeeze margins hurting businesses and consumers. The loss of the interest expense deduction for

a non-depreciable expense is punitive, and should not be part of a plan that the House Ways and Means Committee adopts.

ESTATE TAX

NGA supports the full and permanent repeal of the estate tax.

Well over half of the assets of a typical supermarket—the highest of any other industry sector—are not liquid, so the death of an owner creates a serious obstacle to continuation of the business. Because the estate tax is assessed on the value of a business at the owner's death, it often forces families to borrow funds to pay the tax. As a result, it forces the sale of the business or it reduces the ability to invest and hampers growth of the business.

The estate tax is especially burdensome to family-owned retailers and wholesalers and undermines important American values of hard work, entrepreneurship, thrift, and intergenerational savings. Estate taxes put family-owned businesses at a severe disadvantage when they compete with corporations that will never face the prospect of being forced to borrow funds or liquidate an ongoing enterprise in order to pay an enormous tax. The estate tax can deal a fatal blow to a family-owned business at its weakest moment, costing communities jobs and tax revenue.

BORDER ADJUSTABLE TAX

The border adjustable tax outlined in the House GOP Blueprint is a serious issue for the retail community and supermarkets in particular. Nearly 20 percent of the products in supermarkets are imported, according to NGA data. In the fresh produce aisle, the percentage of imported products could be as much as 40 percent depending on the season. What's more, food products include items that are imported. The focus of the border adjustment tax thus far has been on bananas, coffee, coco, and certain types of fresh flowers—finished products—but if one considers all the products that contain imported ingredients, the amount of products that could be affected by a border adjustment tax could be much, much greater.

Retailers operate on narrow margins of two percent or less. If the costs of goods goes up, it is going to squeeze margins. Independent supermarkets are committed to delivering the best value possible to their customers and to the communities they serve. If prices rise too much, however, it is conceivable that the rising costs of goods could possibly be passed on to consumers, meaning higher grocery bills.

Higher grocery bills are not what NGA or NGA member companies want. As mentioned, independent supermarkets want to continue to deliver the best possible value to consumers and the communities they serve. To ensure this remains possible, NGA would encourage the House Ways and Means Committee not to include a border adjustable tax in its final tax proposal.

LAST-IN, FIRST-OUT ACCOUNTING (LIFO)

The Last-In, First-Out (LIFO) method of accounting is an accounting method widely used by the food retail and wholesale industry. Under LIFO, the last good taken into inventory is considered the first sold. In times of rising prices, the LIFO method more accurately matches the costs of goods sold to revenue and helps protect against price shocks. NGA believes it is imperative that

Congress protect LIFO, which has been a widely accepted method of accounting since 1939. NGA also believes that Congress should not tax LIFO reserves. LIFO reserves are a book keeping entry. There is no money set aside in a “LIFO reserve”. Nearly 40% of our members indicated that even if given 10 years they could not pay off their LIFO reserve. A tax on LIFO reserves could severely harm NGA members.

MAKE TEMPORARY PROVISIONS PERMANENT

Provisions that expire and are retroactively reinstated provide a limited benefit to businesses. Businesses need to plan and need certainty to take advantage of provisions in the Code that are designed to spur economic growth. The stop and start nature of certain provisions means that businesses will either not use or will not fully utilize the provisions, which is detrimental to economic growth.

Two provisions that need to be made permanent are the Work Opportunity Tax Credit (WOTC) and the New Markets Tax Credit (NMTC).

WOTC is critically important to businesses as a hiring incentive to create jobs. Small businesses, including independent supermarkets, use WOTC and other tax credits to expand the number of workers they hire. As a measure that helps drive jobs and the economy, WOTC is critical and it works.

Under the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), Congress extended the WOTC for five-years. Unfortunately, this credit expires from time to time. The expiration of the credit and the uncertainty that it will be there consistently makes it hard for businesses that utilize this credit to plan. Moreover, it makes business more reluctant to use the credit if they are not sure it will be available. This program drives hiring, helps the economy, and boosts economic growth. It is time to make this credit permanent so that businesses can adequately plan for maximizing the credit.

The NMTC provides an incentive to investors that invest in low income communities. Some low-income communities are food deserts—a place where there is not a grocery store. The NMTC has been used by the industry to help spur development of new stores in some food deserts. The opening of a store in a food desert or a low-income community provides jobs to local residents, increased economic activity in a community, and access to more food options. The credit is set to expire on December 31, 2019. For NGA members who make long-term investment plans, it is important that this credit be made permanent so that it can be maximized, which will lead to an overall economic benefit to the economy and benefits to local consumers.

WHAT THE CODE NEEDS: LOWER RATES, SIMPLICITY, AND PERMANANCE

First and foremost, tax reform needs to lower effective rates for independent food retailers and wholesalers. Food retailers and wholesalers pay high effective tax rates—in some cases more than 30 percent. As privately-held and closely-held businesses, NGA members reinvest their earnings into their businesses for expansion purposes. A lower effective tax rate for independent food retailers and wholesalers will allow a business to reinvest in purchasing more equipment, expanding, and hiring more people—all of which will help grow the economy.

The tax code also needs to be simpler. According to The Tax Foundation, the average business return takes 23 hours to prepare, and for NGA member companies a return can take significantly more time. Independent food retailers and wholesalers are experts at what they do, and are not necessarily experts at tax preparation. Doing taxes for their business requires having an internal tax department or using outside experts. This is money that is being diverted away from more productive uses such as hiring more employees and helping to grow the economy.

Congress also needs to provide certainty to taxpayers. It does not help businesses plan from year-to-year if they do not know what the tax rate is going to be or if there are going to be provisions that could be reinstated retroactively.

IN CLOSING

NGA would like to thank the Chairman, Ranking Member, and Members of the Committee for allowing NGA to offer these comments on this critical matter. To restate, NGA is committed to tax reform. NGA believes it is critical for moving the economy forward. But the House Ways and Means Committee needs to carefully consider how the ramifications of tax reform could affect an industry that employs nearly a million people across the country, including in every congressional district, and how reform will affect the millions of consumers who rely on independent supermarkets for their groceries. NGA would encourage both parties to put partisan differences aside and work to help family-owned Main Street businesses.



NATIONAL LOW INCOME
HOUSING COALITION

Tax Reform Proposal to Grow the Economy and Create Jobs
Submitted to the Committee on Ways and Means
U.S. House of Representatives
May 18, 2017

The National Low Income Housing Coalition (NLIHC) urges Congress and the Trump administration to use tax reform as an opportunity to help address one of the most critical issues facing extremely low-income families today: the lack of decent, accessible, and affordable housing. Through smart, modest reforms to the mortgage interest deduction (MID) – a \$70 billion tax write-off that primarily benefits higher income households – Congress can reprioritize and rebalance federal spending on housing to help make the deeply targeted investments in affordable rental housing that our nation needs to help the economy, our communities, and families thrive. *All without increasing costs for the federal government.*

NLIHC is dedicated solely to ensuring that people with the lowest incomes in the United States have affordable and decent homes. Our members include state and local housing coalitions, nonprofit housing providers, homeless service providers, fair housing organizations, researchers, public housing agencies, private developers and property owners, local and state government agencies, faith-based organizations, residents of public and assisted housing, and concerned citizens. While our members include the spectrum of housing interests, we do not represent any segment of the housing industry. Rather, we work with and on behalf of extremely low income households who receive or need housing assistance.

Research confirms that access to an affordable rental home is essential to economic prosperity and job creation. Having an affordable place to call home allows families to participate fully in the economy, making it easier for adults to find and keep good jobs and contribute to economic growth. An affordable home improves children's health and education in ways that increase their chances of economic success as adults. Federal investment in affordable housing boosts local economies and creates jobs. Despite the benefits of affordable housing, three out of four families eligible for rental assistance go without this help.

NLIHC and our [United for Homes](#) campaign proposes modest reforms to the MID to provide 25 million low and moderate income homeowners with a greater tax break and to reinvest the \$241 billion in savings over 10 years to provide affordable rental homes to families with the greatest needs. With these reforms, Congress and the Trump administration can help end homelessness and housing poverty once and for all, giving all families an opportunity to break through the cycle of poverty and climb the ladder of economic success.

I. The Need for Affordable Housing

Today, the affordable housing crisis in America continues to reach new heights. Rents are rising, wages of the lowest income workers are flat, and more people are renting their homes than ever before. But the supply of affordable housing and rental assistance has not kept pace. As a result, record-breaking numbers of families cannot afford a decent place to call home.¹ Every state and congressional district is impacted. Unless we increase investments in affordable housing to keep up with the need, these challenges will only get worse as demand for rental housing grows over the next decade.²

The greatest need for affordable housing—on the local, state, and national level—is concentrated among extremely low income renters who earn no more than 30% of the area median income (AMI) or the poverty guideline. NLIHC's recent report, [The Gap: The Affordable Housing Gap Analysis 2017](#), found that there is a shortage of 7.4 million affordable and available rental homes for the nation's 11.4 million extremely low income renters. Nationally, only 35 affordable homes are available for every 100 extremely low income renter households. As a result, 71% of the poorest families are severely cost-burdened, spending more than half of their limited income on rent and utilities. These 8.1 million households account for 72.6% of all severely cost burdened renters in the country. They are forced to make difficult choices between paying rent and buying groceries or visiting their doctor. This is the definition of "housing poverty." In the worst cases, these families become homeless.

NLIHC's 2016 [Out of Reach](#) report shows the difference between wages and the price of housing in every state, county, and jurisdiction by estimating each locality's "housing wage," the hourly wage a full-time worker needs to earn in order to afford a modest, two-bedroom apartment. In 2016, the national housing wage was \$20.30 per hour. A worker earning the federal minimum wage would need to work 112 hours a week—or 2.8 full-time jobs—just to afford a modest two-bedroom apartment. While the housing wage changes from state to state and county to county, there is no jurisdiction in the United States where a full-time worker earning the prevailing minimum wage can afford a modest, two-bedroom apartment. And it's not just minimum wage workers for whom rents are out of reach: the average renter in the U.S. earns \$15 per hour - \$5 an hour less than the national housing wage. NLIHC's 2017 edition of this report will be published on June 8.

The public is looking to the White House and Congress for solutions. According to a recent How Housing Matters survey, 81% of Americans believe housing affordability is a problem in America, and 60% characterize affordability as a serious problem. Three out

¹ According to HUD programs, households spending more than 30% of income for these housing costs are considered to be "cost-burdened." Households spending more than 50% are considered to be "severely cost-burdened."

² https://www.washingtonpost.com/news/in-theory/wp/2016/10/11/better-housing-policy-could-save-us-all-money-why-are-we-ignoring-it/?utm_term=.7baa41ec3cb9

of four (76%) Americans believe it is important for federal elected officials to take action on housing affordability, and 63% believe the issue is not getting enough attention.³

1. Impact on Economic Mobility

Affordable housing is a long-term asset that helps families and children climb the economic ladder. According to the How Housing Matters survey, 70% of Americans agree that “investing in affordable, quality housing is investing in kids and their future.”⁴

Increasing the supply of affordable housing and rental assistance—especially in areas connected to good schools, well-paying jobs, healthcare, and transportation—helps families climb the economic ladder and leads to greater economic and community development. In addition, children who live in a stable, affordable home have better health and educational outcomes, gain greater access to economic opportunities, enjoy better mental and physical well-being, and benefit from stronger communities. Research shows that increasing access to affordable housing is *the most cost-effective strategy* for reducing childhood poverty in the United States.⁵

Groundbreaking research by economist Raj Chetty offers persuasive evidence of the impact of affordable housing on upward mobility for children. Using new tax data, Chetty and his colleagues assessed the long-term outcomes for children who moved at a younger age to lower poverty neighborhoods. Chetty’s study found that children who were younger than 13 when their family moved to lower poverty neighborhoods saw their earnings as adults increase by approximately 31%, were more likely to live in better neighborhoods as adults, and less likely to become a single parent.

Other research shows that children living in stable, affordable homes are more likely to thrive in school and have greater opportunities to learn inside and outside the classroom. Children in low income households that live in affordable housing score better on cognitive development tests than those in households with unaffordable rents.⁶ Researchers suggest that that is partly because parents with affordable housing can invest more in activities and materials that support their children’s development.⁷

Having access to affordable housing allows the lowest income families to devote more of their limited resources to other basic needs. Families paying large shares of their income for rent have less money to spend on food, health care, and other necessities than those with affordable rents.⁸

³ <http://howhousingmatters.org/articles/affordable-housing-investment-kids-future/>

⁴ <http://howhousingmatters.org/articles/affordable-housing-investment-kids-future/>

⁵ <http://www.urban.org/research/publication/reducing-child-poverty-us>

⁶ <http://www.tandfonline.com/doi/abs/10.1080/10511482.2014.899261>

⁷ https://www.macfound.org/media/files/Affordable_Housing_Child_Enrichment_Stronger_Cognitive_Development.pdf

⁸ http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/americas_rental_housing_2015_web.pdf

2. Impact on the Economy and Job Creation

Beyond the broad benefits to economic mobility, an investment in affordable housing for the lowest-income households bolsters productivity and economic growth. By connecting workers to communities with well-paying jobs, good schools, and transit, investments in affordable housing can spur local job creation and increase incomes. Investments in affordable housing also boosts local economies and contributes to neighborhood and community development.

Research shows that the shortage of affordable housing in major metropolitan areas costs the American economy about \$2 trillion a year in lower wages and productivity. Without affordable housing, families have constrained opportunities to increase earnings, causing slower GDP growth. Moreover, each dollar invested in affordable housing boosts local economies by leveraging public and private resources to generate income—including resident earnings and additional local tax revenue—and support job creation and retention. Building 100 affordable rental homes generates \$11.7 million in local income, \$2.2 million in taxes and other revenue for local governments, and 161 local jobs in the first year.⁹

II. The Need to Reform the Mortgage Interest Deduction

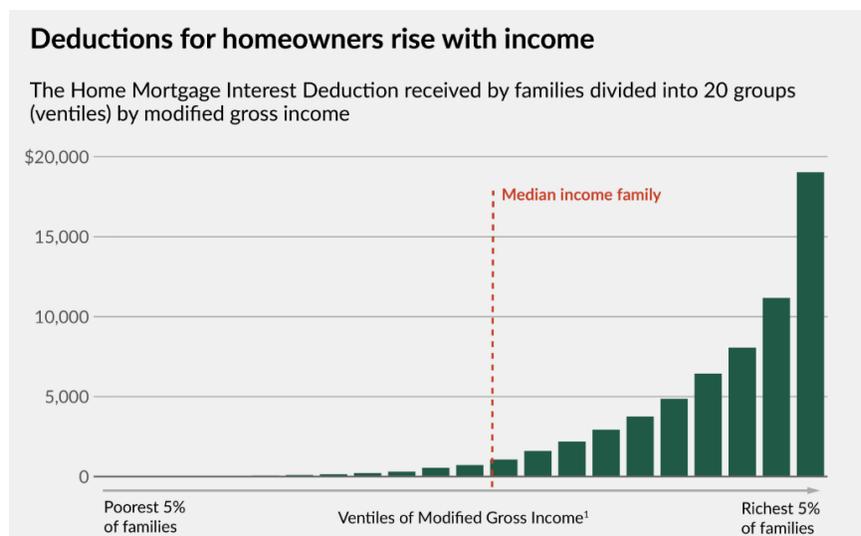
Congress has a clear opportunity to enact tax reform that addresses the growing affordable rental housing crisis facing millions of low-income people in every state and community. That starts with reforming the mortgage interest deduction (MID), our nation’s largest housing subsidy, and reinvesting these scarce resources to serve those with the greatest needs.

MID reform is no longer a political “third rail.” Experts from across the ideological spectrum are increasingly calling the MID what it really is: a wasteful use of federal resources that encourages households to take on higher levels of debt, disrupts the housing market by increasing costs for everyone, and mostly benefits those who do not need federal assistance to live in a stable home. This includes the [Wall Street Journal editorial board](#), [former President George W. Bush advisor Dennis Shea](#), the [CATO Institute](#), the [Ronald J. Terwilliger Foundation](#), [former President Obama advisor Michael Stegman](#), [former Labor Secretary Robert Reich](#), [Pulitzer prize-winning author and sociologist Matthew Desmond](#), and many others.

Each year, the federal government spends almost \$200 billion to help Americans buy and rent their homes. A full 75% of all federal housing resources goes to subsidize higher income homeowners through the MID and other homeownership tax breaks. In fact, the federal government spends more to subsidize the homes of the 7 million households with incomes above \$200,000 than to help the 55 million households with incomes of \$50,000 or less, even those these families are more likely to struggle to afford a place to call home.

⁹ https://www.nahb.org/~media/Sites/NAHB/Economic%20studies/1-REPORT_local_20150318115955.ashx?la=en

The MID is poorly targeted and largely benefits America's highest income households. According to the Congressional Budget Office, 75% of the benefits of the MID go to the top 20% of earners; 15% of the benefits to the top 1%. Almost all of the tax break goes to households with incomes above \$100,000.



Washington Center for Equitable Growth

Everyone else gets almost nothing. Half of all homeowners receive no tax benefit from the MID because they do not itemize their tax deductions and instead take the standard deduction. At the same time, only one in four of the poorest households that are eligible for housing assistance get the help they need because of chronic underfunding.

Economists across the political spectrum agree that the MID does little to promote homeownership. Higher income households that do benefit from the MID would likely choose to buy a home regardless of whether they receive a tax break. Similar countries without a MID have the same homeownership rate as the U.S. or higher.

Moreover, the MID primarily benefits affluent homeowners living in expensive urban areas in just a handful of states. More than 40% of MID dollars claimed go five states, skewed to the higher income homeowners. The rest is divvied up between the remaining 45 states.

III. The United for Homes Proposal

NLIHC's [United for Homes](#) campaign – which has been endorsed by more than 2,300 organizations, local governments, and elected officials – proposes to reform the MID. The changes are simple and modest.

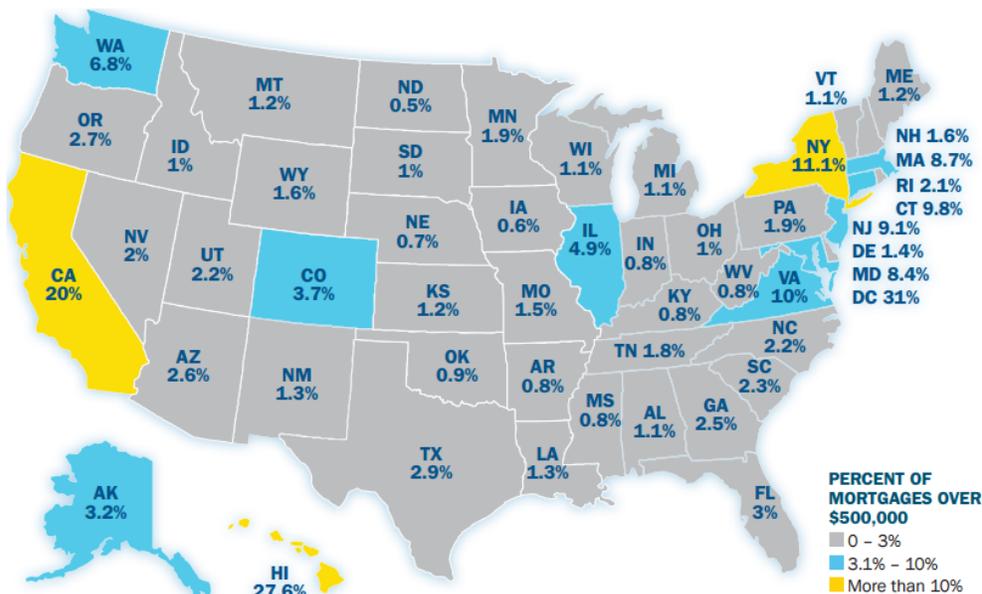
UFH calls for reducing the size of a mortgage eligible for the MID from \$1 million to the first \$500,000, generating \$87 billion in savings over 10 years. [An analysis of 2013-2015 Home Mortgage Disclosure Data \(HMDA\) shows that just 6% of all mortgages in the U.S. are over \\$500,000.](#) Moreover, homeowners with large mortgages would still receive tax relief on the first \$500,000 of their mortgage.

MORTGAGES OVER \$500,000 BY STATE

JUST 6.0% OF MORTGAGES IN THE UNITED STATES FROM 2013 TO 2015 WERE OVER \$500,000

UNITED FOR HOMES proposes reducing the portion of a mortgage eligible for a tax break from \$1 million to \$500,000. An analysis of Home Mortgage Disclosure Act data from 2013 to 2015 shows that just **6.0% OF ALL MORTGAGES IN THE U.S. WERE OVER \$500,000** during those three years.

This map shows the percentage of mortgages over \$500,000 in each state. In 40 states the percentage is less than 3%. Through the United for Homes proposal, **15 MILLION MORE LOW AND MODERATE INCOME HOMEOWNERS WITH MORTGAGES WOULD RECEIVE A TAX BREAK.**



Source: NLIHC analysis of Home Mortgage Disclosure Act (HMDA) data. Includes HMDA-reported mortgages originated during 2013, 2014, and 2015 for home purchase or refinancing. The analysis was restricted to owner-occupied properties with a first lien and single-family homes, two-to-four family structures, and manufactured housing.

UFH calls for converting the deduction into a nonrefundable, 15% capped credit, generating \$191 billion in savings over 10 years.

Half of all homeowners receive no benefit from the MID because they do not itemize their tax deductions. By converting MID to a credit, an additional 15 million homeowners—99% of whom have incomes under \$100,000 – who currently get no benefit under the MID would receive a much-needed tax break. In total, 25 million low and moderate income homeowners would receive a greater tax break than they currently do under the MID.

UFH calls for reinvesting the \$241 billion in savings into affordable rental housing for families with the greatest, clearest housing needs. The UFH reforms would generate \$241 billion in savings over 10 years to be reinvested into targeted rental housing programs that serve families with the greatest needs, including the national Housing Trust Fund (HTF), the creation of a renters’ credit, Housing Choice Vouchers, and public housing.

1. National Housing Trust Fund

The national Housing Trust Fund is the first new housing resource in a generation. It is exclusively targeted to help build, preserve, and rehabilitate housing for people with the lowest incomes.

NLIHC led a national coalition that played a critical role in the creation of the Housing Trust Fund through the passage of the *Housing and Economic Recovery Act of 2008*. In 2016, the first \$174 million in Housing Trust Fund dollars were allocated to states. This is an important step, but far more resources are necessary to meet the need.

The Housing Trust Fund is the *only federal housing program* exclusively focused on providing states with resources targeted to serve households with the clearest, most acute housing needs. Because the Housing Trust Fund is administered by HUD as a block grant, each state has the flexibility to decide how to best use Housing Trust Fund resources to address its most pressing housing needs. Each state distributes the resources based on its annual Allocation Plan, which identifies the state's priority housing needs. States decide which housing developments to support.

The Housing Trust Fund is also *the most targeted federal rental housing production and homeownership program*. By law, at least 75% of Housing Trust Fund dollars used to support rental housing must serve extremely low income (ELI) households earning no more than 30% of the Area Median Income (AMI) or the federal poverty limit. All Housing Trust Fund dollars must benefit households with very low incomes earning no more than 50% of AMI. In comparison, most other federal housing programs can serve families up to 80% of AMI. The statute requires that at least 90% of the funds be used for the production, preservation, rehabilitation, or operation of rental housing. Up to 10% may be used for homeownership activities for first-time homebuyers: production, preservation, and rehabilitation; down payment, closing cost, and interest rate buy-down assistance.

Currently, the Housing Trust Fund is funded with dedicated sources of revenue outside of the appropriations process. The initial source of funding designated in the statute is an annual assessment of 4.2 basis points (0.042%) of the volume of business of Freddie Mac and Fannie Mae, 65% of which goes to the Housing Trust Fund.

The statute also provides that the Housing Trust Fund can be funded by other sources of revenue, such as any appropriations, transfers, or credits that Congress may designate in the future. However, the Housing Trust Fund should be funded with dedicated revenues generated outside of the appropriations process so that it does not compete with existing HUD programs.

2. Renters' Credit

NLIHC supports proposals to establish a tax credit to help make housing affordable for renters with the lowest incomes.¹⁰ Our nation has long provided mortgage tax relief for higher income homeowners, most of whom would be stably housed without assistance. A renters' tax credit that could help ensure that the lowest income households can afford a safe, decent home is long overdue.

A renters' tax credit could complement the existing Low Income Housing Tax Credit—which works well as a subsidy for affordable housing development, but is rarely sufficient on its own to push rents down to levels poor families can pay—and rental assistance programs, such as Housing Choice Vouchers—which are highly effective, but reach only a modest share of the families in need of such assistance.

Any renters' credit should be tailored to benefit primarily families with the lowest incomes. Efforts to ensure that extremely low income households do not pay more than 30% of their incomes on housing should be prioritized.

