Nuts & Bolts of Tax Reform

May 31, 2013

Presentation to the Tax Reform Study Team
Advisory Committee on Social Witness Policy (ACSWP)
UCC Office of Justice & Witness/ Office of Public Witness, PC(USA)

Steve Wamhoff,

Citizens for Tax Justice

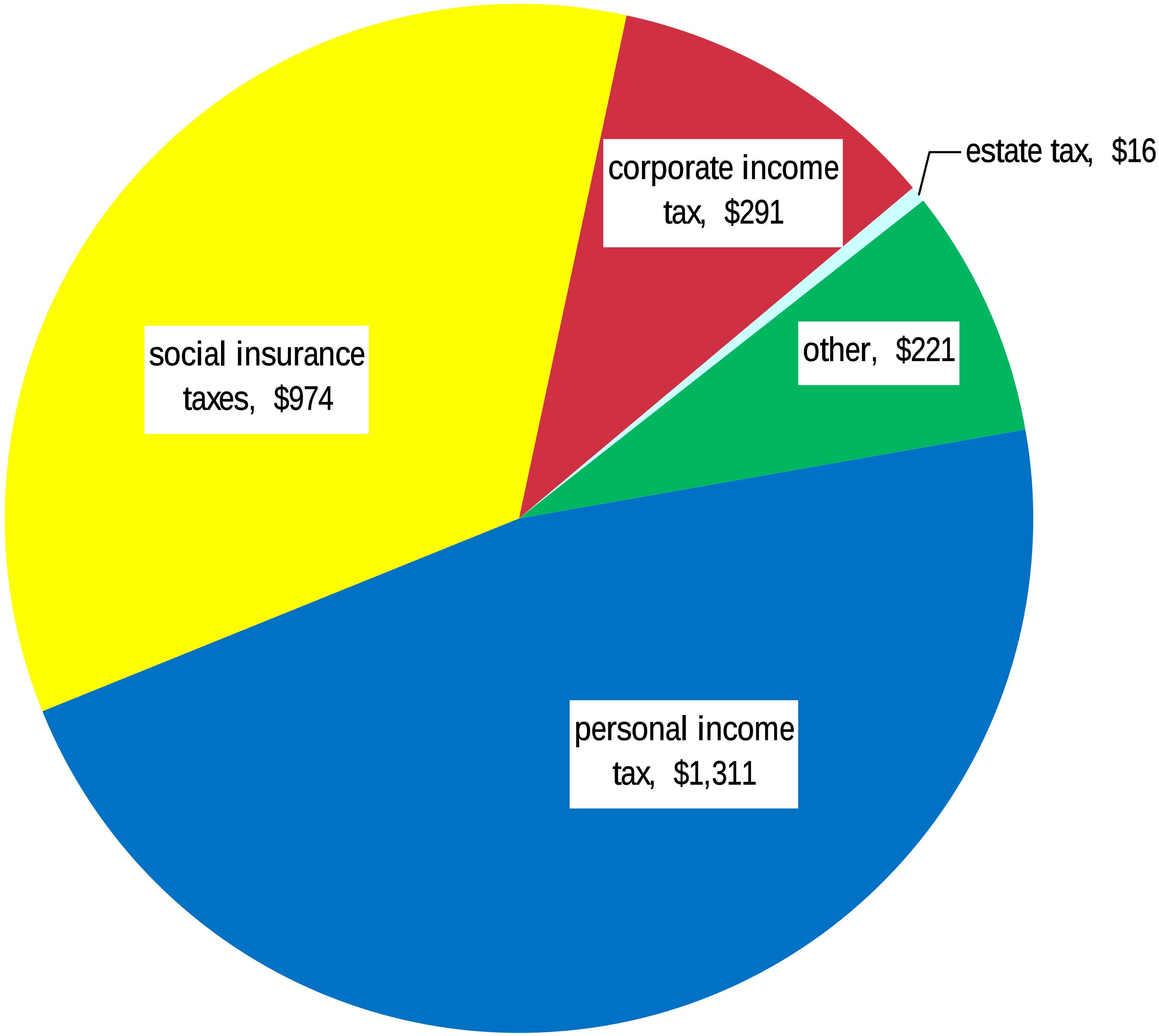
The Work of Citizens for Tax Justice (CTJ) on Federal Tax Policy

- Analyses using our computer model to determine revenue impacts and distributional impacts of the personal income tax and social insurance taxes and proposals to alter them.