Proposals to establish a renters' tax credit offer a promising opportunity to address the affordable housing challenges of the many lowest income households who go without assistance and to help these families keep more of their incomes for other necessities.

3. Housing Choice Vouchers

Housing Choice Vouchers are a proven tool in reducing homelessness and housing insecurity, as well as helping families climb the economic ladder. Housing vouchers help people with the lowest incomes afford housing in the private housing market by paying landlords the difference between what a household can afford to pay in rent and the rent itself, up to a reasonable amount. Administered by HUD, housing vouchers comprise the agency's largest rental assistance program, assisting more than 2.2 million households.

Despite the program's proven success in ending homelessness and reducing housing insecurity, limited funding means that a very low share of eligible families receives this needed assistance. Today, just one in four eligible families receive the rental assistance they need.

Recently, NLIHC published [*Housing Spotlight: The Long Wait for a Home*](#), which examined the waiting lists for federally assisted housing. NLIHC surveyed public housing authorities (PHAs) across the nation and found that more than half (53%) of all waiting lists for Housing Choice Vouchers (HCVs) were closed to new applicants. Of these, 65% had been closed for at least one year. The average wait time for vouchers is

¹⁰ Proposals have been developed by the Center on Budget and Policy Priorities (CBPP) and the Turner Center for Housing Innovation at the University of California Berkeley. Details on the CBPP proposal can be found here: <http://www.cbpp.org/research/housing/renters-tax-credit-would-promote-equity-and-advance-balanced-housing-policy>. The Turner Center proposal can be found here: <http://turnercenter.berkeley.edu/fair-tax-credit>

1.5 years, and a quarter (25%) had waiting lists of at least three years. Some of the largest PHAs had waiting lists of at least seven years.

Given the program's effectiveness, we recommend that Congress significantly expand housing vouchers provide families in need with housing choice.

While housing vouchers offer families the prospect of moving to areas of opportunity, barriers to mobility prevent many from doing so. Many private-sector landlords refuse to accept housing vouchers—whether because of the administrative costs, because vouchers do not cover the full cost of rent in high-cost areas, or outright discrimination. There are a number of steps that can be taken to address these issues, including consolidating public housing authorities' administration of vouchers within a housing market, directing HUD to adopt small area fair market rents (SAFMRs) with strong tenant protections, barring source-of-income discrimination, and funding mobility counseling pilot programs, among others.

4. Public Housing

Public housing is home to more than 1.1 million households and plays a critical role in providing safe, decent housing to families with the greatest needs. The preservation of this important community asset must be a part of any strategy to end housing poverty.

More than half (52%) of all households living in public housing are headed by a disabled and/or elderly resident, and nearly half (41%) have at least one child residing in the home. Nearly three quarters (72%) of households are considered very low or extremely low income, making less than 50% of the area median income, and the average annual tenant income is about \$13,400.

Despite its critical role, public housing capital repairs have been chronically underfunded. Today, public housing faces approximately \$45 billion in unmet capital backlog needs. As a result, HUD is unable to make the repairs needed to preserve its public housing stock and has lost 10,000 to 15,000 public housing apartments each year to obsolescence or decay.

Research shows that the vast majority of the more than 2 million people who live in public housing are satisfied with their homes, even though they rightfully push for solutions to maintenance and management issues. In fact, far more people are trying to get into public housing than leave it. In NLIHC's [*Housing Spotlight: The Long Wait for a Home*](#), we found that public housing waiting lists had an average wait time of 9 months. Twenty-five percent of them had a wait time of at least 1.5 years.

The federal government has already invested significant resources to develop, maintain, and operate public housing. Communities will lose an important asset—and the federal government will lose all of this investment—if Congress continues to underfund public housing. We urge Congress to make a significant investment—through an infrastructure package or otherwise—in rehabilitating and preserving public housing throughout the country.

IV. Alternative Approaches

President Trump's tax reform proposal would indirectly impact the MID. By doubling the standard deduction, fewer households would claim the MID and instead would take the increased standard deduction. This could provide many low and moderate income households a greater, much-needed tax break.

However, without additional reforms, Mr. Trump's proposal would amplify the MID's regressive effect; only the wealthiest Americans would benefit. NLIHC agrees with the Wall Street Journal Editorial Board that if Congress doubles the standard deduction, it should also embrace other reforms to make MID less regressive – like reducing the size of a mortgage eligible for the MID from \$1 million to \$500,000 - and reinvest the savings into deeply targeted affordable rental housing.

V. Conclusion

NLIHC and our members look forward to working with Congress and the Trump administration to address the lack of decent, accessible, and affordable housing, especially among families with the greatest needs, through tax reform legislation. Together, we can together help end family homelessness and housing poverty once and for all.

The National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) respectfully submit this statement for the record for the House Ways and Means Committee's May 18, 2017, tax reform hearing titled *How Tax Reform Will Grow Our Economy and Create Jobs*.

For more than 20 years, the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) have partnered in a joint legislative program to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of nearly 170 state and local affiliates, NAA encompasses over 72,000 members representing more than 8.4 million apartment homes throughout the United States and Canada.

Background on the Multifamily Housing Sector

Prior to addressing the multifamily housing industry's recommendations for tax reform, it is worthwhile to note the critical role multifamily housing plays in providing safe and decent shelter to millions of Americans, as well as the sector's considerable impact on our nation's economy.

Today, 111 million Americans, over one third of all Americans, rent their housing (whether in an apartment home or single-family home).¹ There are 18.7 million renter households, or over 15 percent of all households, who live in apartments (properties with five or more units).² On an aggregate basis, the value of the entire apartment stock is \$3.3 trillion.³ Our industry and its 38.8 million residents contributed \$1.3 trillion to the national economy in 2013 while supporting 12.3 million jobs.⁴

The U.S. is on the cusp of fundamental change in our housing dynamics as changing demographics and housing preferences drive more people away from the typical suburban house. Rising demand is not just a consequence of the bursting of the housing price bubble. In the five years ending 2016, the number of renter households was up by 5.8 million; homeowners were up by 1.3 million. Going back 10 years, there were 9.9 million new renter households and approximately 1.6 million new owner households. In other words, the growth in renter households precedes the 2008 housing crisis.⁵

Changing demographics are driving the demand for apartments. Married couples with children now represent only 21 percent of households. Single-person households (28 percent), single parent households (9 percent) and roommates (6 percent) collectively account for 43 percent of all households, and these households are more likely to rent.⁶ Moreover, the surge toward rental housing cuts across generations. In fact, nearly 73 million Baby Boomers (those born between 1946 and 1964), as well as other empty nesters, have the option of downsizing as their children leave the house and many will choose the convenience of renting.⁷ Over half (56.6 percent) of the net increase in renter households from 2006 to 2016 came from householders 45 years or older.⁸

Unfortunately, the supply of new apartments is falling well short of demand. An estimated 300,000 to 400,000 units a year must be built to meet expected demand; yet, on average, just 244,000 apartments were delivered from 2012-2016.⁹ Furthermore, according to Harvard's America's Rental Housing, the

¹ 2015 American Community Survey, 1-Year Estimates, US Census Bureau "Total Population in Occupied Housing Units by Tenure."

² 2015 American Community Survey 1-Year Estimates, US Census Bureau, "Tenure by Units in Structure."

³ NMHC estimate based on a report by Rosen Consulting. Updated 6/2014.

⁴ National Multifamily Housing Council and National Apartment Association.

⁵ NMHC tabulations of 2016, 2011, and 2006 Current Population Survey, Annual Social and Economic Supplement, US Census Bureau.

⁶ 2015 Current Population Survey, Annual Social & Economic Supplement, US Census Bureau, "America's Families and Living Arrangements: 2015: Households (H table series), table H3 / Family groups (FG series), table FG6.

⁷ Annual Estimates of the Resident Population by Single Year of Age and Sex for the United States: April 1, 2010 to July 1, 2015, US Census Bureau. Baby Boomers are defined as those born 1946 through 1964.

⁸ NMHC tabulations of 2016 Current Population Survey, Annual Social & Economic Supplement, US Census Bureau

⁹ US Census Bureau, New Residential Construction, updated 2/2016.

number of renter households could rise by more than 4.4 million in the next decade (depending upon the rate of immigration).¹⁰

The bottom line is that the multifamily industry provides housing to tens of millions of Americans while generating significant economic activity in communities nationwide. Changing demographics and growing demand will only cause the industry's footprint to expand in the coming years. As will be described below, tax policy will have a critical role to play in ensuring the multifamily industry can efficiently meet the needs of America's renters.

Key Priorities for Tax Reform

Owners, operators and developers of multifamily housing, who favor pro-growth tax reform that does not disadvantage multifamily housing relative to other asset classes, have a considerable stake in the outcome of the debate over how to reform and simplify the nation's tax code. Industry participants pay federal tax at each stage of an apartment's lifecycle. Federal taxes are paid when properties are built, operated, sold or transferred to heirs.

In providing our recommendations, which we respectfully make below, we are guided by the principle that real estate relies on the free-flow of capital and that investment decisions are driven by after-tax rates of return rather than by statutory tax rates standing alone. Thus, the number of layers of taxation, the marginal rate of tax imposed on income, cost recovery rules, investment incentives and taxes imposed when properties are sold, exchanged or transferred to heirs are all critical in assessing the viability of an investment. In developing reform proposals, we recommend that the Ways and Means Committee and Congress certainly consider -- but also look well beyond -- lowering statutory tax rates and focus on the ability of a reformed system to efficiently allocate capital and drive job-creating business investment. As is outlined in the pages below, NMHC/NAA believe that any tax reform proposal must:

- Protect Pass-Through Entities from Higher Taxes or Compliance Burdens;
- Ensure Depreciation Rules Avoid Harming Multifamily Real Estate;
- Retain the Full Deductibility of Business Interest;
- Preserve the Ability to Conduct Like-Kind Exchanges;
- Maintain the Current Law Tax Treatment of Carried Interest;
- Preserve and Strengthen the Low-Income Housing Tax Credit;
- Maintain the Current Law Estate Tax; and
- Repeal or Reform the Foreign Investment in Real Property Tax Act to Promote Investment in the Domestic Apartment Industry.

NMHC/NAA recognize that the Ways and Means Committee is considering the House Republican Tax Blueprint that would move the nation from the current income tax toward a cash-flow tax.¹¹ This proposal would dramatically alter current-law cost recovery rules, principally by providing for the full expensing (instead of depreciation) of property held for investment (except land) and denying the deductibility of business interest. The multifamily industry's recommendations for tax reform that are made below are provided in the context of reforming the current-law income tax. The multifamily industry continues to analyze the House Republican Blueprint and is committed to working with the House Ways and Means Committee to consider a full range of options to achieve a viable plan. Following the discussion of our tax reform priorities, the multifamily industry offers a few preliminary thoughts on how the Blueprint may impact cost recovery.

Priority 1: Tax Reform Must Not Harm Pass-Through Entities

The multifamily industry is dominated by "pass-through" entities (e.g., LLCs, partnerships and S corporations) rather than publicly held corporations (i.e., C corporations). Indeed, over three-quarters of

¹⁰ Harvard Joint Center for Housing Studies, "America's Rental Housing" (2015).

¹¹ A Better Way: Our Vision for a Confident America, Tax, June 24, 2016.

apartment properties are owned by pass-through entities.¹² This means that a company's taxable income is passed through to the owners, who pay taxes on their share of the income on their individual tax returns. This treatment contrasts with the taxation of large publicly held corporations that generally face two levels of tax. Those entities remit tax at the corporate level under the corporate tax system. Shareholders are then taxed upon the receipt of dividend income.

In addition to pass-through entities, a significant number of industry participants are organized as REITs. So long as certain conditions are satisfied, REITs pay no tax at the entity level. Instead, REIT shareholders are taxed on distributed dividends.

The multifamily industry opposes any tax reform effort that would lead to higher taxes or compliance burdens for pass-through entities or REITs. For example, while many are calling for a reduction in the nation's 35 percent corporate tax rate, flow-through entities should not be called upon to make up the lost revenue from this change.

Priority 2: Ensure Depreciation Rules Avoid Harming Multifamily Real Estate

Enabling multifamily developers to recover their investment through depreciation rules that reflect underlying economic realities promotes apartment construction, economic growth and job creation. Tax reform should ensure that depreciation tax rules are not longer than the economic life of assets by taking into account natural wear and tear and technological obsolescence.

In this regard, NMHC/NAA recommend that the Ways and Means Committee consider a recent study that suggests the depreciation of multifamily buildings should certainly be no longer than the current-law 27.5-year period and perhaps shorter. In particular, David Geltner and Sheharyar Bokhari of the MIT Center for Real Estate in November 2015 published a paper, *Commercial Buildings Capital Consumption in the United States*, which represents the first comprehensive study on this topic in nearly 40 years.¹³ By including capital improvement expenditures, the MIT study finds that residential properties net of land depreciate at 7.3 percent per year on average, which is a significantly faster rate than previously understood. Translated into tax policy terms, *we believe this data shows that the current-law 27.5-year depreciation period overstates the economic life of an underlying multifamily asset by over eight years.*

The apartment industry would be particularly concerned by proposals to extend the depreciation period of multifamily buildings, such as those made in the past to set multifamily depreciation periods at 40 or even 43 years. These proposals, which would create an arbitrary and discriminatory cost recovery system that does not reflect the economic life of actual structures, would have a devastating effect on the apartment industry's ability to construct new apartment buildings, particularly when, as noted above, supply continues to fall short of demand. Extending the straight-line recovery period for residential rental property from 27.5 years to 43 years, for example, would reduce a multifamily operator's annual depreciation deduction by 36 percent. This result would diminish investment and development in multifamily properties, drive down real estate values and stifle the multifamily industry's ability to continue creating new jobs. Put another way, the proposal would significantly impact cash flows and investment returns that are at the heart of a developer's analysis of whether a particular project is economically viable.

Furthermore, it is not just property owners who would suffer the consequences of depreciation periods that do not reflect the economic life of underlying assets. For example, pension plans and life insurance companies, which provide retirement and income security to millions of working Americans and retirees, could be harmed as their real estate investments lose value. Local governments would also see lower revenues as the value of multifamily properties decline, leaving a smaller amount of property taxes to finance core services, including law enforcement and schools. In this regard, the Tax Foundation found that

¹² US Census Bureau & US Dept. of Housing & Urban Development, *Rental Housing Finance Survey*, 2012.

¹³ David Geltner and Sheharyar Bokhari, MIT Center for Real Estate, *Commercial Buildings Capital Consumption in the United States*, November 2015.

in fiscal year 2014, property taxes accounted for 31.3 percent of state and local tax collections, more than general sales taxes individual income taxes and corporate income taxes.¹⁴

Finally, a note is warranted regarding so-called depreciation recapture. Under current law, when a multifamily property is sold, there are two types of taxes that apply. First, gain from the sale of the property is taxed as a capital gain, typically at a rate of 20 percent for a general partner and 23.8 percent for a limited partner. Second, the portion of the gain attributable to prior depreciation deductions is generally subject to a 25 percent tax. This second tax is referred to as depreciation recapture.

NMHC/NAA believe that depreciation recapture taxes as they stand today can have a pernicious effect on property investment and should be made no worse. After decades of operations, many multifamily owners have a very low tax basis in their properties. If sold under current law, owners would have to pay large depreciation recapture taxes. To avoid this huge tax bill, many current owners of properties with low tax basis will not only avoid selling their properties, but they will also be reluctant to make additional capital investments in properties. The result is deteriorating properties that are lost from the stock of safe, affordable housing. The other alternative is for the long-time owners to sell their properties to an entity that is able to pay a large enough sales price to cover the recapture taxes. To make their investment pay off, however, the new owner will likely convert the property to higher, market-rate rents, meaning a loss of our nation's affordable housing stock.

Therefore, either scenario can have the same result: the possible loss of hundreds of thousands of affordable housing units. Increasing depreciation recapture taxes will exacerbate this result and further discourage owners from selling these properties to entities that can retain them as affordable housing.

Priority 3: Retain the Full Deductibility of Business Interest

Under current law, business interest is fully deductible. However, efforts to prevent companies from overleveraging are leading to an examination of whether the current 100 percent deduction for business interest expenses should be curtailed. Unfortunately, curtailing this deductibility would greatly increase the cost of debt financing necessary for multifamily projects, curbing development activity.

As mentioned above, over three-quarters of multifamily properties are owned by pass-through entities. Although such entities can access some equity from investors, they must generally borrow a significant portion of the funds necessary to finance a multifamily development. A typical multifamily deal might consist of 65 percent debt and 35 percent equity. Because such entities often look to debt markets, which lend money at a rate of interest, to garner capital, the full deductibility of interest expenses is critical to promoting investment. Indeed, according to the Federal Reserve, as of December 31, 2016, total multifamily debt outstanding was \$1,186.7 billion.¹⁵ Reducing the full deductibility of interest would undoubtedly increase investment costs for owners and developers of multifamily housing and negatively impact aggregate construction.

In addition to harming the multifamily industry, it is also instructive to note that modifying the full deductibility of business interest would be precedent setting. Drs. Robert Carroll and Thomas Neubig of Ernst & Young LLP concluded in their analysis, *Business Tax Reform and the Tax Treatment of Debt*:

The current income tax generally applies broad income tax principles to the taxation of interest. Interest expenses paid by borrowers are generally deductible as a business expense, while interest income received by lenders is generally includible in income and subject to tax at applicable recipient tax rates. With this treatment, interest income is generally subject to one level of tax under the graduated individual income tax rates. This

¹⁴ Tax Foundation, *Facts & Figures, How Does Your State Compare?*, 2017, p. 14.

¹⁵ Board of Governors of the Federal Reserve System, *Mortgage Debt Outstanding*, By type of property, multifamily residences, 2016Q4, March 2017.

is the same manner in which most other business expenses, such as wages payments to employees, are taxed, and also follows the practice in other developed nations.¹⁶

Priority 4: Preserve the Ability to Conduct Like-Kind Exchanges

Since 1921, the Internal Revenue Code has codified the principle that the exchange of one property held for business use or investment for a property of a like-kind constitutes no change in the economic position of the taxpayer and, therefore, should not result in the imposition of tax. This concept is codified today in section 1031 of the Internal Revenue Code with respect to the exchange of real and personal property,¹⁷ and it is one of many non-recognition provisions in the Code that provide for deferral of gains.¹⁸

Like-kind exchanges play a significant role and are widely used in the multifamily industry. Current-law like-kind exchange rules enable the smooth functioning of the multifamily industry by allowing capital to flow more freely, which, thereby, supports economic growth and job creation. Multifamily property owners use section 1031 to efficiently allocate capital to optimize portfolios, realign property geographically to improve operating efficiencies and manage risk. By increasing the frequency of property transactions, the like-kind exchange rules facilitate a more dynamic multifamily sector that supports additional reinvestment and construction activity in the apartment industry.

According to recent research by Drs. David C. Ling and Milena Petrova regarding the economic impact of repealing like-kind exchanges for real estate and the multifamily industry in particular:¹⁹

- Assuming a typical nine-year holding period, apartment rents would have to increase by 11.8 percent to offset the taxation of capital gains and depreciation recapture income at rates of 23.8 percent and 25 percent, respectively.
- Whether based on the number of transactions or dollar volume, multifamily properties, both large and small, are the property type most frequently acquired or disposed of with an exchange.
- Nearly nine in 10 (88 percent) of commercial properties acquired by a like-kind exchange result in a taxable sale in the very next transaction. Thus, like-kind exchange rules are not used to indefinitely defer taxes.
- Governments collect 19 percent more taxes on commercial properties sold following a like-kind exchange than by an ordinary sale.

¹⁶ Drs. Robert Carroll and Thomas Neubig, *Business Tax Reform and the Tax Treatment of Debt: Revenue neutral rate reduction financed by an across-the-board interest deduction limit would deter investment*, Ernst & Young LLP, May 2012, p. 3.

¹⁷ Section 1031 permits taxpayers to exchange assets used for investment or business purposes, including multifamily properties, for other like-kind assets without the recognition of gain. The tax on such gain is deferred, and, in return, the taxpayer carries over the basis of the original property to the new property, losing the ability to take depreciation at the higher exchange value. Gain is immediately recognized to the extent cash is received as part of the like-kind exchange, and the taxes paid on such gain serve to increase the newly acquired property's basis. Congress has largely left the like-kind rule unchanged since 1928, though it has narrowed its scope.

The like-kind exchange rules are based on the concept that when one property is exchanged for another property, there is no receipt of cash that gives the owner the ability to pay taxes on any unrealized gain. The deferral is limited to illiquid assets, such as real estate, and does not extend to investments that are liquid and readily convertible to cash, such as securities. Furthermore, the person who exchanges one property for another property of like-kind has not really changed his economic position; the taxpayer, having exchanged one property for another property of like-kind is in a nearly identical position to the holder of an asset that has appreciated or depreciated in value, but who has not yet exited the investment.

¹⁸ Under the tax code, the mere change in value of an asset, without realization of the gain or loss, does not generally trigger a taxable event. In such situations, the proper tax treatment is to defer recognition of any gain and maintain in the new property the same basis as existed in the exchanged property. This is similar in concept to other non-recognition, tax deferral provisions in the tax code, including property exchanges for stock under Section 351, property exchanges for an interest in a partnership under section 721, and stock exchanges for stock or property under section 361 pursuant to a corporate reorganization.

¹⁹ David C. Ling and Milena Petrova, *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate*, June 2015.

Additional research suggests that like-kind exchanges play such a critical role in driving investment that repealing the ability to conduct them would harm the economy even if the resulting revenue were used to reduce tax rates. Indeed, Ernst & Young LLP estimates that repealing like-kind exchange rules and using the resulting revenue to enact a revenue-neutral corporate income tax rate reduction or a revenue-neutral business sector income tax reduction (i.e., encompassing both C corporations and flow-through entities) would reduce Gross Domestic Product by \$8.1 billion each year and \$6.1 billion each year, respectively.²⁰ Put another way, a tax rate reduction financed by repealing like-kind exchange rules would, on a net basis, harm the economy.

Ernst & Young LLP summed up its analysis of how repealing like-kind exchanges would impair investment by concluding, “While repealing like-kind exchange rules could help fund a reduced corporate income tax rate, its repeal increases the tax cost of investing by more than a corresponding revenue neutral reduction in the corporate income tax rate and reduces GDP in the long-run.”²¹ This result, of course, moves in the opposite direction of one of the stated goals for tax reform put forward by many of its proponents.

Priority 5: Maintain the Current Law Tax Treatment of Carried Interest

A carried interest, also called a “promote,” has been a fundamental part of real estate partnerships for decades. Investing partners grant this interest to the general partners to recognize the value they bring to the venture as well as the risks they take. Such risks include responsibility for recourse debt, litigation risks and cost overruns, to name a few.

Current tax law, which treats carried interest as a capital gain, is the proper treatment of this income because carried interest represents a return on an underlying long-term capital asset, as well as risk and entrepreneurial activity. Extending ordinary income treatment to this revenue would be inappropriate and result in skewed and inconsistent tax treatment vis-à-vis other investments. Notably, any fees that a general partner receives that represent payment for operations and management activities are today properly taxed as ordinary income.

Taxing carried interest at ordinary income rates would adversely affect real estate partnerships. At a time when the nation already faces a shortage of affordable rental housing, increasing the tax rate on long-term capital gains would discourage real estate partnerships from investing in new construction. Furthermore, such a reduction would translate into fewer construction, maintenance, on-site employee and service provider jobs.

Notably, former House Ways and Means Committee Chairman Camp recognized the devastating impact that a change in the manner in which carried interest is taxed would have on commercial real estate when he specifically exempted real estate from a change he sought to the taxation of carried interest in his *Tax Reform Act of 2014*.²²

Finally, some in Congress see the tax revenue generated by the carried interest proposal as a way to offset the cost of other tax changes. Enacting a bad tax law, such as changing the taxation of carried interest, merely to gain revenue to make other tax changes, is a distorted view of good tax policy, which demands that each tax proposal be judged on its individual merits.

Priority 6: Preserve and Strengthen the Low-Income Housing Tax Credit

The Low-Income Housing Tax Credit (LIHTC) has a long history of successfully generating the capital needed to produce low-income housing while also enjoying broad bipartisan support in Congress. This public/private partnership program has led to the construction of nearly 3 million units since its inception

²⁰ Ernst & Young LLP, *Economic impact of repealing like-kind exchange rules*, March 2015 (Revised November 2015).

²¹ Ibid.

²² H.R. 1, *Tax Reform Act of 2014*, Section 3621, Ordinary income treatment in the case of partnership interest held in connection with performance of services.

in 1986.²³ The LIHTC program also allocates units to low-income residents while helping to boost the economy. According to a December 2014 Department of Housing and Urban Development study, *Understanding Whom the LIHTC Program Serves: Tenants in LIHTC Units as of December 31, 2012*, the median income of a household residing in a LIHTC unit was \$17,066²⁴ with just under two-thirds of residents earning 40 percent or less of area median income.²⁵ Finally, the National Association of Home Builders reports that, in a typical year, LIHTC development supports approximately: 95,700 jobs; \$3.5 billion in federal, state and local taxes; and \$9.1 billion in wages and business income.²⁶

Maintaining and bolstering the LIHTC's ability to both construct and rehab affordable housing is critical given acute supply shortages. Indeed, the Harvard Joint Center for Housing Studies estimated that there were only 58 affordable units for every 100 very low-income households (those earning up to 50 percent of area median income) in the United States in 2013.²⁷

The LIHTC has two components that enable the construction and redevelopment of affordable rental units. The so-called 9 percent tax credit supports new construction by subsidizing 70 percent of the costs. Meanwhile, the 4 percent tax credit can be used to subsidize 30 percent of the unit costs in an acquisition of a project or new construction of a federally subsidized project and can be paired with additional federal subsidies.

Developers receive an allocation of LIHTCs from state agencies through a competitive application process. They generally sell these credits to investors, who receive a dollar-for-dollar reduction in their federal tax liability paid in annual allotments, generally over 10 years. The equity raised by selling the credits reduces the cost of apartment construction, which allows the property to operate at below-market rents for qualifying families; LIHTC-financed properties must be kept affordable for at least 15 years, but, in practice, a development receiving an allocation must commit to 30 years. Property compliance is monitored by state allocating agencies, the Internal Revenue Service, investors, equity syndicators and the developers.

First and foremost, Congress should retain the LIHTC as part of any tax reform legislation. In so doing, Congress must take care to offset any reduction in equity LIHTC could raise attributable to a reduction in the corporate tax rate. Furthermore, NMHC/NAA reminds Congress that tax-exempt private activity multifamily housing bonds are often paired with 4 percent tax credits to finance multifamily development, and that such tax-exempt bonds should be retained in any tax reform legislation as they play a critical role in making deals viable to investors.

Second, Congress should also look to strengthen the credit by both increasing program resources so that additional units can be developed or redeveloped and making targeted improvements to the program to improve its efficiency. Congress could increase program authority by allocating additional tax credits. Additionally, a part of the LIHTC that could benefit from a targeted adjustment involves program rules that require owners to either rent 40 percent of their units to households earning no more than 60 percent of area median income (AMI) or 20 percent to those earning no more than 50 percent of AMI. If program rules were revised to allow owners to reserve 40 percent of the units for people whose *average* income is below 60 percent of AMI, it could serve a wider array of households.

Priority 7: Preserve the Current Law Estate Tax

²³ National Council of State Housing Agencies, *2016 Housing Credit FAQ*, February 25, 2016.
<https://www.ncsha.org/resource/2016-housing-credit-faq>.

²⁴ Department of Housing and Urban Development, *Understanding Whom the LIHTC Program Serves: Tenants in LIHTC Units as of December 31, 2012*, December 2014, p. 23.

²⁵ *Ibid*, p. 24.

²⁶ Robert Dietz, *The Economic Impact of the Affordable Housing Credit*, National Association of Home Builders, Eye on Housing, July 15, 2014. <http://eyeonhousing.org/2014/07/the-economic-impact-of-the-affordable-housing-credit/>.

²⁷ Harvard Joint Center for Housing Studies, "The State of the Nation's Housing 2015: Housing Challenges" (2015), available at <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs-sonhr-2015-ch6.pdf>

As part of the *American Taxpayer Relief Act of 2012* (P.L. 112-240), Congress in January 2013 enacted permanent estate tax legislation. The Act sensibly made permanent the \$5 million exemption level (indexed for inflation) enacted as part of the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010* (P.L. 111-312) and set a top tax rate of 40 percent. Crucially, it also retained the stepped-up basis rules applicable to inherited assets. As many apartment executives prepare to leave a legacy to their heirs, it is vital to have clarity and consistency in the tax code with regard to estate tax rules. For this reason, the apartment industry remains supportive of the permanent estate tax legislation passed in early 2013.

There are three key elements to the estate tax: (1) the exemption level; (2) the estate tax rate; and (3) the basis rules. While all three elements can be important for all types of estates, estates with significant amounts of depreciable real property are especially concerned with how various types of basis rules may affect them.

- **Exemption Levels:** The estate tax exemption level is, in simplified terms, the amount that a donor may leave to an heir without incurring any federal estate tax liability. In 2017, there is a \$5.49 million exemption.
- **Tax Rates:** The estate tax rate applies to the value of an estate that exceeds the exemption level. The maximum rate is 40 percent.
- **Basis Rules:** The basis rules determine the tax basis to the recipient of inherited property. There are generally two different ways that basis is determined—stepped-up basis and carryover basis. The estate tax today features stepped-up basis rules, and under this regime, the tax basis of inherited property is generally reset to reflect the fair market value of the property at the date of the decedent's death. By contrast, under carryover basis, the tax basis of the inherited properties is the same for heirs as it was for the donor. This includes any decreases in tax basis to reflect depreciation allowances claimed by the donor in prior years. Retaining a stepped-up basis rule is critical for estates that contain significant amounts of depreciated real property as it helps heirs reduce capital gains taxes and maximize depreciation deductions.

Priority 8: Reform the Foreign Investment in Real Property Tax Act to Promote Investment in the Domestic Apartment Industry

The Foreign Investment in Real Property Tax Act (FIRPTA) (P.L. 96-499) serves as an impediment to investment in U.S. commercial real estate, including multifamily housing. The FIRPTA regime is particularly pernicious because it treats foreign investment in real estate differently than investment in other economic sectors and, thereby, prevents commercial real estate from securing a key source of private-sector capital that could be used to develop, upgrade, and refinance properties. Congress should enact tax reform that either repeals FIRPTA or, at the very least, further mitigates its corrosive effect on foreign investment in U.S. real estate.

Under current law, the U.S. does not generally impose capital gains taxes on foreign investors who sell interests in assets sourced to the U.S. unless those gains are effectively connected with a U.S. trade or business. This means that a foreign investor generally incurs no U.S. tax liability on capital gains attributable to the sale of stocks and bonds in non-real estate U.S. companies.

FIRPTA, however, serves as an exception to the general tax rules and imposes a punitive barrier on foreign investment in U.S. real estate. Under FIRPTA, when a foreign person disposes of an interest in U.S. real property, the resulting capital gain is automatically treated as income effectively connected to a U.S. trade or business. Thus, the foreign investor is subject to a withholding tax on the proceeds of the sale only because it is associated with an investment in U.S. real estate.

In addition to levying tax, FIRPTA also mandates onerous administrative obligations that further deter foreign investment in U.S. real estate. First, the buyer of a property must withhold 15 percent of the sales

price of a property sold by a foreign investor so as to ensure taxes are collected. Second, if they overpay tax through the withholding, foreigners investing in U.S. real estate must file tax returns with the IRS to receive a refund of the overpayment.

The taxes and administrative burdens FIRPTA imposes have negative consequences for U.S. commercial real estate and the multifamily industry. Because foreign investors can avoid U.S. tax and reduce their worldwide tax burden by investing in U.S. securities or in real estate outside of the U.S., they may simply choose not to invest in U.S. real estate. This is particularly harmful to an apartment industry that relies on capital to finance and refinance properties. Furthermore, because it is the sale of a U.S. property interest that triggers FIRPTA, foreign investors may hold on to U.S. real estate solely for tax considerations.

Repealing FIRPTA would ensure that tax considerations will not prevent capital from flowing to the most productive investments. Such reform could unlock billions in foreign capital that could help to both drive new investment and refinance real estate loans. If outright repeal proves impossible, Congress should consider additional targeted reforms to the FIRPTA regime. NMHC/NAA were particularly pleased that Congress in late 2015 enacted legislation to both provide a partial exemption from FIRPTA for certain stock of real estate investment trusts and exempt from the application of FIRPTA gains of foreign pension funds from the disposition of U.S. real property interests.²⁸

The House Republican Tax Blueprint and Cost Recovery

As noted above, the recommendations discussed in previous sections relate to reform of the current-law income tax. The House Republican Tax Reform Blueprint released in June 2016 represents a fundamental change in the way multifamily real estate would be treated for tax purposes. While it would reduce tax rates for the flow-through entities (e.g., LLCs, partnerships, and S corporations) that dominate the multifamily industry, the proposal, by moving from an income tax toward a cash-flow tax, dramatically alters the manner in which owners and investors recover their expenses. Under current law, multifamily real estate is depreciated over 27.5 years, all business interest may be deducted and properties can be like-kind exchanged to keep investment dollars in the real estate sector. In contrast, the House Republican proposal would provide for the immediate expensing of all assets—other than land—while denying interest deductibility. It is silent on like-kind exchanges.

The multifamily industry is continuing to evaluate the impact the House Republican proposal would have on the development of existing and future multifamily housing. The multifamily industry stands ready to work the Ways and Means Committee and Congress to refine this proposal as the policy development process moves forward. In the interim, we would offer the following preliminary observations.

First and foremost, the interest on debt, which has been fully tax deductible for 100 years, plays a critical role in developing multifamily real estate. Given the prevalence of the pass-through structure of ownership, multifamily entities are heavily reliant on debt markets – as opposed to equity markets that corporations access through the issuance of stock – to finance development. Accordingly, reducing the full deductibility of interest would standing alone increase investment costs for owners and developers of multifamily housing and negatively impact aggregate construction.

Second, it is unclear whether the benefits of full expensing would fully offset the loss of interest deductibility. This result is dependent on factors that include whether an entity is able to use the full value of an investment deduction in the year it is generated, the cost of capital, how much leverage a particular investor may choose to employ and statutory tax rates. In this regard, if the value of a deduction must be carried forward in the form of a net operating loss (NOL), it may be less beneficial. The House Republican tax plan proposes to allow NOLs to be carried forward indefinitely and to increase them by an interest factor that accounts for inflation and a real return on capital. It is uncertain how that real return on capital will be determined, but the formula will be critical. Given that a multifamily building may cost millions of dollars to construct, it is likely that many developers will have to recognize NOLs. If a real rate of return on capital

²⁸ Public Law 114-113, *Consolidated Appropriations Act, 2016, Division Q, Protecting Americans from Tax Hikes Act of 2015*.

is determined by reference to Treasury bonds, this will be substantially less valuable than a formula that references returns in equities markets. Until the Committee makes clear how NOLs will be calculated, the multifamily industry will be unable to fully analyze the House Republican proposal.

Third, it is critical to view cost recovery rules as a whole instead of in isolation. As noted above, current tax law, provides for depreciation, interest deductibility and like-kind exchanges. While expensing under the Blueprint may, in some cases, provide for a de facto like-kind exchange, this is not the case for land. Under the proposal, land, which can represent 15 percent to 25 percent of the cost of a typical multifamily deal, may not be expensed. Moreover, interest on land purchases may not be deducted. Thus, the tax treatment of land is materially worse under the House Republican tax plan than under current law that allows for interest deductibility. Although the Blueprint is silent on like-kind exchanges, members may wish to address this problem by retaining like-kind exchanges for land or continuing to allow interest deductibility on land.

Finally, while tax reform focuses on future investment, it is absolutely vital that policymakers do not diminish the value of current assets or adversely impact capital flows serving existing assets and the real estate industry. For this reason, transition rules to any future tax system will arguably be as essential as any new tax rules. This is especially true when it comes to how interest, depreciation and basis will be treated on existing multifamily debt.

According to the Federal Reserve, as of December 31, 2016, total multifamily debt outstanding was \$1.19 trillion. The multifamily industry strongly believes that debt serving existing assets should continue to be fully tax deductible as an ordinary and necessary business expense. Depreciation deductions on existing assets should also continue to be allowed under current law. Furthermore, owners of existing assets should be able to use current-law basis rules. Basis should not be reset to zero on the date of enactment as some have proposed. Any action to curtail interest deductions, diminish depreciation reductions or reduce basis attributable to existing assets has the capacity to greatly increase tax burdens and potentially lead existing multifamily investments to be uneconomic. This would greatly harm our industry's ability to house working Americans.

Conclusion

In closing, NMHC/NAA look forward to working with the House Ways and Means Committee, as well as the entire Congress, to craft tax reform legislation that would promote economic growth and the nation's multifamily housing needs. In communities across the country, apartments enable people to live in a home that is right for them. Whether it is young professionals starting out, empty nesters looking to downsize and simplify, workers wanting to live near their jobs, married couples without children or families building a better life, apartment homes provide a sensible choice. We stand ready to work with Congress to ensure that the nation's tax code helps bring apartments, and the jobs and dollars they generate, to communities nationwide.



May 17, 2017

The Honorable Kevin Brady
Chairman, Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Richard Neal
Ranking Member, Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

As the House Ways and Means Committee holds a hearing today to discuss how tax reform can grow the economy and create jobs, we write to express our support for comprehensive income tax reform but to also voice concern for proposals that would shift the tax burden to the consumer.

By way of background, NRF is the world's largest retail trade association, representing discount and department stores, home goods and specialty stores, Main Street merchants, grocers, wholesalers, chain restaurants and Internet retailers from the United States and more than 45 countries. Retail is the nation's largest private sector employer and contributes \$2.6 trillion to annual GDP.

NRF believes the most important aspect of any tax reform measure is its impact on the economy, jobs, and the consumer. Consumer spending represents two-thirds of GDP, and the retail industry supports the jobs of one out of four Americans, more than 42 million people. NRF believes tax reform that shifts the burden of the corporate tax to the consumer would present an unnecessary risk to our nation's economy. Instead, we support a reform of the current income tax structure by providing a broad base and low rates. We believe that approach rather than a shift toward a consumption tax would bring the greatest economic efficiency and stimulate economic growth without causing the economic dislocations inherent in the transition to a new tax system.

We are particularly concerned with elements of the House Blueprint that would increase the tax burden on consumers, including the border adjustment tax. Our studies show that the Blueprint's shift of the corporate tax base more towards consumption would likely cause retail spending to decline for six years compared with current law projections, while retail employment would decline for the same period. If the border adjustment tax proposal is included on top of this shift, there would be an even steeper decline in retail spending.

We believe there are other options for tax reform that would achieve economic growth and not shift the burden to the consumer. Reagan-style income tax reforms such as the 1986 Tax Reform Act or the Tax Reform Act of 2014 proposed by former Ways and Means Committee Chairman Dave Camp would each have positive effects on both the economy and the consumer.

We welcome the opportunity to work with the committee on this much-needed effort to bring about income tax reform.

Sincerely,

David French
Senior Vice President
Government Relations

cc: Members, Committee on Ways and Means

NATIONAL **RETAIL** FEDERATION
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Washington, DC 20005
www.nrf.com

May 16, 2017

The Honorable Kevin Brady, Chairman
House Ways & Means Committee
1011 Longworth House Office Building
Washington, DC 20510

The Honorable Richard Neal, Ranking Member
House Ways & Means Committee
341 Cannon House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

I write today on behalf of the hundreds of sporting goods retailers and institutional dealers operating more than 20,000 stores throughout the United States – many of which are small, family-owned businesses. These retailers and dealers would be unfairly damaged if a Border Adjustment Tax were to be included in the upcoming tax reform process.

Combined with the unfair sales tax advantage our members fight against, many of America's 42 million retail jobs are at risk if the cost of goods sold increases. It is estimated that the cost of everyday essential products like food, clothing and medicine would increase for consumers by more than \$1,700 annually. Those dollars reduce discretionary spending that comprise many sports, fitness and recreation purchases, which keep our nation active and healthy. We oppose government choosing winners and losers, and the Border Adjustment Tax would do just that by penalizing American families who struggle to keep up with growing expenses, while their incomes increase at a snail's pace – if at all. Within the last 24 months, three of the top ten full line sporting goods retailers have declared bankruptcy, triggering significant job loss in the retail sector. These are facts, not theories, and these merchants need relief not hurdles.

As tax reform begins to take shape, we ask the Committee to look favorably on the many family-owned, job-creating businesses by creating a tax reform package that removes the many burdens placed on these community-based businesses and to say no to the unfair Border Adjustment Tax. Please consider legislation, like the Remote Transactions Parity Act (H.R. 2193) which allows state and local governments to collect all taxes due, not just taxes from those of us who purchase things at brick and mortar stores, as the better alternative. State and local police departments can use some of the estimated \$26 billion in uncollected internet sales taxes to achieve the stated purposes of a Border Adjustment Tax.

We would appreciate an opportunity to discuss this issue and will be available to meet at your convenience.

Sincerely,



Matt Carlson
President & CEO

cc: NSGA Board of Directors
Larry Weindruch, Director of Public Affairs



Submitted by Bill Parks, President NRS Inc., 2009 South Main Street, Moscow, Idaho 83843

Written Testimony Before the Committee on Ways and Means, U.S. House of Representatives
Washington, DC
May, 2017 Statement of Bill Parks

Chairman Brady, Ranking Member Neal, and members of the committee: I am a retired professor of finance and the founding President of NRS, a 100% employee-owned company, which is the largest supplier of paddle sports accessories in the world. I have also published numerous articles in respected journals, including Tax Notes.

I would like to address a critical part of our current corporate tax system that is failing because it discourages small business capital formation. The code, perhaps inadvertently, dissuades small companies from being taxed as corporations. Speaker Ryan has pointed out the corporate rate for small business is 44.6% in the U.S. versus 15% in Canada.¹

An unintended consequence of our corporate tax system is that it discourages small businesses from growing. This happens because small businesses can easily avoid double taxation and paying any corporate income tax by simply organizing as “pass-through” entities like S corporations or limited liability companies. Only the C corporation can easily provide an incentive to reinvest in the business in the form of retained earnings. Therefore, while being a “pass-through” entity provides obvious tax advantages to small business owners, it discourages capital formation and growth. A small business organized as a C corporation, however, has an incentive to retain earnings not only directly for growth, but also because they are critical to obtaining loans to further finance growth. Those retained earnings will provide the safest, most accessible source of funds to grow the business. It is much more difficult for an S corporation or an LLC to reinvest its earnings because multiple owners will have disparate investment objectives and needs. Also, there is a psychological barrier to returning earnings to the company after they have been taxed.

Pass-through entities are clearly the right vehicle for most situations; I am not advocating their demise. However, I am urging you to modify the corporate tax rate structure to make the C corporation a more attractive option to small businesses. Here are two ways to accomplish this:

1. Eliminate the “nasty notch”

The Tax Reform Act of 1986 made the C corporation even less attractive to small business by adding a surtax that brought the total federal marginal tax rate to 39% for income between \$100,000 and \$335,000. This nasty notch had the unintended consequences of not only discouraging C corporation formation, but also causing existing small C corporations to switch to S corporation or LLC status at the first opportunity.² In doing so, small businesses have avoided the corporate tax, but at the same time, they have less incentive to retain the earnings that are critical to growing a successful business.^{3 4} The

¹ Ryan, Paul. Interview by Greta Van Susteren. *On the Record*. Fox News Television Network, New York. 4 November 2015.

² Since 1986, while S corporations have grown at approximately 7% per year and LLCs multiplied many fold, C corporations have declined by approximately 1.5% per year.

³ Bill Parks, Can Corporate Tax Reform Build on Apple’s Proposal?, *Tax Notes*, April 4, 2016. p.93.

⁴ Edward D. Kleinbard, *Why Corporate Tax Reform Can Happen*, *Tax Notes*, April 6, 2015, p. 94.



39% marginal rate keeps all but the most stubborn entrepreneurs from electing C corporation status.⁵ The first step toward making C corporations more attractive to small business is to repeal the “nasty notch.”

Deleted: .

2. Introduce a preferential corporate rate for small business

Over the last thirty years, the number of C corporations has plummeted. In 1980, the White House Conference on Small Business proposed that the number one need for small business was more graduation in corporate taxes. However, this has not happened. One reason is that many experts have seen corporate tax graduation as a give away to “high net worth individuals” that own most small businesses.⁶ But even if it were true, it is of little importance compared to the need to help small business grow. Many small businesses, induced into becoming LLCs or S corporations, may not be aware of how tilted the playing field is against them. They lack the retained earnings that make them good candidates for loans needed to fuel their growth.

With only 2% of business income tax coming from C corporations with less than \$50 million in sales,⁷ giving small business an incentive to be taxed as corporations by lowering their rate could provide great help to small and medium-sized businesses without seriously affecting revenue.

Therefore, I suggest that the corporate tax rate for the first \$1 million in income be 10% and 15% from \$1-5 million and that further graduation be considered.

Conclusion

Professors of tax accounting say, only partly in jest, that an accountant should lose his or her license for helping create a small business as a C corporation. Professors in law school state that an attorney should be disbarred for creating a small C corporation. And of course, many new businesses should start as S corporations or LLCs in order to flow through initial losses to offset other income. But after attaining profitability, the code should encourage growing companies to be taxed as corporations in order to encourage growth via retained earnings.

Eliminating the “nasty notch” and introducing preferential graduation for small business will stimulate growth and employment. Graduating corporate taxes to be far below the individual rates up to two million dollars or more would provide a powerful incentive for small businesses to be taxed as C corporations

⁵ My personal stubbornness enabled NRS to grow over 40 years from an initial \$2,000 investment to almost \$40 million in sales as a C Corporation before recently becoming 100% employee owned.

⁶ This is ironic because The Tax Reform Act of 1986 prevented high income tax payers from turning themselves into corporations because it repealed the General Utilities Doctrine, “that permitted a firm to liquidate its assets at more than book value and to pass the proceeds of the liquidation through to stockholders without making the firm pay income taxes on the gains. As a result of the repeal, any gain from liquidation is taxed twice: once to the liquidating firm (C corporation) and again to the stockholders.”

⁷ TESTIMONY OF THE STAFF OF THE JOINT COMMITTEE ON TAXATION BEFORE THE SENATE COMMITTEE ON FINANCE HEARING ON NAVIGATING BUSINESS TAX REFORM1 APRIL 26, 2016 by Thomas Barthold. p. 5

May 31, 2017

The Honorable Kevin Brady
Chairman, Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Richard Neal
Ranking Member, Committee on Ways & Means
1139E Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

As a pioneer and global leader in the business of employee recognition, we write to encourage you to maintain the employee achievement award exemption in tax reform.

As you know, in most cases, all cash and in-kind gifts from an employer to an employee are considered compensation and taxed as such. However, one narrow exception since 1986 is for an employee achievement award defined by Sec. 274(j) of the Internal Revenue Code. This provision is good for workers, businesses and the economy.

In 2013, we conducted an impact study – The Power of Recognition – about the economic impact of this provision. The results show:

- Recognizing service and safety achievements of employees generates an estimated total of \$44 billion in economic benefits due to productivity improvements, safety achievement and decreased turnover costs.
- Non-monetary awards have been found to improve worker productivity by an average of 19 percent.
- Non-monetary awards reduce employee turnover by approximately 13 percent.
- Safety awards programs can reduce workplace accidents by as much as 25 percent.

This study includes data from 2004 to 2012, so growth of employee achievement awards in the past five years could mean an even greater impact than reported in the impact study.

With tax reform on the horizon, we want to remind Congress about the economic value of employee recognition awards and the importance of the tax code provisions that encourage employers to celebrate and appreciate their employees.

Attached to this letter you will find the executive summary from the impact study mentioned above. As Congress moves toward tax reform, we are hopeful the Ways and Means Committee will keep the value of the employee achievement exemption and those businesses that provide those award programs in mind.

THE POWER OF RECOGNITION:

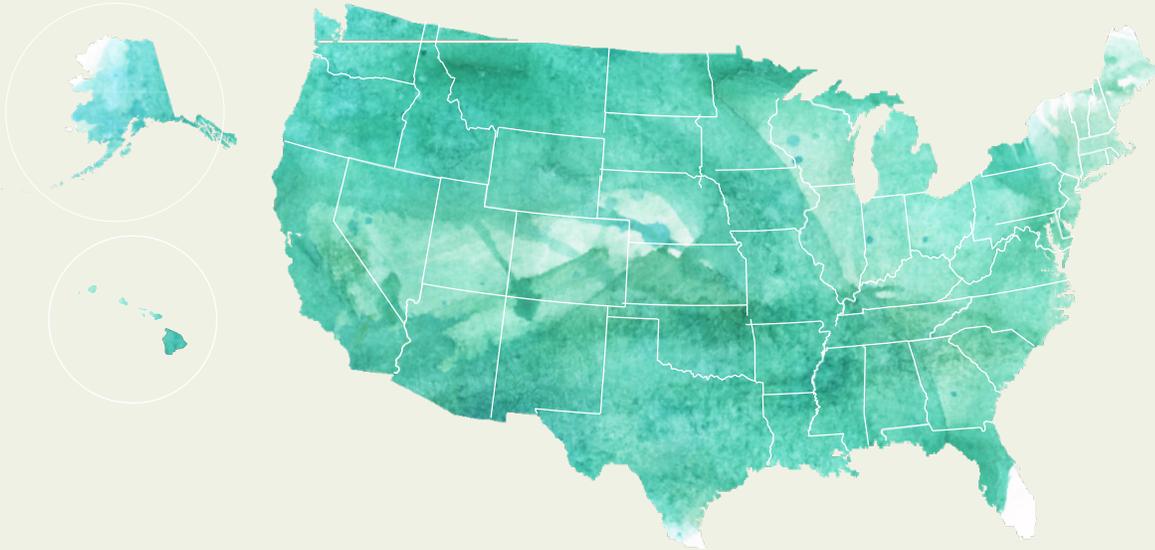
What drives the workers that drive American business?



executive summary

American workers are what make American businesses great. Because of their tenacity and dedication, the economy is recovering from the most serious economic crisis since the Great Depression.