- Research on the corporate income taxes paid or avoided by specific corporations.

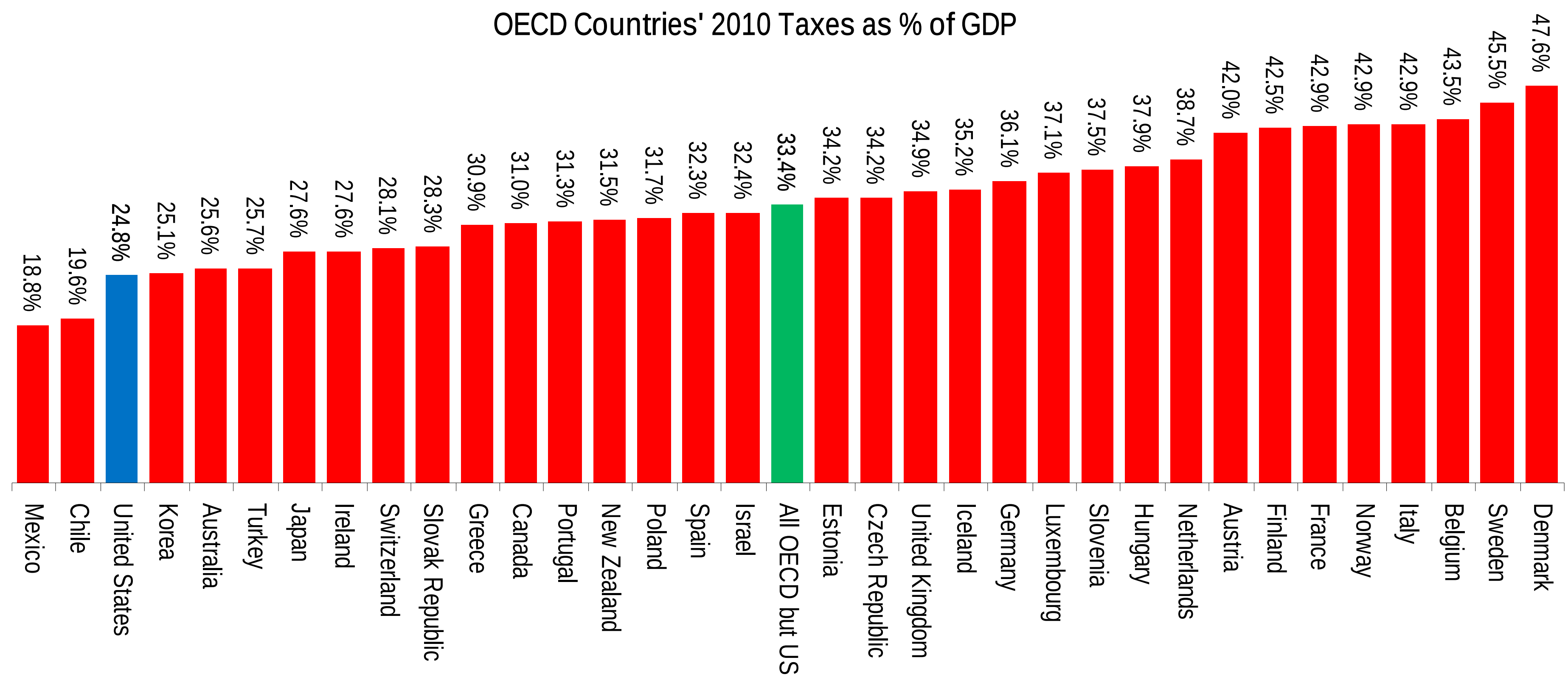
- Simple-as-possible explanations of tax policy and proposals to change it.