Since their creation, workplace awards that honor length of service and safety achievements have supported millions of jobs and helped build American businesses across the country. Indeed, employee recognition programs and reward strategies show hardworking employees they are appreciated and trusted by their employers, communicate employee value, and encourage employees to engage in the missions of their organizations. Regardless of the larger economic climate, all employees have a need to be connected—to a manager, to a company, to a purpose—and they want to be recognized for the work they do.



The best companies, big and small, appreciate the power of recognition

and there are thousands of businesses running recognition programs in every state in the country. Companies as varied as Blue Cross Blue Shield, Constellation Wines, AstraZeneca, and AT&T understand that awards can be significantly more effective than salary increases at influencing positive behavior. They know that workplace awards lead to quantifiable gains in worker productivity, tenure and overall safety.

\$44 Billion: measuring a nation's return on recognition

Employee awards and recognition aren't just a nice thing to do; they are a necessary thing to do. Recognizing service & safety achievements makes good business sense, and leads to quantifiable gains in productivity, tenure, and workplace safety.

Service and safety awards programs and their many benefits are encouraged through a provision that allows employees to receive an average of \$400 in qualifying service recognition every 5 years, tax-free. This small investment in the safety and productivity of American workers has a significant macroeconomic benefit, producing annual gains to the economy approaching \$44 billion: \$22 billion from productivity improvements, \$7 billion by improving safety, and \$15 billion in savings from decreased employee turnover costs.

RETURN ON RECOGNITION



Improved worker performance and productivity

When employees know they are a valued member of the team, they work harder, improving their overall performance. Setting objectives for employees to reach, such as a goal for safe behavior, can also increase desired performance. Non-monetary awards have been found to improve worker productivity by an average of 19 percent. And what's good for employees is good for business. A 2009 study by Towers Watson found that companies with engaged employees increased their operating income by 19 percent, as compared to companies with a less engaged workforce, which saw their operating income drop by a third.



Improved worker retention and satisfaction

Turnover can cost an organization up to 30%-50% of the annual salary of entry-level employees, 150% of middle-level employees, and up to 400% for specialized, high level employees.



Add in the non-quantifiable, but equally critical, loss of knowledge and experience, and the cost of turnover can be devastating.

Non-monetary awards have been found to reduce employee turnover by approximately 13% thanks to increased employee satisfaction.

A recent global quantitative and qualitative study by the Cicero Group found organizations that offer a service recognition program keep employees an average of two years longer than organizations that don't.



Moreover, a 2012 study by economist, Dr. Ike Brannon, Director of Research at the R Street Institute, a public policy research institute, estimated that increases in worker retention linked to non-monetary recognition awards produced an annual economic benefit of \$15 billion in reduced turnover costs.



Improved safety habits in the workplace

Safety awards programs reduce workplace accidents by as much as 25 percent. Investing in reward strategies to boost safe work practices translates directly to a happier, healthier workforce and higher company profits through fewer lost workdays, fewer workers' compensation claims, and less downtime in general.

Statement by Chair of the Patriotic Millionaires Morris Pearl

May 31st, 2017

Chairman Brady, Ranking Member Neal, and other members of the Committee,

Thank you for the opportunity to submit this testimony.

I represent The Patriotic Millionaires. One of our organization's central tenets is that prosperity begins with a strong middle and working class -- people who can afford to shop in our businesses -- not with tax breaks for the rich. Wealth in America has become increasingly concentrated over recent decades, and our citizens and economy have suffered as a result. Our nation needs a tax code that works for all Americans, not just a wealthy few. We were troubled by Chairman Brady's remarks during the hearing on May 18th, and we urge you to set aside the comprehensively disproven theory of trickle-down economics when you consider tax reform proposals.

Giving wealthy Americans and corporations large tax cuts will not help the actual job creators who enable economic growth, but will rather further concentrate wealth at the very top, giving a break to those who need it the least. It will grow the savings of the few, but do nothing to grow the spending of the many. Chairman Brady repeatedly claimed in his opening statement on May 18th that we are in desperate need of "pro-growth tax reform," but evidence has shown time and time again that tax cuts for the wealthy do not cause growth for anything, except for the savings of the wealthy.

Wealth doesn't trickle down; it flows up.

You can neither cut your way to prosperity nor grow your way out of inequality, yet we continue to hear these suggestions year after year. Supply-siders argue they are growing the pie for all Americans, but rather than feeding all Americans, the result has been more pie for those who are already at the table. The rest of America is left scrambling for crumbs.

Over the last few decades we, wealthy Americans, have done very well, in no small measure because we benefited from public education, government services, a civil society, and world-class infrastructure, all provided by the government. However, our good fortune has not been shared by the majority of our fellow citizens, and since our success has been supported by the general public, we feel that we, and people like us, have an obligation to pay back. We know that growing inequality will make the way of life we now enjoy untenable, and we are afraid that Chairman Brady's proposals are moving in that direction.

We are extremely concerned, based on Chairman Brady's statements, that upcoming attempts at tax reform will ask less of us, the wealthy, and ask more of our fellow citizens. We ask that you make a public statement upholding the Mnuchin rule, saying absolutely no new tax cuts for the wealthy.

Thank you,

Morris Pearl

Chair of the Patriotic Millionaires



Statement for the Record

American Insurance Association
National Association of Mutual Insurance Companies
Property Casualty Insurers Association of America
Reinsurance Association of America

Hearing on
“How Tax Reform Will Grow Our Economy and Create Jobs”

House Ways and Means Committee

May 18, 2017

The property and casualty (“P&C”) insurance industry recognizes the importance of tax reform to ensuring the growth and competitiveness of the American economy. We welcome the opportunity to work with the Congress in developing changes to the Code that would improve the competitiveness of U.S. corporations, and simplify administration while still ensuring policyholder protection and overall tax fairness.

Executive Summary

The P&C insurance industry provides coverage of commercial risks and personal risks that are critical to the protection and expansion of the American economy. The industry is regulated for solvency and consumer protection by the states, which use the Annual Statement filed with state insurance regulators as the basis for accounting. Unlike other corporations, insurance companies receive premium income first, and pay claims and other expenses afterward. The Annual Statement accounting method provides deductions for future claims and expenses needed to obtain a clear reflection of income.

The policy recommendations include:

- Preserve conformity with state insurance regulatory method of accounting,
- Maintain deductibility of reserves,
- Maintain current treatment of municipal bond interest,
- Modernize the Exempt Insurance Income definition and Active Finance Exception for deferral of underwriting and investment income, respectively, of foreign insurance subsidiaries,
- Allow capital losses on the bond portfolio to be treated as ordinary losses,
- Repeal the obsolete barriers to life/non-life consolidation,
- Preserve Net Operating Loss carrybacks, and
- Because P&C insurers’ deduction for advertising expenses is already subject to restriction under current law, if advertising expenses are limited for ordinary corporations, avoid imposing a double denial of deductions for advertising expenses to insurance companies.

A more detailed discussion of these policies follows.

Profile of the Property and Casualty Insurance Industry

The American Insurance Association, the National Association of Mutual Insurance Companies, the Property Casualty Insurers Association of America, and the Reinsurance Association of America (collectively the “Trades”) represent the great majority of insurance and reinsurance companies underwriting property and casualty insurance throughout the United States. P&C lines of business include personal lines such as homeowners and automobile insurance, and commercial lines written for

businesses and other organizations, such as workers' compensation, commercial general liability, commercial property and business interruption, product liability, surety and fidelity.

The P&C insurance industry pays approximately \$300 billion in claims annually, covering businesses and individuals. Without proper insurance protection for loss of property, injury or liability American businesses cannot open their doors for business, much less grow and expand. The insurance industry, including P&C, life and health, and related activities, employs more than 2.1 million people, accounting for about 28 percent of the workforce in the U.S. financial activities sector.

The insurance industry also plays a significant role in public financing of needed services and infrastructure. The P&C industry holds 21 percent of its investable assets in municipal bonds. The industry also invests in direct pay bonds, such as Build America Bonds, private activity bonds and as partners in public private partnerships. As major investors, the industry plays a role in facilitating the development of transportation projects, utilities, health care facilities, schools and affordable housing. As such, it is incumbent that policymakers carefully consider the implications of tax changes on the P&C insurance industry.

Fairness, Efficiency and Simplicity

Fairness, efficiency and simplicity are the principals that President Ronald Reagan outlined for successful tax reform. The Trades believe those serve as valuable guidelines for today and are essential to promote economic growth. The provisions of Subchapter L of the Internal Revenue Code, based on the Annual Statement method of accounting, provide the special rules necessary to treat insurance companies fairly in light of their regulatory requirements and unique business structure.

Tax policies that mirror and work in concert with regulatory requirements reduce distortion and promote economic efficiency. The measure of true economic income for P&C insurers tracks the state regulatory framework. Lastly, simplicity in administration reduces complexity and compliance burdens. In the context of P&C insurance taxation, simplicity lies in following the accounting, financial solvency and investment standards imposed by state regulatory authorities. Conformity with the regulatory framework reduces administrative burdens and minimizes economic distortions.

Conformity with Regulatory Framework

Unlike most businesses, which generally make upfront expenditures and earn income in the future, insurance companies receive advance payments in the form of premiums in exchange for the promise to pay any covered losses (i.e. customer claims) that will occur in the future. As accepting premiums obligates insurers to pay losses on future claims, insurance companies record liabilities (i.e. reserves) when losses are

incurred by policyholders. Under state regulatory accounting principles, a loss is incurred when the event giving rise to the liability occurs (i.e., a car accident), and P&C insurers may not establish a loss reserve before the underlying loss event occurs. The principle of “conformity” with the Annual Statement underlies the federal income tax system for P&C insurance companies. The accounting and tax treatment of insurers reflects the fundamental difference between insurance companies and other financial institutions – insurers receive premiums up-front and pay losses and related expenses later while most other businesses incur their expenses up-front and sell their products and services later. *From a statutory accounting standpoint, a P&C insurer cannot treat premium income as its own until it is clear that these amounts are not needed to pay policyholder claims and expenses.* Taxing premium income as received without deducting reserves for unpaid losses would distort income by overstating income in the year of the policy, and understating income in later years when losses under the policy are paid.

Policy Recommendations

Given the inextricable link between solvency regulation and insurance company economic income, it is imperative that the link between regulatory-based accounting and reserve requirements and federal income tax treatment be maintained. With this in mind, the Trades believe the following principles should guide Congress as it considers tax changes affecting the P&C insurance industry.

- **Preserve Statutory Accounting as Basis for Tax Accounting:** The basic components of insurance company taxable income are taken from the Annual Statement and are based on statutory accounting. Continued reliance on statutory accounting and the Annual Statement is essential for proper measurement of insurance company taxable income.
- **Maintain Deductibility of Reserves:** Central to the proper matching of income and expenses is the deduction for loss reserves and loss adjustment expenses. These expenses are estimated by professional actuaries based upon an adjuster’s evaluation of the incurred loss and evaluations of trends in reserve components, such as court awards, inflation, or medical expenses. Maintaining a deduction for reserves in the year in which the premium is received and losses are incurred is essential to prevent a mismatch of income and expenses.
- **Maintain Current Treatment of Municipal Bond Interest (“Proration”):** P&C insurers hold more than \$325 billion in state and local bonds, making the P&C insurance industry one of the largest holders of municipal securities. Since 1986, P&C insurers have been required to include in taxable income 15 percent of the interest received on otherwise “tax-exempt” bonds as a reduction of their deduction for reserves. Increasing the taxable percentage would discourage P&C

insurers from investing in state and local bonds, and, at the same time, increase the borrowing costs of state and municipal governments.

- **Modernize Exempt Insurance Income definition and the Active Finance Exception:** Underwriting income of a foreign insurance subsidiary is deferred from inclusion in Subpart F if it meets the definition of Exempt Insurance Income. The “Active Financing” rule of Subpart F allows foreign insurance subsidiaries to defer investment income received as part of active insurance operations in the same manner as other active businesses. Briefly, we support revising the definition of “Exempt Insurance Income” and “Qualified Insurance Company” to be consistent with business models used in multinational insurance and reinsurance businesses. These changes are essential, given the modernization of insurance regulation since these two provisions were originally enacted. Any one-time tax on foreign accumulated earnings of insurance companies should not apply to income subject to local restrictions on earnings available for repatriation.
- **Allow Capital Losses on Investments to be Treated as Ordinary Losses:** The tax code currently permits P&C insurance companies in limited situations to deduct capital losses against ordinary income to fund operating cash deficits. The provision allows capital losses to be turned into “abnormal losses” and to fund operating cash deficits with sales of capital assets to allow insurers to meet the cyclical demands of policyholder claims. This provision should be broadened to allow all losses on investment assets to be treated as ordinary, rather than capital.
- **Repeal the Life/Non-Life Consolidation Rule:** Obsolete rules prohibit life insurance companies from fully consolidating taxable income with companies that are not life insurers, creating enormous complexity and distorting economic income. Due to changes in tax law made since the Tax Reform Act of 1986, the policy justification for prohibition on consolidation no longer exists. This rule should be repealed.
- **Preserve Net Operating Loss (“NOL”) Carrybacks:** P&C insurers are subject to periodic large catastrophe losses, which create the situation in which insurers paying claims have more allowable tax deductions than taxable income. Under current law, an NOL incurred in one taxable year may be carried back to the two taxable years preceding the taxable year of such loss and carried forward to the 20 taxable years following the taxable year of the loss. Utilizing a carry back to recoup previously paid taxes creates an immediate cash infusion and provides direct access to funds needed to meet policyholder claims. Congress should not reduce the current net operating loss carry back period for P&C insurance companies.

- **Maintain Deductibility of Interest Expense** – Insurance companies are subject to strict regulation intended to ensure the availability of funds to pay policyholder claims. As a result, the ability of an insurance company to issue debt, make payments on debt, or dividend funds to a parent holding company with debt, is limited. Mutual insurers have no other source of raising capital other than debt markets as they have no access to equity markets. Excluding insurance industry groups (insurance company as well as affiliated group entities) from any interest expense limitation recognizes the unique relationship between an insurance group’s capital and related claims obligations, the role of an insurance holding company to issue debt to raise insurer capital, and the unique regulation of the industry that limits the ability to issue excessive debt.
- **Advertising:** P&C insurers currently are taxed on twenty percent of their unearned premiums as a proxy for capitalizing certain “premium acquisition expenses,” such as advertising expenses, even though such expenses otherwise would be immediately deductible. As a result of this special treatment, a substantial portion of the advertising expense of P&C companies is effectively deferred under current law. Proposals to change the deductibility of advertising expenses for P&C companies would result in a “double denial” of the advertising deduction and should not be applied to P&C insurers.

Conclusion

As Congress moves forward with comprehensive tax reform, it is imperative that policy makers understand the business of P&C insurance, its fundamental differences from other financial services sectors, and the unique tax provisions applicable to the P&C industry. The P&C industry is integral to the vitality of the economy and care should be exercised to avoid disruptions to a well-functioning, competitive, state-regulated P&C market.



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May 18, 2017

U.S. House of Representatives
Committee on Ways & Means
Washington, DC 20515

Submitted via email to: waysandmeans.submissions@mail.house.gov

Re: Submission for the Record for Hearing Entitled “How Tax Reform Will Grow Our Economy and Create Jobs”

Dear Chairman Brady, Ranking Member Neal, and Honorable Committee Members,

On behalf of Public Citizen’s more than 400,000 members and supporters, we urge you to formulate a tax reform package that will benefit average Americans and Main Street businesses, not the wealthy elite and multinational corporations. The voting public understands that the tax code is currently rigged to benefit the richest of the rich and allows some hugely profitable corporations to pay zero taxes while the rest of us taxpayers pick up the tab. It’s far past time to change that so that corporations, millionaires and billionaires pay their fair share.

Right now, our nation is suffering under a false austerity. While vital social services like Meals on Wheels and Medicaid are slated to be drastically cut under recent proposed budgets and are expected to see similar cuts in FY2018 proposals as well, America is leaving billions in potential tax revenues on the table by allowing corporations and the rich to game the system.

Trickle-down economics didn’t work before and it won’t work now. Instead of giving tax cuts to the top classes, we should be increasing the progressivity of our tax system so that those who can pay more—corporations and the rich—do so, rather than the middle class and small businesses.

In 2014, corporations paid taxes equal to less than two percent of the Gross Domestic Product (GDP), but in 1950s the average corporate share was double that, at more than 4 percent share of the GDP¹. However, in 2014, individuals’ tax payments equaled more than 8 percent of the GDP, four times the corporate share.² Though our statutory rate is 35 percent, effective rates for corporations are much less, with many profitable companies like General Electric, PG&E and Priceline.com paying no taxes at all in recent years.³ Corporations utilize public services like our roads, our courts, and our educated workforce, so it is only reasonable to have them cover their portion of the tax responsibility for paying for these essential services.

¹ *Historical Source of Revenue as Percent of GDP, Receipts by Source as Percentage of Gross Domestic Product: 1934-2020*, TAX POLICY CENTER, (Updated Feb. 4, 2015), <http://tpc.io/1INzwqu>.

² *Id.*

³ MATTHEW GARDNER, ROBERT S. MCINTYRE, AND RICHARD PHILLIPS, THE 35 PERCENT CORPORATE TAX MYTH, INSTITUTE FOR TAXATION AND ECONOMIC POLICY (March 2017), <http://bit.ly/2mtMmHY>.

One of the most obvious loopholes in need of closure that keeps corporate effective tax rates so low is so-called “deferral,” which allows multinational companies to indefinitely avoid paying taxes on the profits that they book offshore, until the point that they are “repatriated” to the U.S. and reinvested or paid out as dividends to shareholders. Right now, there is an estimated \$2.6 trillion in profits booked offshore by American corporations, meaning corporations are avoiding an estimated \$767 billion in taxes.⁴ Deferral provides a hefty incentive for corporations to offshore investments, as that provides the vehicle for profit shifting and other accounting maneuvers to move profits to the books of foreign subsidiaries, and be allowed to defer paying taxes on those profits. True tax reform to benefit the American economy would end deferral and force corporations to pay taxes annually instead of allowing them to use foreign subsidiaries to avoid taxation.

Moreover, allowing a repatriation “holiday” for those hoarded profits would do nothing but further incentivize offshoring since corporations would just bide their time, knowing another tax break would be coming their way, and would continue to defer taxation on their foreign-booked profits. Whereas the huge pot of money sitting (at least on the books) offshore is tempting source of funding for important public investments like infrastructure, to tax those deferred profits at anything less than the full statutory rate would incentivize the type of profit shifting that will continue to erode our tax base for years to come.

The American public is deeply offended by unpatriotic “inverting” corporations that merge with a foreign corporation and reincorporate in another country. The public backlash over inversions stopped several such mergers in their tracks, and Treasury rules to limit serial inverters and profit shifting will do much to stem the tide of inversions. However, comprehensive tax reform would also include measures to stop inversions, such as requiring companies with a majority ownership of U.S. shareholders and management and control of the corporation based in the U.S. to be considered domestic corporations for tax purposes. And, inverting companies should have to pay an exit tax on their foreign-booked deferred profits.

As bad as inversions are, though, if tax reform were to move the U.S. to a territorial system rather than the hybrid global system we are currently under, multinational corporations would not even need to go through the kabuki theater of reincorporating in a foreign country. They would simply move even more profits to the books of foreign corporations, defer paying taxes, and eat away our remaining tax base, leaving the rest of us taxpayers to pick up the pieces.

Nor should the mega wealthy avoid paying their fair share. We should strengthen the estate tax by lowering the exclusion levels and institute other reforms. And, we must keep in place the Alternative Minimum tax, so that every person will contribute a reasonable amount toward the upkeep of our government.

The disastrous economic crash and Great Recession were fueled in part by tax policies that incentivized risk-taking by financial industry professionals. As part of the Take on Wall Street campaign to strengthen financial reforms to protect our nation’s economy, we seek to close several loopholes such as disallowing corporate tax deductions for executives earning more than \$1 million per year. And, to create greater fairness in the tax code, investment fund managers’ income should not be allowed to be taxed as capital gains instead of as wages. And, corporations should not be allowed to deduct from their taxes the cost of settlements for misdeeds.

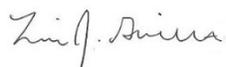
⁴ INSTITUTE ON TAXATION AND ECONOMIC POLICY, FORTUNE 500 COMPANIES HOLD A RECORD \$2.6 TRILLION OFFSHORE (March 2017), <http://bit.ly/2pUZENS>.

In addition to closing loopholes, Public Citizen and our allies in the Take on Wall Street campaign are also seeking to enact new, progressive taxes that will require the financial industry to pay their fair share of taxes. For example, though Americans pay sales tax on our purchases like cars, shoes, tools, and everything else, Wall Street traders are not taxed on financial transactions like stock, bond, and derivative trades. To enact a fraction of a percent tax on Wall Street trades would strengthen our economy by calming our markets that are currently prone to flash crashes, exacerbated by high-frequency trading algorithms.⁵ In 1914 through 1965, the U.S. had a modest Wall Street tax, also known as a financial transaction tax – ranging from 0.02 to 0.06 percent – in place. In fact, the economy grew at 5 percent annually from 1959 until 1965, the period in which the legacy Wall Street tax most closely resembled modest current day policy proposals. Incentivizing long-term investments over high-speed trading will put capital investments in Main Street America, growing jobs and providing economic security for small businesses. Other taxes like a bank leverage fee or taxing derivatives mark-to-market are also critical improvements that will grow significant revenue while making our markets safer and our economy more stable.

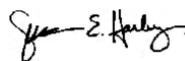
In addition to addressing fairness in our tax code and creating revenue for investing in our economy, comprehensive tax reform should look at other ways that the tax code is used—for example standardizing the definition of electioneering activity in the Internal Revenue Code so that electioneering front groups can be easily distinguished from genuine 501(c) nonprofit organizations and be required to register as political committees. Rules must also be in place to ensure that nonprofits can fully participate in our democracy while ensuring that they play by the rules when it comes to influencing our elections. And, tax reform must absolutely not do more to dilute the voice of the American public by increasing the ability of special interests to influence our elections. For example, that means preserving the Johnson Amendment that prohibits 501(c)3 tax-exempt organizations from funding, endorsing or opposing political candidates. If we were to allow partisan politics into religious and charitable life would threaten the public's confidence that their contributions would be used for universally valued purposes rather than mere partisan politics and would open those institutions to partisan exploitation by donors and leaders with political agendas.

American corporations are reporting record profits. They are dodging taxes at outrageous levels. There is zero rationale for cutting corporate taxes and zero reason to think that lower taxes will generate more investment. We urge you to keep the interests of the American people and Main Street businesses at heart so that wealthy and the financial elite do their civic duties like the rest of us and pay their fair share of taxes. That's the real recipe for a strong and prosperous economy.

Sincerely,



Lisa Gilbert
Vice President of Legislative Affairs
Public Citizen's Congress Watch



Susan Harley
Deputy Director
Public Citizen's Congress Watch

⁵ TAYLOR LINCOLN, PUBLIC CITIZEN, THE FINANCIAL TRANSACTION TAX, AN OLD SOLUTION TO A NEW PROBLEM (Oct. 8, 2015), <http://bit.ly/2pUzi8U>.



Testimony to the House Ways and Means Committee America's Corporate Tax Rate is Killing Our Economy

Thank you, Chairman Brady and Ranking Member Neal, for receiving this testimony from the RATE (Reforming America's Taxes Equitably) Coalition, which is comprised of nearly three-dozen corporations and associations, representing some 30 million workers in all of America's states and territories.

As the Ways and Means Committee begins to take action to reform our broken and outdated tax code for the sake of spurring growth, the RATE Coalition urges a prime focus on reform of the corporate income tax, which is routinely described as the single most detrimental aspect of our current tax system. Corporate tax reform is desperately needed for the sake of spurring growth and ensuring that all corporations are treated equally.

In particular, we wish to point out that for many years now, the United States has had the highest corporate tax rate among the leading economies of the world – a combined 39.1 percent. Here we are speaking of the 35 member-countries of the Organization for Economic Cooperation and Development (OECD). Surely, for the U.S., in a world characterized by ever more intense economic competition, this is a dubious, even dismal, distinction!

Still, many people do not see the connection between America's high corporate tax rate and her slow economic growth. One of the most frequent responses to this fact is, "Yes, but nobody pays that high rate because there are so many loopholes."

There are two big problems with that response.

First, many corporations — indeed, the vast majority, nationwide — actually *do* pay at or near the high rate, because they are primarily based in the U.S. In fact, the RATE Coalition's member companies pay an average effective federal tax rate of 32 percent. And so, the tax-rate differential puts them at a severe disadvantage in the international arena.

We can quickly see that if our competitors can enjoy greater returns on capital due to their lower tax rate, then they have a significant competitive advantage relative to American firms. And that significant advantage for them translates into a significant *disadvantage* for our companies and,

therefore, our workers.

Second, some companies —so far, only a few, but more and more companies are considering the option —are exercising the ultimate tax avoidance strategy and moving their headquarters to other countries where the corporate tax rate is lower. The spate of “inversions” in recent years is testament to the fact that the high corporate tax rate *in and of itself* is driving businesses and jobs away from America.

Thus we can see: This anti-competitive U.S. corporate tax rate has handicapped us against our international competitors. The current code has made it more difficult to invest in our American employees and operations, while limiting the value that our member companies have been able to create for our shareholders and stakeholders.

This basic inequity in the tax code can be easily fixed by lowering the corporate tax rate so that it is more competitive with the average of our major trading partners —the OECD countries — which is around 24 percent. (At the same time, RATE believes that other aspects of the code, too, might need adjusting, with an eye toward fairness and simplicity.)

Meanwhile, so long as our rate remains the highest, American employees, shareholders, and suppliers will all be suffering the consequences of our crippling corporate tax rate. Unfortunately, the results will also cripple job creation, dampen economic security, and overall reduce investment in the United States.

For years now, both Democrats and Republicans have supported lowering the corporate tax rate. Indeed, the RATE Coalition, and its allies, have long regarded the 1986 Tax Reform Act as a model of bipartisan problem-solving.

More than 30 years ago, House Democrats joined with Senate Republicans to produce a landmark piece of legislation that was enthusiastically signed into law by a Republican President, Ronald Reagan.

To this day, the Tax Reform Act stands as a testament to the good that can come when the two parties work together for the common good. That is, *clean up the tax code by lowering the rate and broadening the tax base*. It was good public policy then, and we believe that it's good public policy now.

Admittedly, much has changed over the last three decades, and yet interestingly, the same positive spirit of bipartisan cooperation has continued, albeit often below the radar. We know that Republicans and Democrats have long agreed —sometimes publicly, sometimes privately — that rate-lowering corporate tax reform is a good idea.

Today, the RATE Coalition joins with many others in the hope that 2017 will be the year that the legislative and executive branches can come together to create meaningful tax reform —for the

www.RATEcoalition.com

sake of growth, jobs, and, yes, hope.

The Washington Times

[Cutting the drag of heavy corporate taxes](#)

By Elaine C. Kamarck and James P. Pinkerton

May 16, 2017

On Thursday, the House Ways and Means Committee will have a hearing examining how tax reform will grow our economy and create jobs.

It's an important issue, perhaps one of the most important topics to be decided by Congress this year.

There is ample evidence that if Congress would reduce the corporate tax rate, it would grow the economy. America leads the world when it comes to taxing its business sector and that leading position is stifling our economy.

We can't promise that slashing the corporate tax rate to make it more competitive with the rest of the world will lead to 4 percent growth, but there are plenty examples to point to where such a policy was implemented and did successfully yield such a result.

In Ireland, the growth rate was 7.2 percent. Their corporate tax rate is set at 15 percent and is scheduled to be cut to 10 percent. In the United Kingdom, the corporate tax rate is 19 percent while the economy grew at about double that of the United States.

Japan had a corporate tax rate similar to the United States and last year had anemic growth similar to ours. The Japanese government decided to join with the Irish and the English and slash their corporate tax rate to levels more competitive with their competitors.

Unless we get our own version of corporate tax reform, we will be left behind, in the dust.

For many years now, America has had the highest corporate tax rate in the world — 35 percent. And yet, many people don't see the connection between the high corporate tax rate and America's slow economic growth. One of the most frequent responses to this fact is, "Yes, but nobody pays that high rate because there are so many loopholes."

That's wrong. Most corporations — indeed, the vast majority, nationwide — actually do pay the high rate, and this puts them at a severe disadvantage in the international arena: If our competitors can enjoy greater returns on investment thanks to their lower rate, then they have a significant advantage. And that significant advantage for them translates into a significant disadvantage for our companies, and our workers.

Now some companies — especially the larger ones, with more internal flexibility — do exercise the ultimate tax avoidance strategy and move their headquarters to other countries where the tax rate is lower. The spate of “inversions” in recent years is testament to the fact that the high corporate tax rate in and of itself is driving businesses and jobs away from America.

Thus, businesses that create jobs in America often find themselves taxed at higher rates than those that don't. The RATE Coalition's member companies employ one-third of America's private-sector workers, and contrary to the conventional wisdom, our membership pays an average effective federal tax rate of 32 percent.

This anti-competitive U.S. corporate tax rate has handicapped us against our international competitors for too long. It has made it more difficult to invest in our American employees and operations, while limiting the value we're able to create for our shareholders.

So long as our rate remains the highest, American employees, shareholders and suppliers will all be bearing the consequences of our high corporate tax rate — and the result is anemic job creation, dampened economic security, and overall reduced investment in the United States.

For years now, both Democrats and Republicans have supported lowering the corporate tax rate. President Obama spoke about it in most of his State of the Union Addresses. And in their first debate back in 2012, Mr. Obama and Republican candidate Mitt Romney agreed on the need to lower the rate.

Former President Bill Clinton is on the record supporting a lower rate. And, of course, President Trump has made it a centerpiece of his tax plan.

Lowering the rate is a simple and fair way to address the fact that America's jobs are disappearing. In this polarized era, it is one important step we can take to get the American economy growing in America again. America's workers need a win. Real tax reform starts with the rate.

Elaine C. Kamarck and James P. Pinkerton are co-chairs of the RATE Coalition

Dear House Ways and Means Committee,

Subject: End Citizenship-Based Taxation and Implement Resident-Based Taxation For All Americans Abroad

I would like to thank you for the opportunity to provide your committee my inputs for the current debate on tax reform. This debate could not have come soon enough.

I am an American overseas living under the tourniquet known as citizenship-based taxation (CBT). As you may know, Americans, wherever we live, we must report our global income to the IRS, annually. You may also know, this law had its roots in the Civil War, a war fought over the right to hold slaves, and has stayed on the books since but has become more refined and more virulent over the many decades.

For starters, Congressional representation does not extend to Americans abroad. I've written to both senators and congressperson over the years about the problems associated with the tax laws for overseas residents and have not gotten as much as a reply. Congress does not mind imposing ever more harsher tax laws as long as some other constituency pays it. The bottom-line is since I don't have representation I am highly vulnerable to CBT abuse.

What is clear is many Congresspersons don't understand the implications of global taxation laws. Members seem to be in a perpetual state of denial - not wanting to know - as to the penalizing effects of CBT.

To make matters more difficult Congress is not interested spending a cent on studying the implications of CBT, either. Americans abroad are not included in government surveys or census reporting. As a general rule, we optimize what we measure. Since there are no bona-fide government sponsored statistics I am an 'incognito' - except for taxation. This is grossly unfair.

Americans abroad, like myself, drive, eat, attend school, pay taxes, work, etc., do everything locally. When I need police help, I call the local police. When my house is on fire, I call the local fire department. This is the crux of the problem with CBT. The American government will not intervene to support me in any way when I am overseas. What I see as local Congress sees it as - foreign, overseas, abroad - and therefore dangerous.

What are some of the problems I experience with my American citizenship while living overseas? There are several. My local (overseas) bank closed my savings account and brokerage accounts once the Foreign Account Tax Compliance Act (FATCA) was put into gear. They informed me due to the complexity of U.S. tax reporting they could no longer keep my interest bearing accounts open. When I moved to another country I could not open a single bank account. Bank staff said they did not want to retain American account holders because they were petrified of the potential of a 30% withholding penalty for failing to report American account holders.

I tried to open a checking account at a local bank to get a mortgage. They advised me because I am an American, they could not open an account.

I once tried to mail a check to the IRS to pay my taxes from China. Because China is under tight capital controls, the postal clerk refused to forward my letter. I had to seek other channels to pay the IRS.

I had to avoid any partnership deals. Being in a partnership would open the whole organization to IRS reporting. Regrettably, I had to sideline several potentially lucrative deals.

Being extra careful as an American overseas cannot be overdone. When I was at several employers I had to be sure not to gain signature authority over any financial accounts. Due to the evils of CBT my employability was and is severely hampered. Employers across the world are gaining knowledge not to hire qualified Americans. With FATCA, Congress has made overseas employability near impossible.

Opening a joint account with a foreign born spouse is problematic. Your spouse suddenly loses his/her privacy. Their income / assets are reportable to the IRS.

Local pensions are double-taxed so Americans abroad must carefully weigh how this loss in income will impact their future. Many are tossing their citizenship to save for the future. Keep in mind Americans back in Wisconsin, for example, will not have their pensions double taxed.

When I provided my stateside bank my overseas address they restricted my mutual fund holdings and froze other financial instruments. I had to move the proceeds to a non-interest bearing account. If that was not bad enough my stateside brokerage company is rumored to be closing accounts for Americans with overseas addresses. Luckily, I have not received such a letter yet but it could happen any day. They cited the reasons for closing the accounts was due to FATCA.

Constitutional protections should apply to all U.S. citizens regardless of their residence, and all the constitutional protections afforded U.S. citizens should be respected, whether residing abroad or in the U.S. The right of privacy, as well as other constitutional rights, are also encompassed in the IRS's Taxpayer Bill of Rights, which is also applicable to all U.S. taxpayers.

¹

Since I live overseas, Congress does not think I am entitled to Constitutional protections. While someone from Nebraska, for example, has only to report to the IRS the interest or capital gains they gained with their financial accounts, I am obligated to report not only interest and capital gains, but I also have to report total account values. Unfortunately, my privacy rights were not a

¹ The Bopp Law, PC,
<https://www.dropbox.com/s/qc86l0icfoxdf47/POST%20FATCA%20HEARING%20RESPONSE%20BOPP%20TO%20MEADOWS%20150517.pdf?dl=0> May 15, 2017

concern to FATCA and CBT authors. For what it's worth, to get the Nebraska account holders bank balance a warrant is required. His / her privacy is protected. Not mine.

My Constitutional protections fall apart on another level. Let's say I 'forgot' to report my 'local' account(s) to the IRS. Everyone makes mistakes and should not expect armageddon, right? Not so under the Internal Revenue Code (IRC) as it relates to 'offshore.' Congress weaponized the IRS so that it can get oversized fines for minor tax filing infractions. Civil rights, as expressed in the Constitution, were not considered when penalty assessments were authored into the IRC for overseas account holders. Maximum pain was the overriding factor.

When I complete my filing I almost never need to pay additional taxes to the IRS. However, the big winner is my tax accountant. He gets the lion's share and not the U.S. Treasury because the tax code is loaded with so many landmines only competent tax preparers can help me navigate through the maze of arcane laws.

I've had to provide all of my personally identifiable information to my tax accountant whom I have entrusted to keep secure. Congress made no effort to provide a more secure environment for tax filing. If my tax info gets into the wrong hands it is up to me, not my tax accountant nor the IRS, nor my bank to stymie any potential wrongdoing.

Congress has aided and abetted a distorted view about Americans abroad. They have described us 'rich' and 'tax cheats' who are trying to avoid paying our 'fair share' in taxes. This is so wrong. We pay taxes where live, where we get public service.

But Congress' continued red baiting me as a tax scofflaw when nothing could be further from the truth is helping to sustain tax-exempt NGOs, generally Washington based, in poisoning the debate on tax fairness. They've used their tax-exempt status to distort the truth about CBT and FATCA and therefore help confuse the public. They are not about providing evidence based research, but thrive on groupthink and Washington based ideology. There is nothing objective with these organizations as it relates to discussing issues on overseas taxation.

Congress should refrain from using 'tax cheat' or 'tax evasion' unless there is a court finding that is recorded for such crimes. This will help stop the nonsense spewing from the opinionated Washington based tax-exempt industry which advocates others to pay taxes. Living overseas should not be considered a crime.

Dismiss any suggestion of a same country exemption (SCE) as some sort of bipartisan fix to FATCA. There is nothing bipartisan about it. SCE is a response to a big problem without careful analysis. As I mentioned above, I've had to keep my banking in another country because the one I live in banks regularly refuse Americans. SCE is unAmerican.

In sum, CBT and FATCA were implemented without considering my Constitutional rights. I have no Congressional representation to push back against their abusiveness. Tax filing is a very precarious event that can cause me severe financial penalties for even minor mistakes,

which fellow Americans stateside don't have to worry about. The tax code has hindered my ability to hold overseas and stateside financial accounts. In addition, advancing into meaningful employment is fraught with dangers because of the IRC obsessiveness on wanting to know everything about overseas financial accounts. Congress has provided fuel to a relentless tax-exempt NGOs apparatus that is ill equipped to understand the overseas taxation. Their opinions should always be taken with a degree of skepticism. SCE should be rejected as some sort of fix. The financial burden for many Americans overseas will be kept intact as a result.

I can state categorically CBT is not in the American public interest. Even when all tax reporting requirements are satisfied, the financial hit continues unabated for anyone living overseas. Please end citizenship-based taxation and move to a more responsible residency-based taxation system for Americans abroad as soon as possible. I can then better compete for jobs and have a better outlook to the future as opposed to being worried if I made a mistake(s) on my U.S. tax filing and then being confronted with severe penalties.

Again, I wish to thank the Committee for allowing me to submit my case for the record.

Thank you.

Reg Callaway
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Amersfoort, Netherlands
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Statement for the Record

**U.S. House Ways and Means Committee
Hearing on
“How Tax Reform Will Grow Our Economy and Create Jobs”
May 18, 2017**

**Jennifer Safavian
Executive Vice President, Government Affairs
Retail Industry Leaders Association**

The Retail Industry Leaders Association (RILA) applauds the Committee for holding this hearing on job creation and economic growth through tax reform, and welcomes this opportunity to express our strong support for the enactment of comprehensive tax reform. RILA is the trade association of the world’s largest, most innovative and recognizable retail companies and brands. Our membership includes more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales, millions of American jobs and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

There is no industry that wants tax reform more than retail. RILA is a strong supporter of enacting comprehensive tax reform that reduces the corporate rate, broadens the tax base, and narrows the discrepancies in effective tax rates (the rates that businesses actually pay) among industry sectors.

RILA supports comprehensive tax reform that includes the following principles:

- Substantially lowers the rate for all business taxpayers;
- Eliminates special preferences that give some advantage over others;
- Addresses the tax rules applicable to all business types, as well as individual consumers;
- Simplifies and stabilizes the tax code; and
- Restores America’s global competitiveness by instituting a territorial tax system.

RILA’s member companies make a significant impact on the daily lives of all Americans – from their customers to their employees and families to the communities they serve. We agree that to drive our nation’s economy to grow and foster job creation, Congress and the President must work together to enact tax reform. The retail industry supports enacting tax reform as the foremost domestic job creator, the driver of the U.S. economy, the leading investor in American communities, and among the highest rate payers under the current code.

Creator of American Jobs

More than 42 million jobs in the U.S. are either a retail job or a job that relies on retail. Jobs in the retail industry span from designers and IT professionals to transportation and logistics service providers to customer service representatives. Outside of brick and mortar stores, millions of jobs in manufacturing, finance, insurance, real estate, transportation and warehousing, and services industries are supported by

retailers. For millions of Americans, including Members of Congress and their staff, their first job was in retail. For many executives in RILA's member companies, their entire careers are spent in the retail industry – beginning at a cash register, stocking shelves, or working in a distribution center, then becoming store managers before moving up through the company ranks. Retailers offer flexible schedules that enable individuals to spend more time with their families or complete a degree, and provide employees with extensive training at all job levels and skill sets that lay a core foundation for fundamental career development. Millions of high-tech and high-paying jobs are created by retailers as consumer demand and industry innovation continually advance and change.

Driver of the U.S. Economy

With more than \$553 billion in labor income and more than \$3.8 trillion in sales, retail is one of America's most powerful economic engines. In fact, consumer spending represents two-thirds of U.S. gross domestic product (GDP). There are few industries that have a greater impact on the U.S. economy than retail. We employ millions of Americans throughout the supply chain and provide American consumers with the products they want to buy at the price they want to pay. Retailers pay billions of dollars in federal, state, and local business and real estate taxes each year, and collect and remit billions more in sales taxes to state and local governments, providing a significant tax base for these communities. The depth and breadth of the domestic retail supply chain is far reaching throughout this country and the world.

Steward of Communities

Retailers often serve a central role as stewards of communities beyond that as places to purchase goods and services. Brick and mortar retailers, large and small, provide a significant tax base for core local and state services such as police, fire and rescue, and schools. Beyond investing resources in store operations and job creation, brick and mortar retailers: provide billions of dollars annually to tens of thousands of local and national charities; hire American veterans; sponsor local sports and recreation teams; provide tangible goods donations to schools and homeless shelters; support community workforce development and training programs; and often provide shelter during storms and are the first on the ground after disasters strike to provide families with relief and help communities rebuild. Additionally, even the largest retailers rely on small business vendors in communities, such as plumbers and electricians, to keep stores open and operating.

Leveling the Playing Field Through Tax Reform

The retail industry's treatment under the current tax code belies its prominent place in the economy and stifles job creation, investment, and consumer savings. At 36.4 percent, the retail industry's effective tax rate (the rate that businesses actually pay) is the fourth highest domestic effective tax rate – nearly 10 percentage points higher than the average – of all the 18 major U.S. industrial sectors. The government should not use the tax code to pick winners and losers. Today, it does just that. Thousands of changes to the tax code over nearly three decades have created myriad rules, credits, and deductions that give some industries and individuals advantages over others.

Under current law, domestic effective tax rates vary widely. This combination of high effective tax rates, burdensome requirements, and constantly expiring provisions depresses investment and growth, makes compliance unbearably difficult and costly, and long-term planning nearly impossible.

The increased complexity and inefficiency of the federal tax code trickles down through to the state and local level, creating heavy collection and compliance burdens on top of federal obligations. For example, state and localities continually place taxes and fees on retailers for the sale of items such as air conditioners, refrigerators, soda, motor oil, and even playing cards. State and localities have also implemented regulatory and recycling disposal fees on retailers for goods such as computers and televisions, plastic bags, mattresses, and consumable and personal products.

Additionally, the disproportionate tax rate placed on the retail industry largely undermines U.S. competitiveness. A growing number of U.S. retailers are expanding into the global marketplace through the establishment of both retail operations in other countries as well as subsidiaries that strengthen the supply chain of goods and services they provide to their customers in this country. The United States' current system of taxing worldwide income and proposals to increase the tax burden on U.S. multinationals not only constrain a retailer's ability to grow internationally but also cost the U.S. the well-paying jobs that a company typically must add to oversee such global operations.

A more simple and stable tax code with substantially lower rates has the potential to produce savings that could be reinvested to increase employment, increase wages and salaries, and lower retail prices. If we are serious about giving U.S. businesses the ability to compete effectively in the global marketplace, a substantial reduction in the corporate income tax rate is essential.

Rather than enacting proposals like the border adjustment tax that perpetuates the advantages the current tax code provides for certain sectors of the economy, RILA urges Congress to broaden the base and introduce comprehensive reform that promotes a balanced tax system that fosters overall economic growth and job creation. The border adjustable tax would significantly hurt retail customers by raising prices on everyday consumer staples, and limiting the availability of goods including life-saving drugs and agricultural products that have no domestically manufactured or produced equivalents. The border adjustable tax would also significantly increase the tax liability of retail businesses, resulting in job losses and cutbacks in investment in such businesses and, in some cases, threaten the viability of the business. Because the border adjustable tax will have such a significant negative impact on consumer prices and retail spending, its inclusion in a tax reform package would undermine the package's ability to strengthen the economy and create jobs.

For tax reform to have its greatest effect, it must address the tax code for all taxpayers and all types of businesses. Businesses that are not taxed separately as corporations are subject to taxation under the individual tax rules. These businesses, including many retail establishments, would be left at a further disadvantage if the individual tax rules are not addressed. Additionally, individual taxpayers face the same dizzying patchwork of rules, credits, and deductions as do business taxpayers. If we agree that the corporate tax system desperately needs to be reformed, then we must also agree that the individual tax rules demand the same overhaul. Like businesses, consumers deserve a tax code that is equitable, coherent, and administrable.

Further, as an additional step to secure American competitiveness abroad, the retail industry favors a territorial tax system like those widely adopted around the world. This would focus U.S. taxation on the domestic earnings of U.S. businesses and prevent the double taxation of their foreign operations abroad, which currently puts them at a competitive disadvantage to foreign competitors.

Conclusion

Given the enormous employment footprint of the retail industry, comprehensive tax reform could stimulate job growth in the retail sector and the industries supported by retail. Retailers compete every day for consumers' loyalty and spending. The nation's tax rules, domestic and international, should foster their success – not erect competitive barriers – especially as U.S.-based retailers continue to expand in the global marketplace. Comprehensive tax reform that meets these standards will free retailers, as well as the broader business community, to invest, grow, and most importantly, create new jobs. The status quo is unacceptable.

RILA and its member companies are eager to work with all Members of Congress and the Administration to enact pro-growth tax reform that reduces the corporate rate and broadens the tax base. Reform that substantially lowers the rates that retailers ultimately pay will generate job growth and benefit American families in countless ways.

PUBLIC SUBMISSION, not a witness. But call me :o)

Rick Hohensee presidentbyamendment.com

rick_hohensee@email.com

PROPOSED

A BILL

of proposed law of the United States of America,

edited most recently Feb. 2017: complete re-work

Sent to "Joint Taxation" by Rep. Stivers, sent to Legislative Counsel by Rep. Luhan-Grisham .
Some interest expressed by Rep. Mike Bishop.

*Be it enacted by the Senate and House of Representatives of the
United States of America in Congress assembled,*

SECTION I. SHORT TITLE

Bedtime For Deficits Act, The BFD,

SECTION II. WE FIND THAT

EVERYBODY wants tax reform, and for good reason.

SECTION III. WE THEREFOR ACT AS FOLLOWS,

All of the Title 26 United States Code Subtitles A and B, income taxes, gift taxes, and estate taxes are hereby replaced, thus voiding several thousand pages of existing prior Acts, as follows-

1. Non-Taxable (Government) Income

Payments directly from the USA, a State, or US municipality are not taxed by the USA. This includes wages and salaries of direct government employees, the military, payments on government contracts, government pensions, entitlements, Unemployment Insurance, Social Security, and interest payments on government bonds. This does not include, for

example, wages of government contractors. This clause conditions all following clauses without repetition herein. This also pertains to illiquid or non-money donations from a government to any person, which do not bear the tax described for gifts below.

Although not directly taxable, government income is counted as income when calculating the Standard Credit. In other words, government income does count as income vis-a-vis possible positive tax payments due to an individual from the US Treasury.

2. Taxable Individuals and Businesses

There are two basic taxable entities, Taxable Individuals and Businesses, and their respective modes, the Individual Tax, and the low percentage rate Sales/Gross Receipts/Revenue Tax. The Sales/Gross Revenues rate is basically the same for business receipts and personal sales by Taxable Individuals. In other words, a taxable party may be just a business, or a private individual, possibly with personal and/or business income.

A. Business taxes: All Businesses Pay the Sales/Gross Revenue Tax on all Revenue

1. Any type of business, which is all non-government group economic entities licensed to conduct business as a single entity, including private schools, churches, advocacy groups, charities, political campaigns, fraternal organizations, and commercial businesses, pay the Sales/Gross Revenue Rate, 2.5%, on their gross revenue. Gross revenue is all receipts of money and non-money, payments or gifts (in the case of businesses). The Sales/Gross Revenue tax is applicable to all entities receiving payment for goods or services delivered in the USA.
2. Revenues from foreign sales by US-owned companies are not taxed. All sales for all goods and services delivered in the USA are taxed.
3. Expenditures predominantly for the personal benefit or personal dispensation of an owner or associate of a group economic entity shall be from a salary or other payment to the individual from the group entity, which payment shall bear the Personal Income Tax, which see below.
4. A business entity owning another business entity is liable for the 2.5% rate on it's own revenue, 2.5% on the owned company's revenue, and 1% additional on the subsidiary's revenue, regardless of whether paid by the parent or the subsidiary.
5. This concludes income taxes on businesses and non-government economic groups of all types.