Sources of Federal Revenue in Billions of Dollars in 2013



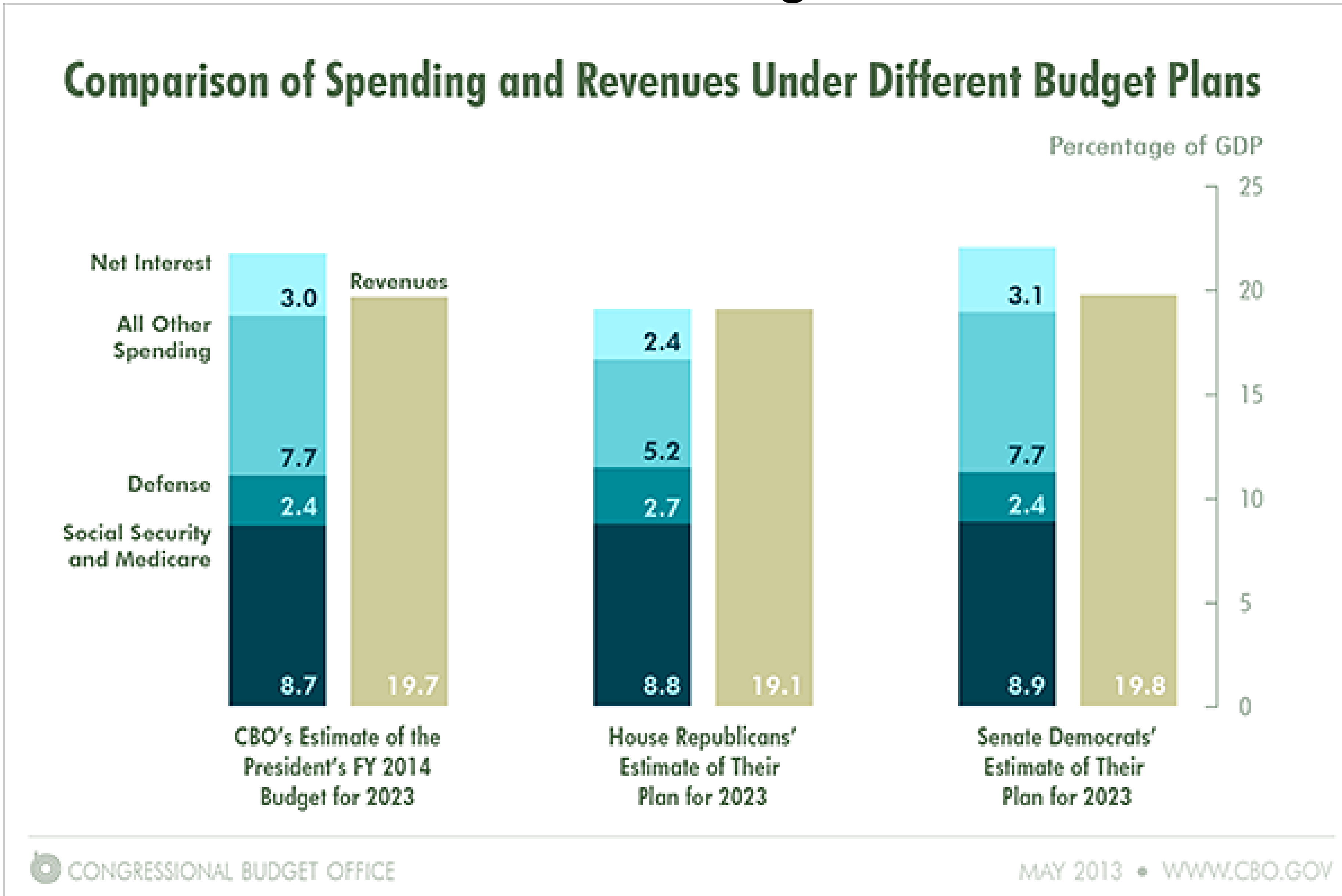
Source: CBO May 2013 and calculations by Citizens for Tax Justice, May 2013