B. Individual Income Taxes

The income tax for individuals is based on a single base rate, a credit for dependents which may result in payments to the private tax party, and a surcharge on higher incomes tied to national indebtedness. A Taxable Individual is one taxpayer and up to three additional economically dependent persons, for a total of one to four dependents per Taxable Individual. Dependents shall be live human beings, each assigned to only one Taxable Individual. Filers claiming dependents shall be actually aiding said dependents for more material value than the Standard Credit Amount, which for example room and board is deemed to be.

1. Gifts and Inheritances

All gifts of money and other liquid assets such as securities to an individual are Wages Income, and all non-money (illiquid) gifts and bequeaths to a Private Taxable Party are to be valued at market rates and the value subject to the Sales/Gross Revenues Rate, 2.5%.

2. Credit for Dependents

The Standard Single Credit for one dependent is \$3,000--. This is a credit against taxes due, not a deduction from income. Potential taxes on all incomes are combined in a simplified way to determine if a payment is due to the Taxable Individual.

The sum of a Taxable Individual's dependents, i.e. the number of persons comprising the Taxable Individual (up to 4 including the filer) times the Standard Credit Amount, is the Taxable Individual's Gross Standard Credit. The Gross standard Credit is a credit directly against the Taxable Individual's total tax otherwise due, rather than an offset of taxable income, and may result in a payment due to the Taxable Individual at low incomes if the Gross Standard Credit is greater than the Taxable Individual's taxable (non-governmental) income. For example, a Taxable Individual with zero income and one dependent, themselves, is due a payment of their entire Gross Standard Credit, which equals the Standard Credit Amount (\$3,000), from the US Treasury, per year.

3. Taxable Income, Liquid and Illiquid

The liquid/illiquid distinction is crucial to this tax system vis-a-vis Taxable Individuals. "Liquid" is in terms of ease of exchange, i.e. almost as transferable as cash. Liquid assets including US legal tender, foreign legal tender, and transferable securities such as bearer bonds or equities may be considered money for tax purposes, when used as payment or gift. Specie metals traded by weight at per weight market rates and collector coins and

paper money traded as nonfungible unique items are illiquid. Current small facial-denominated legal tender coin is money.

Trade of illiquid good for illiquid good is barter, and not taxed.

4. Individual Sales Tax

Individuals receiving payments for the sale or sales of real property, goods, equities, or transferable loans such as bearer bonds, or rents, or interest on personal loans, shall pay the Sales/Gross Revenues Tax Rate, 2.5%, on the sale, rent, or interest. Sales of securities bear the Sales/Gross Revenues Tax. This is in effect a "transaction tax". Dividends and private (non-government) bond interest are taxable as wages, which see below.

Taxable Sales Income has a \$1,000-- deductible. Taxable Sales Income is Sales Income minus \$1,000-- if Sales Income was more than \$1,000. Otherwise Taxable Sales Income is zero. This deductible does not apply when calculating a payment due to a Taxable Individual.

5. Wages Taxes

There are two tax rates on private wages income, the Basic Wages Tax Rate, BPTR, and the Inescapable Pay-Go Rate, IPGR, which might be the same as the Basic Wages Tax Rate if the USA ever retires its debt.. The Inescapable Pay-Go is a conditional surtax, a tax-or-not so to speak, based on the indebtedness of the nation.

Wages, liquid gifts, corporate stock dividends, non-government bearer bond interest shall bear the wage tax rate.

a. Basic Wage Rate

The Basic Wages Tax Rate is $\frac{1}{3}$, 33.33...%. This rate applies to all non-sales incomes.

b. Inescapable Pay-Go Conditional Tax-Or-Not

The Inescapable Pay-Go Rate has a maximum of $\frac{3}{4}$, 75%. It is a conditional surtax on all non-sales income over the Inescapable Pay-Go Threshold, \$100,000--. The Basic Wages Tax Rate is in effect on incomes up to the Inescapable Pay-Go Threshold (\$100,000-- of wages income), and the Inescapable Pay-Go rate applies on wages income over that threshold.

The Inescapable Pay-Go rate is to be computed and published each year by the Internal Revenue Service, with consultation from the

Government Accountability Office, based on the prior year's federal budget. The calculation of the Inescapable Pay-Go Rate shall be :

Phase I
The Inescapable Pay-Go Rate is 75% until \$2T has been repaid to Social Security.

Phase II

- Divide the prior year's budget deficit by the revenue of the federal government for that year. This value is Debt Proportion.
- Multiply Debt Proportion by two. That is Value V.
- Add Value V, expressed as a percentage, to the Basic Wages Tax rate. This value is the Inescapable Pay-Go Test Value.
- If Inescapable Pay-Go Test Value is greater than 75, the Inescapable Pay-Go Rate for the year is 75%, otherwise the Inescapable Pay-go Rate is the Inescapable Pay-Go Test Value.

If Social Security is paid back, and the national debt is retired, the Inescapable Pay-Go Rate becomes the Basic Wages Rate, i.e. the surtax is 0% and the marginal rate becomes the Basic Wage Rate, 1/3 (33.33...%).

6. Individual Tax Elements Combined

Taxable Individuals may be paid a positive tax payment, if their taxable income is below their Break Even Point. Government income and entitlements and sales income are included in income for this purpose. Similar proposals have in the past been referred to as negative income taxes. This bill is written from the people's viewpoint that regular taxes are negative.

To calculate if a payment is due to the Taxable Individual, add their entire gross income from all sources together, including government payments, sales income without asserting the deductible, and illiquid payments and gifts received valued at market rates. Apply the Basic Wages Tax Rate (1/3) to this gross income total (i.e. divide by 3). Now subtract the Taxable Individual's Gross Standard Credit from their Gross Income Total. If it is negative, i.e. if the Standard Credit is larger, the difference is due to the Taxable Individual.

a. PAYMENT DUE TO THE INDIVIDUAL

Daily Electronic Disbursement of Positive Taxes

Positive taxes payable to a Taxable Individual due to credits against taxes due shall be accrued daily, preferably dispensed in daily

electronic transfers, with the standard daily payment being 1/400th of the total due for a year, and a balloon payment of 35/400 of the annual total on December 1st. The IRS shall promulgate a system for distributing said positive taxes due to be paid to Taxable Individuals on a daily basis, via banks and/or similar institutions. Use of existing card systems for entitlements is advised.

The means for applying for such payments shall be filing a tax return, and may be filed at any time. (unsolved problem: timing and lag)

b. TAXES POSSIBLY DUE TO THE TREASURY

The following calculations apply if a Taxable Individual's gross income, times the Basic Wage Tax Rate, is greater than their Gross Standard Credit. Type of income now becomes a factor. A Taxable Individual may have a mix of sales and wages income. It is permitted, and advantageous to the Individual, to consider as much of their wages income as possible to have been offset by their Standard Credit. It also simplifies calculations.

Was your wages income greater than the Break-even Point By itself, without sales income?

- **NO, WAGES < BREAK EVEN POINT**

Individual must have significant Sales Income, some of which is considered to have defrayed credits due. All of Taxable Individuals Wages Income is deemed to have been offset by Standard Credits, so no wages Taxes are due. Some Sales/Gross Revenue Taxes are due. Subtract your Wages Income from your Break-Even Point. Subtract that value from your Taxable Sales Income, computed earlier by subtracting \$1,000-- from Sales Income. The remaining Sales Income bears the Sales/Gross Revenue Tax (2.5%). That value is your total taxes for the year.

- **YES, WAGES > BREAK-EVEN POINT**

If so, was the Individual's wages income over the Inescapable Pay-Go Threshold (\$100,000)?

- **WAGES > \$100,000--**

if so, subtract your Break Even Point from the IPGT (\$100,000--). That is your flat tax wages. That amount bears the Basic Wage Tax (33.33...%). Your wages income minus the IPGT (\$100,000--) bears the Inescapable Pay-Go Rate (likely 75% at the time of enactment of this proposed law) and your Taxable Sales Income, computed as described above, bears the Sales/Gross Revenues Rate (2.5%). The sum of those three values is your taxes due for the year.

- **WAGES < \$100,000--**

if your Wages Income was less than the Inescapable Pay-Go Threshold subtract your Break Even Point from your income. That is your taxable Wages Income . That amount bears the Basic Wage Tax (33.33...%). Taxable Sales Income (Sales Income minus \$1,000--) bears the S/GRT Rate (2.5%). The sum of those two values is the Taxable Individual's taxes due for the year.



last edited -- Feb 2017

Submission of the Semiconductor Industry Association
U.S. House Committee on Ways and Means
Hearing on “*How Tax Reform Will Grow Our Economy and
Create Jobs Across America*”
May 18, 2017

Introduction

The **Semiconductor Industry Association** (“SIA”) appreciates the opportunity to provide to the House Committee on Ways and Means our priorities for comprehensive tax reform. SIA is the voice of the U.S. semiconductor industry. We commend the chairman, members of the committee, and staff for this hearing and continuing efforts to improve our tax system. SIA supports efforts to lower the U.S. corporate rate, move to a territorial international system with appropriate transition rules, and enhance U.S. incentives for research and development.

SIA supports the Better Way corporate tax reform blueprint as an appropriate starting point for reform. We believe the Better Way corporate tax reform blueprint would make America’s corporate tax system more competitive and allow U.S. semiconductor companies to grow, innovate, and create more jobs in the United States. While there are many details of significance to our industry that need to be understood and addressed, we support the proposal as a framework for moving forward with tax reform.

Background on the U.S. Semiconductor Industry

America’s semiconductor industry is critical to U.S. economic growth and national security. Semiconductors are the fundamental enabling technology for the modern economy and an essential component of our nation’s defense and homeland security, information

technology, global finance, transportation, and health care. The U.S. semiconductor industry is one of the world's most advanced manufacturing sectors, and the U.S. semiconductor industry is America's number one contributor to labor productivity growth by making virtually all sectors of the U.S. economy more efficient.

The U.S. semiconductor industry leads the world, accounting for roughly half of global market share through sales of \$164 billion in 2016. Nearly half of U.S. semiconductor companies' manufacturing base is located in the United States, and 21 states are home to semiconductor manufacturing facilities. Over 80% of industry sales are outside the United States, making semiconductors America's fourth-largest export.

Our industry directly employs nearly 250,000 people in the United States and indirectly supports more than 1 million additional American jobs. In 2016, the U.S. semiconductor industry invested approximately 20 percent of revenue into research and development (R&D). This was the second-highest share of any industry.

Global Competition for U.S. Semiconductor Companies

SIA would like to draw the Committee's attention to the fact that the tax policies of other countries present two tiers of competition for the U.S. semiconductor industry. The first tier is the competitive pressure we face along with other U.S. industries because many foreign countries have more attractive tax systems. The U.S. currently has the highest corporate tax rate in the Organization for Economic Cooperation and Development (OECD). In addition to lower rates, most other OECD countries have a territorial tax system. When their companies invest in subsidiary operations in another country, the tax imposed by that other country on the earnings from the investment will generally be the final tax imposed – home country tax generally does not apply when the earnings are repatriated. Finally, the U.S. research tax credit has fallen far behind the incentives for research offered by other countries. These

features of other tax systems – lower rates, a territorial system and strong research incentives – are imbedded in the tax laws of other countries and are available to any taxpayer with transactions that qualify.

Additionally, a second tier of competitive pressures for our industry come from special incentives that are given selectively by governments to taxpayers that bring to the country strategic investments. In our case, governments offer incentives for locating wafer fabrication, assembly/test or R&D. These incentives include full or partial “tax holidays” and other benefits such as loans and reduced utility costs. Countries target the semiconductor industry because they understand that semiconductor manufacturing and R&D operations have a significant positive “spillover” effect on their economies in the form of employment in high tech jobs and the development of an engineering and technology infrastructure. Over time, a package of these incentives usually results in a substantial cost advantage for an operation, compared to a similar operation without such incentives.

These competitive advantages create an after-tax income differential that results in our competitors having more funds for investment, more funds for R&D, and more of a profit cushion so they can drop prices when competing against U.S. semiconductor manufacturers. Importantly, if cash flow from our overseas operations is more valuable in their hands than in ours simply because of tax differences, it is likely that, over time, they will seek to acquire our operations, or more U.S. economic activity will migrate offshore – the after-tax return on offshore investment is simply too compelling. With higher after-tax profit margins, cost of capital is reduced creating financing, offshore hiring, and capital investment advantages. Corporate tax reform must level the multinational competitive landscape for U.S. companies and reinstate the U.S. as an attractive investment location.

Lower, Globally Competitive Tax Rate

The United States currently has the highest corporate tax rate in the OECD. In order for the U.S. to maintain its global leadership in high-tech manufacturing, we must move to an internationally competitive corporate rate of 20 percent or less; at 15 percent, the return to U.S. productive capital investment would reach a tipping point.

While a focus on the OECD average tax rate is useful, it's important to note that U.S. semiconductor companies also compete with companies headquartered in countries outside of the OECD, and their average tax rate is significantly lower. This creates strong competitive advantages for foreign semiconductor companies and we urge policymakers to address these critical areas.

SIA strongly supports the 20 percent rate proposed in the Better Way blueprint, as well as the 15 percent rate proposed by the Trump Administration. These significant reductions in the corporate rate would substantially enhance the competitiveness of semiconductor design and manufacturing in the United States.

Territorial International Tax System

The current U.S. international tax system has been widely criticized. By taxing revenues of foreign subsidiaries of U.S. companies (controlled foreign corporations, or CFCs) at the statutory rate of 35 percent, current law reduces the competitiveness of U.S. companies operating in foreign markets and discourages U.S. companies from repatriating overseas income to the United States and investing it here. Most OECD nations employ a territorial system. In order for the U.S. to maintain its global leadership in high-tech manufacturing, it must move toward a more competitive, territorial international tax system.

Rules for a transition to a territorial system, including a tax on historical CFC earnings that have not been repatriated to the U.S. parent, are a critical issue for the U.S. semiconductor industry. SIA maintains that any mandatory or deemed repatriation should only be considered as a transition to a territorial system in the context of tax reform. SIA also recommends that any transition tax impose a lower rate on earnings that have been invested into plant and equipment than the rate imposed on cash and cash equivalents. This is of particular concern because semiconductor manufacturing is a capital-intensive industry where companies may have reinvested a significant portion of those earnings in high-cost capital equipment.

Companies that have invested in capital assets outside the United States to address the needs of a global marketplace and the cost of capital advantages associated with offshore investment could face a significant tax liability without any corresponding increased cash flow to pay the tax. Any transition tax would impose additional costs and financial statement liability on U.S. companies while their competitors would face no comparable burden during the same period. This may lead to foreign acquisitions of U.S. companies and mergers of U.S. and foreign companies resulting in more offshore headquarters. To ameliorate this concern, companies must be allowed to pay this tax liability over several years. Furthermore, companies must be permitted to elect to offset the tax liability of a deemed repatriation with net operating losses (NOLs).¹

In recent years, the semiconductor industry has experienced a wave of consolidation as companies have acquired and merged with others to reach greater economies of scale and more effectively compete with foreign rivals. As long-term business planning is intrinsic to growth and

¹ If NOLs at 35 percent value are used 1-to-1 against a repatriated amount taxed at a rate significantly lower than that, it would result in a significant loss of value of the NOL. The NOL used must be computed as: $\text{NOL utilized} * \text{deemed repatriation tax rate} / 35\%$. See Section 37B of Singapore tax law (Adjustment of capital allowances and losses between income subject to tax at concessionary and normal rates of tax) as an example of a provision to allow previous NOLs to maintain their tax value when carried forward to lower tax years.

investment strategies, it is important that these business practices are not penalized and that the repatriation rules do not excessively tax foreign cash that is already committed to an acquisition. SIA supports a provision that would treat foreign earnings committed to the acquisition of a foreign company as amounts that have been reinvested to ensure that cash committed to an acquisition is not unduly taxed.

SIA supports the deemed repatriation provisions contained in the Better Way blueprint. The bifurcated rates – an 8.75 percent rate for cash and cash equivalents, along with a 3.5 percent rate for historical CFC earnings that have been invested into plant and equipment – properly address the issues raised above. The 8-year period during which companies would be allowed to pay the liability will minimize the short-term costs and disruptions in this transition.

Incentives for U.S. Research and Development (R&D)

Robust incentives for research and innovation that are competitive with incentives in other countries are another SIA priority. In 2016, the semiconductor industry invested into R&D 20 percent of total revenue – the second-highest share of revenue of any U.S. industry. Retaining the R&D credit and increasing the amount of the Alternative Simplified Credit (ASC) to 20 percent would support semiconductor research and design in the U.S. and American jobs in these fields. The U.S. R&D tax credit is primarily a jobs credit; 70 percent of credit dollars are used to pay salaries of U.S.-based researchers.

Other proposals regarding research tax incentives would harm the U.S. semiconductor industry and deter future research investment in the United States. Computer software is a key element in semiconductor design and manufacturing, and SIA opposes proposals to remove computer software from credit eligibility. No other country specifically denies credit eligibility for all software costs. Similarly, disallowing the credit for the cost of supplies would also reduce the positive effect of the

credit for U.S. semiconductor manufacturers since equipment, raw materials, and other instruments are used in semiconductor manufacturing research. Finally, proposals to limit the ability of companies to deduct the costs of U.S.-based research activities will act as a disincentive to research investment, and companies should not be required to capitalize these costs.

SIA strongly supports maintaining the R&D credit, as envisioned in the Better Way blueprint. SIA also urges Congress and the Administration to enhance the credit by increasing the rate of the ASC to 20 percent. In the 114th Congress, SIA supported H.R. 5187, the Research and Experimentation Advances Competitiveness at Home Act of 2016, the REACH Act of 2016, introduced by Rep. Tiberi, with 22 cosponsors, which increased the ASC rate to 20 percent.

Other Key Provisions

There are several other tax provisions that are significant to the U.S. semiconductor industry. As noted earlier, the semiconductor industry has in recent years experienced a wave of consolidation as semiconductor companies have acquired and merged with others to reach greater economies of scale and more effectively compete with foreign rivals. While some acquisitions will be funded by the use of unremitted foreign earnings, others have been financed through debt instruments. SIA does not oppose the elimination of the deduction for corporate interest contained in the Better Way blueprint, however we strongly recommend any legislation to eliminate this deduction contain a multi-year transition rule to ensure that companies are not unduly penalized for relying on this deduction in past transactions.

Semiconductor manufacturing is a capital-intensive industry, with the cost of a new, leading-edge semiconductor fabrication facility exceeding \$5 billion. The Better Way blueprint's proposal to allow immediate expensing of capital equipment is therefore a potentially

significant change to make U.S. semiconductor manufacturing more competitive. Finally, the semiconductor industry has historically suffered from large cyclical shifts in demand and production from year to year. Preservation of NOL carryforward rules are an appropriate tool to account for such cyclical shifts and help smooth the transition between up and down years.

Conclusion

SIA strongly supports efforts to reform, modernize, and make more competitive the U.S. tax code. Policymakers must seize this opportunity to eliminate the current disadvantages the U.S. tax code imposes on semiconductor research, design and manufacturing in America. Reducing the corporate rate to 20 percent or less, enacting a territorial system for CFC income with appropriate transition rules, and preserving and enhancing R&D tax incentives are policies SIA strongly supports, and which would make U.S. semiconductor companies and operations much more globally competitive. SIA looks forward to working with Congress and the Administration to enact these policies into law.



How Tax Reform Will Grow Our Economy and Create Jobs

Statement for the Record

By

Karen Kerrigan

President & CEO

Small Business & Entrepreneurship Council

Ways and Means Committee

U.S. House of Representatives

The Honorable Kevin Brady, Chairman

The Honorable Peter Roskam, Chairman, Subcommittee on Tax Policy

Statement submitted on:

May 25, 2017

Chairmen Brady and Roskam, thank you for your leadership, commitment to tax reform, and your consistent support for entrepreneurs and small businesses.

On behalf of the Small Business & Entrepreneurship Council (SBE Council) and our nationwide membership and network of just over 100,000 members, I am pleased to submit this statement for the record in support of reforming our nation's tax system. Indeed, pro-growth tax reform *will* grow our economy and create jobs. Reforms that keep the needs of small businesses and entrepreneurs at the center will accomplish these important goals, and much more.

SBE Council is a nonpartisan, nonprofit advocacy, research and education organization dedicated to protecting small business and promoting entrepreneurship. For nearly 25 years SBE Council has worked to advance a range of policy and private sector initiatives to strengthen the ecosystem for startups and small business growth.

Tax reform is vital to the growth of U.S. small businesses and entrepreneurship. The focus of this effort must be on reforms that produce a simple, fair, and productive tax code – one that encourages investment, risk-taking, capital formation, and small business growth. Indeed, our small businesses have experienced a challenging operating environment for more than a decade. The financial crises, the Great Recession, followed by a weak economic recovery plus policy headwinds from Washington, have increased their business costs and sustained tremendous uncertainty. But things have changed. Small businesses and entrepreneurs are pleased that we are currently in a period where Washington has the opportunity to enact policies that create a better U.S. business environment and make our nation more competitive.

The U.S. tax code must encourage our existing businesses to grow and invest, but it must also foster higher levels of entrepreneurship. The dearth in new business creation is a crisis that must be addressed on several levels, but sound policies – including tax policy – play a key role. SBE Council's most recent ["Gap Analysis" report on entrepreneurship](#) finds a massive shortfall of businesses, some 3.4 million, compared to where we should be based on historical trends and key data related to incorporated and unincorporated self-employed, and employer firms as shares of the relevant population. SBE Council believes a pro-growth tax system is a critical part of the policy ecosystem that will enable greater levels of entrepreneurship.

Based in part on what the GOP House leadership and the Trump administration have put forward, the foundation for substantive, productive tax reform has been established. The key now is to move forward with measures that unify the business community and entrepreneurs, such as greatly reducing tax rates, allowing expensing of capital expenditures for all

businesses, simplifying the tax system, eliminating the AMT and death taxes, eliminating special-purpose “loopholes,” among other measures.

Lower Tax Rates Critical to Entrepreneurs

SBE Council supports reducing both the corporate income tax rate, and the tax rate of pass-through entities. This is vital for U.S. business competitiveness and economic growth.

As you well know, the U.S. imposes one of the [highest corporate tax rates on the planet](#). But reducing and reforming the corporate income tax rate is not just a “big business” issue. It’s very much about small business. According to the latest Census Bureau data, 86 percent of corporations have less than 20 employees, and 96.7 percent less than 100 workers. Many of these small businesses are in high-growth sectors, and they - as well as their employees and our economy - would benefit tremendously from reducing the corporate rate.

At the same time, it must be recognized that 95 percent of businesses as non-C corporations pay the personal rather than the corporate income tax, which speaks to the need to reduce individual income tax rates as well. Just as the U.S. corporate income tax rate ranks poorly, [our individual rates are not globally competitive either](#).

As for top personal income tax rates, the 39.6 percent tax rate ranks 106th among 144 nations this year. The news gets worse when factoring in the average state income tax rate (excluding local income tax rates but accounting for the deductibility of state income taxes on federal returns). This adds at least three percentage points to the U.S. rate, taking it up to at least 42.6 percent. That, in turns, pushes the U.S. tax rate global ranking down further to 115th out of 144 nations.

Small business optimism increased markedly following the 2016 elections and it remains strong [in the second quarter of 2017](#). But entrepreneurs and small business owners are counting on substantive tax reform – featuring relief from high tax rates and burdens on investment, onerous regulations, and ridiculous complexity – to help bring them to higher levels of growth and

confidence. In turn, this will lead to more investment, job creation, innovation, and business expansion. With higher levels of growth (and more opportunity), the U.S. will also experience enhanced business startups which means more dynamism, innovation and quality job creation for our economy.

SBE Council's hope is that the House quickly act on a tax reform package, so that small business owners and entrepreneurs can plan for a better tax system in 2018. Again, lowering rates for all, vastly simplifying the system, making the system fair and productive to encourage growth is vital to U.S. competitiveness and leadership in the global economy. With this in mind, we are hopeful your committee will continue to keep entrepreneurs and small businesses at the center of your reform efforts. SBE Council and our members pledge to work with you every step of the way to ensure the U.S. has a modern, pro-growth tax system that does not stand in the way of opportunity and entrepreneurship in America.

Thank you for considering the views of SBE Council and our members.

Respectfully submitted,

Karen Kerrigan, President & CEO

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Protecting Small Business, Promoting Entrepreneurship



STUDENT DEBT REDUCTION COALITION

Submission for the Record for U.S. House of Representatives Committee on Ways and Means Hearing “How Tax Reform Will Grow Our Economy and Create Jobs

The Student Debt Reduction Coalition (“SDR Coalition”) would like to thank the U.S. House of Representatives Committee on Ways and Means for holding this hearing entitled “How Tax Reform Will Grow Our Economy and Create Jobs.” The Coalition appreciates the opportunity to reiterate its support for the committee’s tax reform efforts as this is an opportunity to address the student debt crisis, which has severe negative economic implications. As the committee considers reforms dealing with employer benefits and higher education, the SDR Coalition strongly recommends tax code changes that would encourage student loan borrowers to repay their loans faster.

Borne out of the 2016 ASPEN Future of Work Initiative’s *Toward a New Capitalism* report, a bipartisan effort to identify concrete policies to update the tax code to reflect a 21st Century economy, the SDR Coalition represents a group of companies that believe student loan debt is a serious problem that affects an individual’s financial wellness and the economy as a whole. The SDR Coalition has two major public policy goals: (1) help Americans repay student loans faster; and (2) empower Americans with student loans to increase retirement savings. In order to achieve these critical public policy objectives, the SDR Coalition has developed a series of recommendations and solutions to address the problem-- several of which could be implemented through Congress’ tax reform efforts.

The Impact of Student Debt on the Economy and the Taxpayer

High levels of student debt undercut the opportunities that higher education is intended to provide for young Americans. Over 43 million Americans have more than \$1.3 trillion in student loan debt, a 170 percent increase since 2006.¹ Additionally, 70 percent of graduates leave college every year with student debt. The average student loan balance for borrowers in the class of 2016 was \$37,172, up 6 percent from 2015 and 70 percent from 2006, according to debt.org.

According to the Federal Reserve Bank of New York (“New York Fed”), aggregate student debt is increasing since more students are taking out loans for larger amounts due to the rising costs of tuition. Additionally, repayment rates have slowed down.

¹ New York Fed Consumer Credit Panel/Equifax:
<https://www.newyorkfed.org/medialibrary/media/press/PressBriefing-Household-Student-Debt-April32017.pdf>

According to the U.S. Department of Education (“ED”), national default rates for federal student loans eclipsed 11.3 percent in 2016. This translates to over 593,000 new Americans that defaulted on their student loans in 2016. The highest default rates are attributable to low-income earners. According to recent Internal Revenue Service data, 59 percent of loan defaults are from individuals earning less than \$60,000 annually. However, those with higher student debt are now much more likely to default than in the past, contributing to higher collections.

According to the latest quarterly collection statistics for federal student loans, there are currently \$81 billion in collections. During the final quarter of 2016 (10/1/2016 to 12/31/2016), more than \$16.2 billion was added to collections and only \$2.6 billion was actually recovered by collections.² As the student loan default level continues to hover above 10 percent annually, the impact is significant for the taxpayer because many of these loans are not repaid to the U.S. Treasury.

Recently, the U.S. General Accountability Office (“GAO”) reported that all federally issued Direct Loans made in fiscal years 1995 to 2017 in Income-Driven Repayment (IDR) plans will have government costs of \$74 billion. This cost is attributable to the fact that only \$281 billion of the \$355 billion in federal Direct Loans that have entered IDR plans will ultimately be repaid by borrowers. Therefore, there is a 21 percent subsidy rate, reflecting an average cost to the government of \$21 per every \$100 in loans disbursed.³ The costs to the taxpayer are expected to rise as IDR plan costs have doubled from \$25 to \$53 billion for loans issued from fiscal years 2009 through 2016, largely due to the growing number of loans expected to be repaid in IDR plans. While the IDR plans greatly help ease the student debt burden on borrowers, these costs add up to the taxpayer.

Due to the high default rate of federal student loans and to the hefty costs of subsidizing federal IDR programs, the SDR Coalition believes that new federal solutions should be offered to reduce the expected cost to the taxpayer. Tax writers have an opportunity to reduce student loan default rates and the cost of unpaid student loan debt by providing new tax reform solutions to repay student loans.

Impact on Homeownership

Research indicates that student debt significantly affects other economic factors such as homeownership and retirement savings. While those attending a four-year college see markedly higher rates of homeownership, regardless of debt, homeownership rates are less for student loan borrowers according to a study by the New York Fed. For example, the New York Fed study indicates that for Americans between the ages of 23 and 33, the homeownership rate is about 7 percent lower for people with student debt. Additionally, Americans with more than \$25,000 in student debt are less likely to own a home than those with less than \$25,000 in student debt.⁴ The homeownership gap between students with and without debt also increases over time. As a

² U.S. Department of Education: <https://studentaid.ed.gov/sa/about/data-center/student/default>.

³ U.S. Government Accountability Office: <https://www.gao.gov/products/GAO-17-22>.

⁴ Federal Reserve Bank of New York: <http://libertystreeteconomics.newyorkfed.org/2017/04/diplomas-to-doorsteps-education-student-debt-and-homeownership.html>.

result, instead of a college education acting as an equalizer, for those who graduate with student debt, it actually widens the economic gap.

Saving for retirement and homeownership are core drivers of the American economy, and without the right solutions, student debt can hamper our economic growth. We believe that tax writers have an opportunity to reduce student debt through the tax code and this will also promote savings and purchasing power for millions of Americans.

Impact on Retirement Savings

Student debt also impacts the ability of Americans to save for retirement. According to a survey released by Aon Hewitt, over 51 percent of workers with student loans are contributing 5 percent or less of their pay to retirement plans.⁵ Sixty-three percent of people with student loan debt have saved less than \$50,000 for retirement. Overall, 49 percent of people with debt contribute less to their plans than the recommended amount based on age and income.

A recent study conducted by the Boston College also found that the average student loan balance causes retirement insecurity to rise by more than 5 percent. This level of retirement insecurity is similar in magnitude to an across-the-board cut of nearly 20 percent to future Social Security benefits. According to a recent analysis by GoodCall, having \$28,950 in student loans, less than the national average, amounts to nearly half a million dollars in lost retirement savings for college graduates, compared to a debt-free graduate over a ten-year period, assuming savings of 6 percent of total income and an employer 401(K) match of 3 percent.

Student loan debt also has particularly negative consequences for older Americans. According to an American Student Assistance study, approximately 867,000 households are headed by someone 65 or older who carries student debt. In fact, according to a December 2016 study by the U.S. GAO⁶, the number of older borrowers with student debt has increased over the last decade – since 2005, the number of older borrowers with student debt has gone up 385 percent for those over the age of 65 and 119 percent for those between the ages of 50 to 64. The debt balance for these loan holders has also tripled for the 50 to 64 population from \$43 billion to \$183 billion in outstanding debt.

According to the American Student Assistance, as a result of higher student debt balances, nearly 62 percent of respondents indicated that they have postponed saving for retirement or other investments as a direct result of the need to pay down their student loan debt. In a similar survey conducted by Fidelity Investments, 80 percent of those surveyed indicated that student loans have limited their ability to save for retirement.

⁵ AON Hewitt *Student Loans Hurting Workers' Ability to Save for Retirement*, <http://ir.aon.com/about-aon/investor-relations/investor-news/news-release-details/2016/Student-Loans-Hurting-Workers-Ability-to-Save-for-Retirement/default.aspx>

⁶ U.S. Government Accountability Office, “Social Security Offsets: Improvements to Program Design Could Better Assist Older Student Loan Borrowers with Obtaining Permitted Relief,” <http://www.gao.gov/products/GAO-17-45>.

As a result of the negative impact of student loans on an individual's financial security, it is more important than ever to encourage retirement savings. Saving at a higher rate (10 percent of income, for example) will help significantly narrow the gap in retirement savings between graduates with student debt and those who are debt-free. As a result, it is imperative that Congress use tax reform as an opportunity to incentivize retirement savings and help repay student loan debt for millions of Americans, thereby allowing them to work towards financial security.

Impact on Job Performance and Entrepreneurship

Student debt follows Americans long after graduation, affecting their job and career opportunities. According to a PWC study, 50 percent of workers with student loans spend time at work dealing with financial issues, versus 23 percent without student loan debt. Thirty-two percent also indicated that their productivity at work has been impacted by issues dealing with financial distress.

Offering student debt repayment assistance programs allows employers to reduce their employee's financial stress, thereby improving their productivity. These repayment assistance programs also serve as useful recruitment and retention tools for employers, given that over 80 percent of employees would like to work for a company that offers this benefit. In order to avoid the high costs of turnover, employers are increasingly exploring offering this type of program.

According to 2017 data from the Center for American Progress, employee turnover costs a company up to 213 percent of the total annual salary for highly educated executive positions. For example, the cost to replace a \$100k CEO is \$213,000. For mid-range positions (those earning \$30,000 to \$50,000 a year), the cost to replace an employee is approximately 20 percent of annual salary. For positions where employees earn under \$30,000, it generally costs 16 percent of annual salary to replace the employee. Beyond these tangible costs, there are many intangible, and often untracked, costs associated with employee turnover that makes it preferable for employers to offer benefits that help them retain good workers.

Given this data, by 2018, 26 percent of employers are expected to offer a student loan repayment program, according to the Society of Human Resource Management.

In addition to affecting employee turnover and job performance, student debt also stops Americans from starting their own businesses and undertaking other entrepreneurial ventures. According to Arnobio Morelix, a senior research analyst with the Kaufmann Foundation, the rise in student debt has coincided with a decline in start-ups. This is in part because entrepreneurs need capital to start new businesses, and people with student debt lag far behind on accumulating net worth.

According to a study by the Pew Research Center,⁷ households headed by a young, college-educated adult without any student debt obligations have about seven times the typical net worth (\$64,700) of households headed by a young, college-educated adult with student debt (\$8,700). The wealth gap is also large for households headed by young adults without a bachelor's degree – those with no student debt have accumulated roughly nine times as much wealth as debtor households (\$10,900 vs. \$1,200).

Employer Benefits and Higher Education Tax Reform

The current U.S. tax code provides for various ways for Americans to increase their educational opportunities and achieve financial goals through their employer. For example, the retirement system has been enhanced through tax-advantaged employer contributions to retirement accounts. Additionally, many education credits and tuition reimbursement incentives have enabled Americans to pay for college, including the Section 127 employer educational assistance exclusion and 529 Savings Accounts. As the Ways and Means Committee considers changing the tax code, the SDR Coalition recommends expanding existing programs to help Americans repay their student loans faster.

Most companies already help Americans save for retirement, pay for healthcare costs, and reimburse tuition. Tax writers should consider encouraging companies to offer student loan repayment assistance benefit programs. Several private sector companies already provide student loan repayment assistance. However, employer student loan repayment contributions are taxed as compensation by the Internal Revenue Service, often making it cost-prohibitive to offer the benefit. Reducing this tax on employer student loan repayment contributions will encourage many more employers to start offering these types of plans.

Student Loan Tax Reform Policy Recommendations

The SDR Coalition believes student debt reduction can be achieved through fundamental tax reform, allowing employers the option to provide student loan repayment contributions as an employer benefit. As Americans enter the workforce, they have many financial concerns, including saving for retirement, paying for healthcare costs, saving for education, and paying off their student loans. The tax code should reflect the current demographics of the modern workforce by creating a benefit system that allows Americans at every stage of their life to choose from a suite of benefits that help them improve their financial future. Americans should have several tools at their disposal and be allowed to choose what is best for their financial future.

One of the ways this can be achieved is allowing employees to use a certain percentage of their unused 401(K) exclusion to pay down their student debt. For example, employers should be encouraged to use a percentage of their “employer match” to help pay down the employee’s

⁷ *Young Adults, Student Debt and Economic Well-Being*, <http://www.pewsocialtrends.org/2014/05/14/young-adults-student-debt-and-economic-well-being/>.

student loans. The remainder of the employer match would go towards the employee's 401(K) account. The SDR Coalition recommends requiring employees to make a minimum contribution to a retirement savings account, before taking advantage of the loan repayment matching contribution. Additionally, employers would choose where they invest their employer match – they would not be required to contribute a percentage to repaying student loan debt.

Studies show that employees who are able to participate in this type of student repayment plan are able to pay off student debt faster. According to early user data from Student Loan Genius, each \$100 monthly employer student loan contribution (\$1,200 annually) can reduce repayment time by an estimated average of 7 years for a \$5,000 loan carrying a \$50 minimum payment. Consequently, calculations show that a \$100 employer contribution to student loans reduces repayment time on a \$37,123 loan by 13 years and 7 months. These estimates are based on an interest rate of 4.45%.

Members of Congress already recognize that student debt repayment has enormous consequences on Americans' financial future. In the past few years, members have championed various proposals that address this issue. For example, several bipartisan bills have been introduced this Congress to expand the Section 127 exclusion for employer educational assistance programs in the U.S. tax code and allow this money to be used to repay existing student loan debt. Legislation includes including H.R. 795, the *Employer Participation in Student Loan Assistance Act*, and H.R. 1656, the *HELP for Students and Parents Act*.

Given that only 30 percent of young workers save for retirement through 401(k) programs,⁸ the loan repayment benefits would help increase participation, especially among millennials. By connecting retirement savings and student loan repayment in the minds of young workers, this policy will have a beneficial long-term impact on their saving habits. A similar proposal was featured in the bipartisan Aspen Institute's January 2017 report "Toward a New Capitalism."⁹

Congress has a unique opportunity to tackle one of the most challenging financial issues for today's generation of young workers – empowering them to repay their loans faster. As a result, these policy options would help reduce student loan default rates, help Americans save for retirement faster, and begin to purchase a home faster than they would if they continued to hold student debt, amongst other positive consequences.

The SDR Coalition looks forward to working with the House Ways and Means Committee to improve the financial situation of millions of Americans. We stand ready to work with you on these proposals in a way that grows the economy and reduces the cost on the taxpayer.

⁸ Bloomberg: *Millennials Are Freaking Over Retirement—and Not Doing Much About It*, <https://www.bloomberg.com/news/articles/2016-08-16/millennials-are-freaking-over-retirement-and-not-doing-much-about-it>

⁹ ASPEN Institute Future of Work Initiative: *Toward a New Capitalism*, https://assets.aspeninstitute.org/content/uploads/2017/01/New_Capitalism_Policy_Agenda.pdf

About The Student Debt Reduction Coalition:

Formed in 2017, the mission of the Student Debt Reduction Coalition is to champion public policy solutions that improve the student debt crisis in America. The Coalition supports federal and state legislative initiatives that would reduce the employer and employee tax on student loan assistance plans and would improve financial counseling for student debt borrowers. The Coalition believes the reduction of student loan debt would contribute to increased retirement savings, along with a host of other economic benefits. To learn more, visit www.studentdebtcoalition.com.



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May 18, 2017

U.S. Representative Kevin Brady
Chairman
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

U.S. Representative Richard Neal
Ranking Member
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Brady and Ranking Member Neal:

On behalf of TechNet and our members, we appreciate your commitment to reforming America's broken, burdensome, and complicated tax code in a manner that unleashes strong job creation and higher paychecks throughout America's economy. As the House Ways and Means Committee holds a hearing today examining "How Tax Reform Will Grow Our Economy and Create Jobs," we renew our commitment to helping you, the committee's members, and the entire U.S. House of Representatives enact meaningful and impactful tax reform during the 115th Congress.

At TechNet, we represent a diverse group of more than 70 technology companies. Our members range in size from small or medium, to large and multinational; operate across various sectors of the innovation economy; and include young startups as well as more established and iconic American tech innovators.

It has been 31 years since Congress last passed fundamental tax reform legislation. Back in 1986, many of our member companies had not been founded. In fact, some of our companies' founders had not yet even been born. These two facts alone underscore just how outdated our tax code is and how in need it is of a dramatic overhaul.

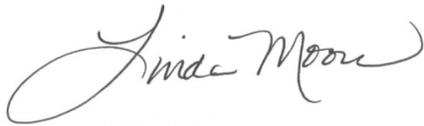
As Congress continues its work on a job-creating economic agenda, we recognize the American economy cannot grow at its full potential without a thriving technology sector, just as the technology sector cannot succeed without the right federal policies in place. From the perspective of America's technology sector, there is no single federal policy being considered by Congress and the administration that holds as much potential to unleash a wave of dynamic and robust job creation as tax reform.

Specifically, we believe the following measures are essential components of tax reform that will maximize job creation, boost workers' paychecks, and increase investment for sustainable long-term growth:

- Lowering the corporate tax rate so that American businesses are able to compete globally on a more level playing field.
- Adopting a competitive, market-based territorial tax system with balanced safeguards against base erosion and profit shifting that does not discriminate against any particular income, including income from intangible property.
- Enabling U.S. companies to bring home approximately \$3 trillion in overseas earnings and invest it here at home.
- Defending the legal right of U.S. corporations to structure global business operations consistent with relevant legal requirements.
- Preserving and enhancing the research and development (R&D) tax credit.
- Encouraging intellectual property to be created and commercialized in the U.S.
- The continued prohibition of federal internet access taxes.
- Simplified tax requirements for mobile workers.
- Accelerated and full business expensing.
- The renewal of Section 48 of the Investment Tax Credit (ITC), which enables projects with long development cycles, including both large fuel cell power generation systems and distributed generation systems, to effectively access the credits.

The coming months represent the best opportunity in a generation to achieve fundamental tax reform that modernizes our tax code for the future. We encourage you and your colleagues throughout the federal government to seize it, and we stand ready to support you in getting this done for the American people.

Sincerely,

A handwritten signature in cursive script that reads "Linda Moore". The signature is written in black ink and is positioned above the printed name and title.

Linda Moore
President & CEO



1401 Eye Street NW, Suite 800, Washington, DC 20005 (202) 783-3300

June 1, 2017

The Honorable Kevin Brady
Chairman
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

The Honorable Richard Neal
Ranking Member
Committee on Ways & Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Brady and Ranking Member Neal:

Thank you for the opportunity to submit a statement on tax reform to the Committee on Ways and Means. As the Executive Director of The Advertising Coalition, I am pleased to submit with this letter a statement regarding the history and principles related to the Section 162 deduction for the cost of business advertising.

Respectively,


James H. Davidson

The ADvertising Coalition

Comments Regarding Hearing on How Tax Reform Will Grow Our Economy and Create Jobs To The Committee on Ways and Means U.S. House of Representatives

May 30, 2017

Executive Summary

We appreciate the opportunity to submit these comments on behalf of The Advertising Coalition (TAC) in response to the Committee's request for comments on tax reform and the economy. TAC includes national trade associations whose members are advertisers, advertising agencies, broadcast companies, cable operators and program networks, and newspaper, magazine and online publishers. Our coalition represents perhaps the single broadest constituency of advertisers, advertising agencies, and media-related businesses in this country engaged in protecting the free flow of advertising content and volume. As a direct correlation to that objective, TAC members are vitally interested in assuring that any reform of the Tax Code preserves the current ability of businesses to deduct the cost of advertising as an ordinary and necessary business expense.

While we agree with the general goal of lowering the statutory corporate tax rate, we believe that it would be counterproductive and in direct conflict with 104 years of established tax policy to impose limits on the deduction for advertising in an effort to "pay-for" such changes. The stated goals of tax reform are to make the U.S. more competitive, stimulate growth and simplify the tax code, but burdening advertising with additional tax liabilities would not further any of these important initiatives. Our concerns are not merely hypothetical as former Ways and Means Chairman Dave Camp included a \$169 billion tax on advertising in his 2014 comprehensive reform proposal (the Tax Reform Act of 2014).

Historically, Congress has reviewed the operation of the Tax Code and proposed revenue raising measures that involved limiting or eliminating nonproductive, revenue losing provisions such as tax expenditures identified by the Joint Committee on Taxation or the Office of Management and Budget. The deduction for the cost of advertising, however, has been an accepted business expense since the adoption of the corporate Tax Code, along with the deduction of other business operating expenses such as rent, salaries and office supplies. This deduction has never been characterized as a tax expenditure or in any way inconsistent with sound tax policy. However, it has become the focus of tax reform for the same reason that Willie Sutton once explained why he robbed banks. "I rob banks because that's where the money is."

One of the unintended consequences of the proposed tax on advertising is that it would result in less information being available to consumers through internet publishers, newspapers, magazines, radio and television stations and networks, and cable networks and operators. Advertising is essential to

the operation and even the survival of our national independent providers of news and information, particularly in rural and smaller communities. Reducing the advertising revenue received by these media outlets would reduce their ability to make information available and would weaken a core underpinning of our democracy - an informed electorate.

A tax on advertising such as what was proposed in the Camp legislation would not only damage the advertising and media industries, but also would negatively affect the jobs and sales generated by advertising's ripple effect throughout the economy. A 2015 study conducted by the world-renowned economics and data analysis firm IHS Economics and Country Risk ("IHS") determined that every \$1 spent on advertising generates nearly \$19 in economic activity (sales), and that every million dollars in advertising supports 67 American jobs. In 2012, advertising drove \$5.8 trillion of the \$36.7 trillion in U.S. economic output and supported 20 million of the 142 million jobs in the United States.¹ These figures demonstrate that every form of advertising – ranging from newspapers, magazines, and television to the Internet – strengthens business and triggers a cascade of economic activity that stimulates job creation and retention throughout the U.S. economy.

The nation's businesses that advertise would annually feel the brunt of a Camp-like proposal, leaving them with fewer resources to commit to advertising spending year after year. The resulting decrease in advertising purchases would, as described above, cause a chain reaction throughout the economy and sharply affect media companies that depend on advertising as a critical source of revenue for daily operations. Given the complex role of advertising in the economy, this type of tax policy would work counter to the key objectives of tax reform of making the Tax Code simpler and more efficient, and fostering a pro-growth environment.

A tax on advertising is neither supported by sound economic policy nor informed tax policy. Two leading experts on the role of advertising, Nobel laureates in Economics Dr. Kenneth Arrow and Dr. George Stigler, concluded that "Proposals to change the tax treatment of advertising are not supported by the economic evidence," and that any policy of making advertising more expensive would cause a decisive decline in advertising spending.² In addition to helping businesses communicate the benefits of their products and services, advertising is a critical driver of U.S. economic activity and should remain a fully deductible expense, just like salaries, rent, utilities, and office supplies.

Advertising Consistently Has Been Defined as an Ordinary and Necessary Business Expense

The treatment of business advertising costs as an ordinary and necessary business expense under Section 162 of the Tax Code has been upheld in the U.S. Tax Court³, supported by a Revenue Ruling from the Internal Revenue Service,⁴ as well as endorsed by Dr. Arrow and Dr. Stigler.⁵ The commitment by leaders in Congress to improve the way the government identifies and collects tax revenues can bring important and productive changes to the Tax Code, including a reevaluation of

¹ "Economic Impact of Advertising in the United States." IHS Economics and Country Risk. (March 2015).

² Arrow, Kenneth et al. "Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures." Lexecon Inc. (August 1990).

³ *RJR Nabisco Inc. v. Commissioner*, 76 T.C.M.71 (1998).

⁴ See Rev. Rul. 92-80, 1992-39 I.R.B. 7.

⁵ Arrow, Kenneth et al. "Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures." Lexecon Inc. (August 1990).

what constitutes a “tax expenditure,” to be more consistent with sound tax policy. However, it is essential to maintain a clear distinction between the definition and treatment of tax expenditures and the need for businesses to deduct ordinary and necessary business expenses, such as advertising.

The Congressional Budget Act defines tax expenditures as “revenue losses [to the government] caused by provisions of the tax laws that allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”⁶ In other words, a tax expenditure is a form of federal spending designed to encourage specific behavior. However worthy the objective, a tax expenditure is an exception to sound tax policy. ***Neither the Joint Committee on Taxation nor the Office of Management and Budget has ever classified the deduction for advertising costs as a tax expenditure.***

The deduction for advertising costs is essential to the proper calculation of the net income tax liability of a business. This principle has been upheld by the U.S. Tax Court in the face of challenges from the Internal Revenue Service that have attempted to test this standard over a period of several decades.⁷

Advertising Creates Millions of Jobs and Adds Trillions of Dollars to the U.S. Economy

As the nation’s leading advertisers and media companies, members of The Advertising Coalition understand first-hand the extent to which advertising is a powerful tool that not only may be used to promote goods and services, but also helps to educate consumers about the world around them. Advertising also is responsible for generating trillions of dollars in economic activity. IHS Economics and Country Risk, using an economic model developed by Dr. Lawrence R. Klein, the 1980 recipient of the Nobel Prize in Economics, demonstrated how advertising performs as a key driver of economic activity and a generator of jobs.⁸ This macroeconomic model has been employed by the Treasury Department, Commerce Department, Labor Department, and most Fortune 500 companies. IHS concluded in 2015 that the jobs of 14 percent (19.5 million) of all U.S. employees are related to advertising, the sales driven by advertising, and the induced economic activity that occurs throughout the economy as a result of advertising.⁹ Additionally, IHS previously established that advertising does not merely shift market share among competing firms, but rather stimulates new economic activity that otherwise would not have occurred. This, in turn, triggers a cascade of economic activity and stimulates job creation and retention throughout the U.S. economy.”¹⁰

The IHS study quantifies the levels of sales and employment that are attributable to the stimulus produced by advertising. It comprehensively assesses the total economic contribution of advertising expenditures across 16 industries, plus government, in each of the 50 states, Washington, D.C., and each of the 435 Congressional Districts in the United States. The overall economic impact of advertising consists of the direct impact of advertising dollars and subsequent sales, supplier sales, inter-industry sales, and resulting consumer spending. Each of these effects also creates and

⁶ P.L. 93-344, 88 Stat. 297, enacted July 12, 1974.

⁷ *Id.* RJR Nabisco Inc.

⁸ “Economic Impact of Advertising in the United States.” IHS Economics and Country Risk. (March 2015).

⁹ “The Economic Impact of Advertising Expenditures in the United States, 2012-2017.” IHS Economics and Country Risk, Inc. (June 2013).

¹⁰ *Ibid*

maintains new jobs that are needed to support a higher level of production. The IHS analysis quantifies the economic impact of advertising along four dimensions:¹¹

- **Direct Economic Impact.** This category refers to the dollars and jobs dedicated to developing and implementing advertising in order to stimulate demand for products and services. It includes the work of advertising agencies and the purchase of time and space on a host of media like radio, television, newspapers, magazines, the Internet, and other outlets. This level of impact stimulates transactions such as the sale of an automobile or an insurance policy sold as a direct result of television advertising.
- **Supplier Economic Impact.** Advertising-generated sales set off chain reactions throughout the economy and create sales and jobs supported by first-level suppliers. Using the example of a car sale, this level of impact encompasses activity by the suppliers of raw materials for upholstery, plastic, tires and parts, radio and GPS receivers, and other products and services that are used to produce the vehicle.
- **Inter-industry Economic Impact.** In the automobile example, sales to first-level suppliers generate subsequent inter-industry economic activity that creates jobs in a host of related industries, such as rail and truck transportation, gasoline and oil, insurance, and after-market sales of automobile products. The demand for products and services, sales, and jobs at this inter-industry tier depends upon the initial consumer purchase of the automobile, which is facilitated by advertising.
- **Induced Consumer Spending.** Every person with a direct, supplier, or inter-industry job also plays the role of consumer in the U.S. economy. They spend a portion of their salaries in the economy on items such as food, consumer goods and services, healthcare, and other needs. This spending initiates multiple rounds of economic activity, stimulates additional sales, and creates jobs.

Leading Economists Have Reinforced Deduction for Advertising

For the past quarter century following enactment of the Tax Reform Act of 1986, a wide range of proposals have been advanced to limit the deduction for advertising costs as a means of raising additional revenue for the federal government. These proposals to change the treatment of advertising as an ordinary and necessary business expense generally have been based on the theories that (1) advertising is durable and generates revenues beyond the period in which the cost is incurred; (2) advertising costs create intangible assets and should, therefore, be capitalized in part, and (3) advertising costs are incurred with a future expectation of income and also should be capitalized in part.

In response to the 1987 book of revenue options drafted by the Joint Committee on Taxation that included limits on the deductibility of advertising,¹² TAC worked with Drs. Arrow and Stigler to identify economic policies and data that would provide a counterpoint to proposals to limit this deduction. The American Institute of Certified Public Accountants similarly examined and rejected a

¹¹ "Economic Impact of Advertising in the United States." IHS Economics and Country Risk. (March 2015).

¹² "A Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means," Joint Committee on Taxation, pp. 138-139 (1987).

proposal to capitalize advertising costs for book income treatment.¹³ The analyses of our economic advisers support the principle that advertising costs should continue to be treated as ordinary and necessary business expenses while concluding that theories advocating otherwise are not sustainable.

Durability of advertising. This argument centers on the notion that the benefit of advertising extends beyond the year in which it is purchased, and that it is more appropriate to link advertising expenses and the income they generate by requiring a portion of advertising costs to be deducted in subsequent years. TAC asked Arrow and Stigler, and the economic consulting firm Lexecon, Inc., to explain the role of advertising in the economy and provide their analysis of this theory. Dr. Arrow was awarded the Nobel Prize for Economics in 1972 and Dr. Stigler was awarded the Nobel Prize for Economics in 1982 for research on consumer choice and the role of consumer information in the economy. Together they prepared the “Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures.”¹⁴

Drs. Arrow and Stigler specifically examined a number of economic studies that proposed increasing the cost of advertising to the advertiser. The goal of many of these studies was to demonstrate the longevity of the impact of advertising on sales in order to justify capitalizing all or part of advertising costs. The Nobel economists concluded that these studies on the durability of advertising had reached such different conclusions that they could not be used as a coherent basis for formulating tax policy. Moreover, Drs. Arrow and Stigler found that these studies suffered from technical flaws that rendered their conclusions meaningless. ***Their analysis suggests that most, if not all, advertising is short-lived.***¹⁵ The economists cautioned against changing the tax treatment of advertising, which would make advertising more expensive:

“Since the information conveyed by advertising is valuable, one must be particularly cautious about taxes that would raise the cost, and hence lower the quantity of advertising. Such taxes would reduce the overall flow of economic information available to consumers. As a result, we expect that prices would rise, the dispersion in prices for particular products would increase, and consumers would be less able to find goods that satisfy their preferences.”¹⁶

Intangible assets. Critics of the current deduction for advertising costs have contended that it creates a preference for businesses that invest in advertising rather than tangible assets, and that advertising similarly must be depreciated over time. They also say it raises questions about whether the current deduction of advertising costs results in the creation of intangible assets.

However, the economic research provided by Drs. Arrow and Stigler shows that the intangible asset is the firm’s product, not the advertising for the product. The results indicate that advertising only communicates information about the product to customers. Arrow and Stigler said that while some economists have attempted to measure the relationship between a firm’s advertising costs and its intangible capital, they incorrectly ignore the fact that there are many economic factors other than advertising that determine a firm’s market value. Indeed, the value of the firm’s product – e.g., its

¹³ The American Institute of Certified Public Accountants. “Statement of Position 93-7: Reporting on Advertising Costs.” (1993).

¹⁴ K. Arrow, et. al.

¹⁵ K. Arrow, et. al., at p. 23.

¹⁶ *Ibid* at p. iii.

effectiveness or innovativeness – is the firm’s true intangible asset. Advertising is only a means by which the firm can exploit fully the value of that asset.¹⁷

Arrow and Stigler offered the innovative user interface developed by Apple Computer as an example of this point. “The ‘Finder,’ which it provides on its Apple . . . personal computer . . . has been enormously popular and Apple has exploited its value by advertising its advantages to potential users. As a result of the success of this product [and other Apple innovations including the iPhone and iPad], Apple’s sales have soared, as has its market value. But Apple’s advertising [Mac versus PC, et. al.] is not the intangible here; it is only a tool for maximizing the value of the true intangible – the interface.”¹⁸

Legal background. The case law supporting the current deduction of business costs had been settled for more than 20 years when the U.S. Supreme Court in 1992 introduced a different viewpoint in *INDOPCO, Inc. v. Commissioner of Internal Revenue*.¹⁹ Prior to *INDOPCO*, an expense would have been capitalized only if it “create[d] or enhance[d] . . . a separate and distinct additional asset.”²⁰ The Court in *INDOPCO* held that legal fees and other costs incurred by Unilever United States in the acquisition of *INDOPCO, Inc.* (formerly National Starch and Chemical Corporation) should be capitalized and not deducted in the year in which they were incurred because the resulting legal structure enhanced the future value of the enterprise.

The decision in *INDOPCO* focused on the tax treatment of legal fees related to a corporate acquisition – whether they should be deducted in the year incurred or capitalized because they contribute to future company income. The Court’s ruling, however, prompted TAC and many other industry groups jointly to ask the Internal Revenue Service (IRS) whether this decision might in the future be extended to advertising expenditures and require any portion of advertising costs to be capitalized. The IRS Office of Chief Counsel responded on September 11, 1992:

“Section 162-1(a) of the Income Tax Regulations expressly provides that ‘advertising and other selling expenses’ are among the items included in deductible business expenses under Section 162 of the Code. Section 1.162-20(a)(2) of the regulations provides, in part that expenditures for institutional or goodwill advertising which keeps the taxpayer’s name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the [business] patronage the taxpayer might reasonably expect in the future.”²¹

Congress in 1993 also addressed the treatment of intangible business expenses that are incurred in generating consumer sales. Supporters of a change in the tax treatment of intangible assets advocated that some of these costs should be capitalized. The Omnibus Budget Reconciliation Act of 1993²² provided that these costs generally should be amortized ratably over 15 years, but Congress specifically exempted any intangible “created by the taxpayer.”²³ The legislation also excluded from

¹⁷ *Ibid* at p. 36.

¹⁸ “Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures,” Arrow, et. al.

¹⁹ *INDOPCO, Inc. v. Commissioner of Internal Revenue*, 503 U.S. 79 (1992).

²⁰ *Commissioner v. Lincoln Savings & Loan Assn.*, 403 U.S. 345, 354 (1971).

²¹ Rev. Rul. 92-80, 1992-39 I.R.B. 7, 1992-2 C.B. 57, 1992 WL 224893 (IRS RRU), September 11, 1992.

²² P.L. 103-66, 107 Stat. 312, enacted August 10, 1993.

²³ *Ibid*, sec. 197 (c)(2).

amortization “any franchise, trademark, or trade name.”²⁴ In other words, advertising that promotes an intangible asset – such as the brand name of a product – should not be capitalized, but rather may be deducted in the year the cost was incurred.

In the period leading up to the Omnibus Budget Reconciliation Act of 1993, the accounting profession conducted a formal examination of the business accounting standards for the treatment of advertising costs. The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) issued a Statement of Position in 1993 that recommended expensing advertising costs either as incurred or at the first time the advertising takes place, unless the advertising meets criteria for capitalizing direct-response advertising.²⁵ Because the Congress and the Committee on Ways and Means regularly look to the treatment the accounting profession recommends or requires for guidance in the treatment of business expenses, TAC was pleased that AcSEC affirmed the current deduction of advertising costs.

Conclusion

Decades of legal and policy justifications support the current tax treatment of advertising as an ordinary and necessary business expense, rather than an asset to be capitalized over time. TAC strongly opposes efforts that would tax the business cost of advertising. Our coalition includes companies and associations of all sizes that share the common goals of protecting the right of companies to advertise, and securing a fair, affordable business tax rate.

Thank you for your consideration of our views.

²⁴ *Ibid*, sec. 197 (d)(1)(F).

²⁵ American Institute of Certified Public Accountants, Accounting Standards Executive Committee, Statement of Position 93-7, December 29, 1993.

Written Statement for the Record of Ways and Means Hearing on “How Tax Reform Will Grow Our Economy and Create Jobs”

Thursday, May 18, 2017

Submitted by J. Michael Keeling, President, The ESOP Association, 1200 18th Street, NW, Washington, DC 20036, Suite 1125. Telephone: 202-293-2971. Email michael@esopassociation.org

The ESOP Association is a tax-exempt, 501(6) trade association with over 1600 corporate members that sponsor an employee stock ownership plan, or ESOP; also as secondary members are professionals providing services unique to creating and maintaining an ESOP, educational members who work for academic institutions, and corporations that are considering creating an ESOP. Total membership is over 2900 members.

The statement follows:

“Mr. Chairman, and distinguished members of the House Ways and Means Committee, my testimony focuses on jobs, and proven policy that sustains jobs of working Americans.

May I make two points before providing proof of what I will say is supported by objective data since 2002.

While many of the Committee did not serve with my former “boss,” Congressman J.J. “Jake” Pickle, I will never forget that when I started work for him in August 1972, he said to me “Michael, when you help me understand a proposal, a suggested amendment, a possible project for the 10th District of Texas, or Austin, Texas, the first thing you think about is ‘How will this proposal, this law, this project impact jobs in my Congressional District?’” And I always followed his directions.

I know that women and men who serve in Congress today remain focused on the issue of jobs. My experience is that any member of Congress—whether left, right, in the middle, Republican, Democrat, or Independent—will pledge to work for policies that “create” jobs, somewhat the title of this hearing today.

No one is against policies that “create” jobs, but what helps American employees most are policies to maintain jobs.

Today my submission is brief: At the end of my submission is a scan from page 12 of a book released in late January of this year, published by the Upjohn Institute for Employment Research, Kalamazoo, Michigan, “How Did Employee Ownership Firms Weather the Last Two Recessions?”

The authors are respected academics: Fidan Ana Kurtulas, Associate Professor of Economics, University of Massachusetts, Amherst, a Wertheim Fellow at Harvard Law School, research fellow at the Institute for the Study of Labor (IZA), and a research coordinator for LERA Employment Policy Research Network; and, Douglas L. Kruse, Distinguish Professor of Economics at Rutgers University School of Management and Labor Relations, a research associate of the National Bureau of Economic Research, a research fellow at the Institute for the Study of Labor (IZA), an editor of the *British Journal of Industrial Relations*, and director of the Rutgers Program for Disability Research.

Their conclusions are based on data from:

- The prestigious General Social Survey, conducted by the National Opinion Research Center, headquartered at the University of Chicago.
- Years of IRS Form 5500's, which are filed by sponsors of retirement savings plans.
- Previous academic research on employment and employee ownership.

While my statement includes only one chart, the book is full of charts and I commend it to you and your staff as you review how to have policies that are job maintenance policies.

So to conclude, as the chart says what I want to convey—data from the GSS's 2002, 2006, 2010, and 2016 surveys evidences that companies with employee stock ownership laid off employees at a rate that was, on average over these years (which included two recessions), **four to eight times less than layoff rates at conventionally owned companies.**

Please note, this book, this research was not paid for by The ESOP Association, or any other interest group.

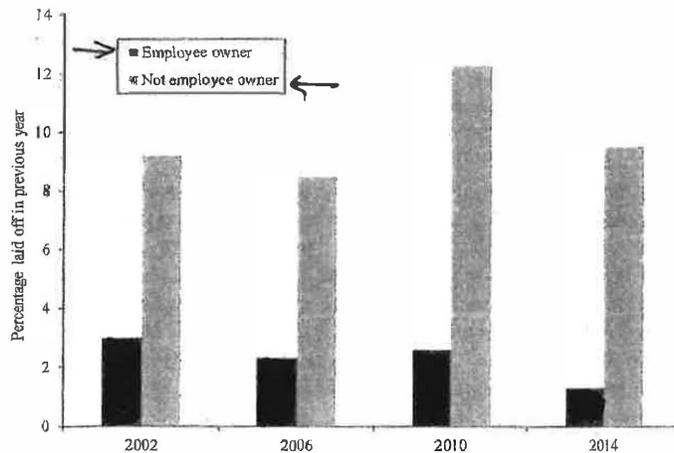
In sum, as you do the heavy lifting of tax reform, as it is not an easy task having participated in numerous tax reform efforts and the major tax bills of the 80's, remember—you want to have policy that results in people keeping their jobs—consider proposals, and the existing laws that encouraging more Americans being owners of the companies where they work.

Thanks for permitting me to submit this statement. Above is my contact information if anyone wishes to speak to me about what I say today.

Employee Stock Ownership a Proven Best Policy to Preserve American Jobs

Job Security and Firm Survival. The GSS results show that both actual layoffs (Figure 1.2) and the perceived likelihood of layoff (Figure 1.3) are lower for employee-owners than for nonowners. As we can see in Figure 1.2, in each year, workers who participated in employee ownership programs indicated a lower incidence of losing their jobs than workers who were not employee owners. For example, in 2002, 3.0 percent of employee owners reported being laid off from their jobs in the past year compared to 9.2 percent of non-employee owners. In each

→ **Figure 1.2 Layoffs and Employee Ownership**



→ NOTE: Layoff information based on the GSS variable *laidoff*, which indicates whether the employee was laid off from his or her main job at any time in the past year. Figure illustrates mean response by employee ownership.

SOURCE: Data are from the GSS on employees at private firms.

Testimony Submitted for the Record for Hearing on
How Tax Reform Will Grow Our Economy and Create Jobs across America

The Massachusetts Development Finance Agency, a quasi-public finance and development entity otherwise known as MassDevelopment, respectfully requests that any tax-reform package preserve the status of tax-exempt bonds, which play a critical role in the U.S. economy.

In 2015 and 2016, MassDevelopment issued more than \$8 billion in tax-exempt debt to fund nearly 200 projects throughout Massachusetts. These economic development, health care, higher education, and non-profit transactions supported the creation of more than 9,000 new jobs and more than 21,000 construction jobs. The savings in interest as a result of the 25-30% tax-exempt discount made the deals affordable and provided the necessary incentive for borrowers to engage in capital projects that ultimately served important public purposes.

Under the leadership of Chairman Brady and Ranking Member Neal, the House Committee on Ways & Means seeks to produce tax-reform legislation that will grow our economy and create jobs. MassDevelopment strongly supports these objectives and urges the Committee to do no harm by protecting tax-exempt bonds given the great contributions these tools make to achieving pro-growth goals.

Case studies from each of the nine Massachusetts House districts illustrate the vital roles that tax-exempt bonds play in driving the Massachusetts economy.

Bianco & Sons, Medford

Using proceeds from a \$5.1 million MassDevelopment [industrial development bond](#), Bianco & Sons Inc., a family-owned meat and sausage maker in Revere, bought and renovated a 29,200-square-foot building in Medford to house its manufacturing operations. Founded in 1960 by the late Joseph Bianco Sr., the company started as a small retail meat and sausage market and has expanded to incorporate many different products, including an increasing variety of meats, sausages, and other specialty items. The Medford building allowed Bianco & Sons to move from three spaces it leased in Revere into one facility, which accommodates the entire operation and provides a larger and more efficient layout for sausage production. The bond also helped the company buy furniture, fixtures, and production equipment. Bianco estimates the project will create 15 jobs and 21 construction jobs.

Dean College, Franklin

Founded in 1865, Dean College is a private residential college serving nearly 1,400 students. To accommodate its growing student body, the College needed to create more housing. With the help of a \$4.5 million MassDevelopment [tax-exempt bond](#), Dean College bought a 36,000-square-foot mixed-use building with first-floor retail businesses underneath 21 apartments. This project, which will create 15 jobs, allowed Dean College

to provide safe, convenient housing for 75 students. The first-floor retail activity helps both the College and downtown Franklin continue to grow.

D'Youville, Lowell

MassDevelopment issued an \$8 million [tax-exempt bond](#) on behalf of Lowell's D'Youville Life and Wellness Community, allowing the organization to increase its capacity to provide assisted living and healthcare solutions to low- and moderate-income seniors. D'Youville used proceeds from the bond to build a 60-unit affordable assisted living residence in Lowell known as the Saab Residence. The residence includes a café, fitness center, wellness center, outdoor garden, and courtyard. Within the residence, 15 units are reserved for individuals suffering from early memory loss and 15 units are rented at market price, while the remaining 30 units remain affordable.

MassDevelopment had previously issued D'Youville \$20.5 million in [tax-exempt bonds](#) in 2010 that the organization used to build a 33-bed transitional care unit in Lowell. That unit includes four hospice suites and provides space for short-term rehabilitation.

Finicky Pet Food Inc., New Bedford

Finicky Pet Food processes fish for suppliers and manufacturers in the pet food industry. To reduce soaring electricity costs, the company wanted to purchase and install solar panels on the roof of its facility. MassDevelopment issued a \$5,267,500 [industrial development bond](#) on behalf of the project. The company's canopy system solar installation includes its parking lot and adjoining land. The tax-exempt bond enabled Finicky Pet Food to invest in renewable energy, create 20 jobs, reduce operating costs, and devote more resources to delivering a high-quality product to the pet food industry. The project created 20 construction jobs.

Harborlight Community Partners, Beverly

Harborlight Community Partners is an affordable housing manager and developer in Beverly. With proceeds from a \$4 million MassDevelopment [tax-exempt bond](#), the organization bought and renovated Harborlight House, an affordable senior living facility. The developers improved the building's energy efficiency and renovated its housing units to improve wheelchair accessibility. This bond also helped Harborlight maintain the building's 30 units as affordable for another 30 years. This project created 14 construction jobs.

Jarvis Surgical, Westfield

Jarvis Surgical Inc. is a manufacturer of precision titanium and cobalt chrome medical parts like shoulder, knee, hip and spine implants. With proceeds from a \$2.2 million MassDevelopment [industrial development bond](#), the company built a 15,000-square-foot addition on its facility and bought new manufacturing equipment. The company also bought 1.9 acres of land adjacent to its facility, which it used to expand employee parking. The improvements will allow Jarvis to add 24 jobs, six construction jobs, and help stimulate Massachusetts' vital manufacturing industry.

Madison Williams, Boston

With a \$9.5 million MassDevelopment [tax-exempt bond](#), Madison Park Development Corporation, a nonprofit that promotes the redevelopment of the Roxbury neighborhood in Boston, is transforming the neighborhood's former Tropical Foods Supermarket into a vibrant mixed-use development. The building will include 7,500 square feet of ground floor retail space and 30 units of mixed-income housing. The redevelopment of this building qualifies for Historic Tax Credits and will follow National Park Service guidelines for historic rehabilitation. The project is creating 101 construction jobs.

Patriot Homes, Boston

South Boston Veterans Housing LLC used a \$6.2 million MassDevelopment [tax-exempt bond](#) to build a low-income housing development for veterans called Patriot Homes. A joint venture between Braintree affordable housing nonprofit Caritas Communities and the South Boston Neighborhood Development Corporation, South Boston Veterans Housing LLC used the bond to finance the Patriot Homes development, which includes 24 new rental apartment units for low-income veterans. The project is creating 52 construction jobs. In its first phase, the project's sponsors acquired a former police station to convert into 12 studio apartments and to create office space for the South Boston Neighborhood Development Corporation. The second phase included construction of a 12-unit building. All 24 units of the Patriot Homes are reserved for households earning no more than 50 percent of area median income.

UMass Memorial Healthcare, Worcester

UMass Memorial consists of UMass Memorial Medical Center with its Memorial, University, and Hahnemann Campuses in Worcester; UMass Memorial-Clinton Hospital in Clinton; UMass Memorial-HealthAlliance Hospital in Leominster and Fitchburg; and UMass Memorial-Marlborough Hospital in Marlborough. UMass Memorial used \$168,750,000 in MassDevelopment [bonds](#) to purchase new equipment and complete construction and renovation projects at several of its hospitals. UMass Memorial used funds to build a 24-bed observation and admission unit, and to build and redevelop its dialysis center at the University campus; to connect two entrances with a new atrium and corridor at its Memorial campus; and to install emergency power and combined heat power systems at its Leominster and Fitchburg campuses to better serve patients in adverse conditions. The project created 264 construction jobs.

I appreciate the opportunity to submit this testimony to the Committee and thank you for considering these comments.

Marty Jones
President and CEO
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617-330-2000
617-330-2001 (fax)



T H E M I L I T A R Y C O A L I T I O N

201 North Washington Street
Alexandria, Virginia 22314
(703) 838-8143

April 26, 2017

The Honorable Kevin Brady
Chairman, Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

The Honorable Orrin Hatch
Chairman, Committee on Finance
United States Senate
Washington, D.C. 20515

The Honorable Richard E Neal
Ranking Member, Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

The Honorable Ron Wyden
Ranking Member, Committee on Finance
United States Senate
Washington, D.C. 20515

Dear Chairmen Brady, Hatch, Ranking Members Neal, and Wyden,

The Military Coalition (TMC), a consortium of uniform services and veterans associations representing more than 5.5 million current and former service members and their families and survivors, thanks you and the Committee for your efforts to improve the employment prospects of veterans by extending the VOW To Hire Heroes Act tax credits and the Work Opportunity Tax Credit (WOTC) for five years.

The VOW To Hire Heroes Act, signed in 2011, strengthened the WOTC by significantly increasing the financial incentives to employers for hiring veterans, including veterans with disabilities. Department of Labor (DOL) statistics show that 35,904 veterans were certified for WOTC during the three-year period before the VOW Act. By contrast, 278,611 veterans were certified during FY 2013-15, an increase of more than 700 percent. The WOTC has been a critically important tool for solving the veteran unemployment problem.

However, the constant cycle of expiration and retroactive renewals of these tax credits causes a great deal of uncertainty among employers. By reforming the tax code to include a permanent WOTC, employers will build veteran employment into their decision-making processes. Additionally, veterans will have certainty this is one more arrow in their quiver so they can more effectively pitch themselves to employers.

TMC also urges you to include military spouses in a permanent WOTC. Military spouses often find themselves penalized and disadvantaged in the labor marketplace because of constant relocations. Unemployment and underemployment are chronic problems in the military spouse community, both of which adversely affect military families. You can help address these issues by including them in this tax credit.

Sincerely,

The Military Coalition
(Signatures enclosed)