The U.S. Is Undertaxed

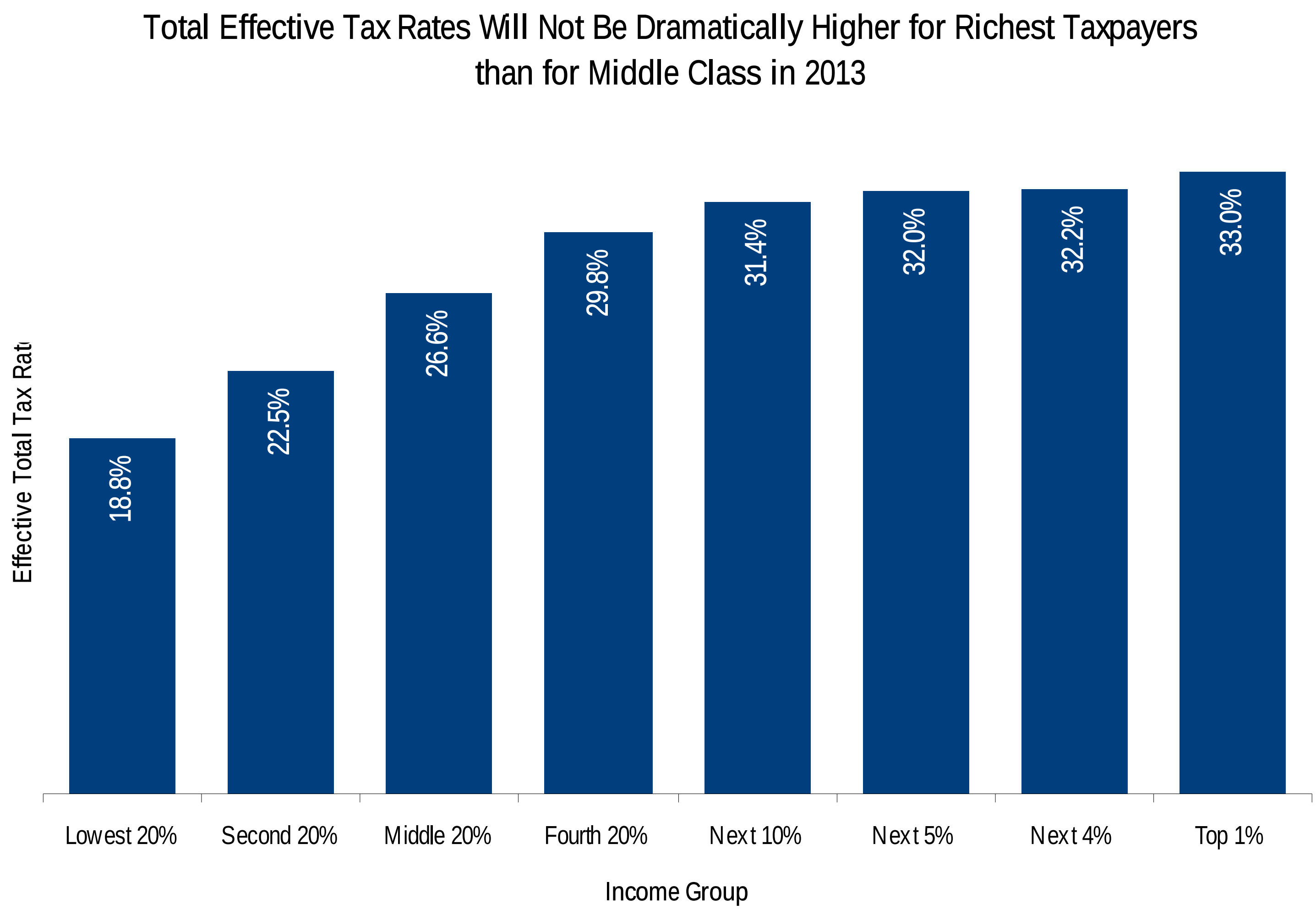


For more, see CTJ report from 4/8/2013

The Most Frequently Discussed Budget Plans Will Not Raise Enough Revenue



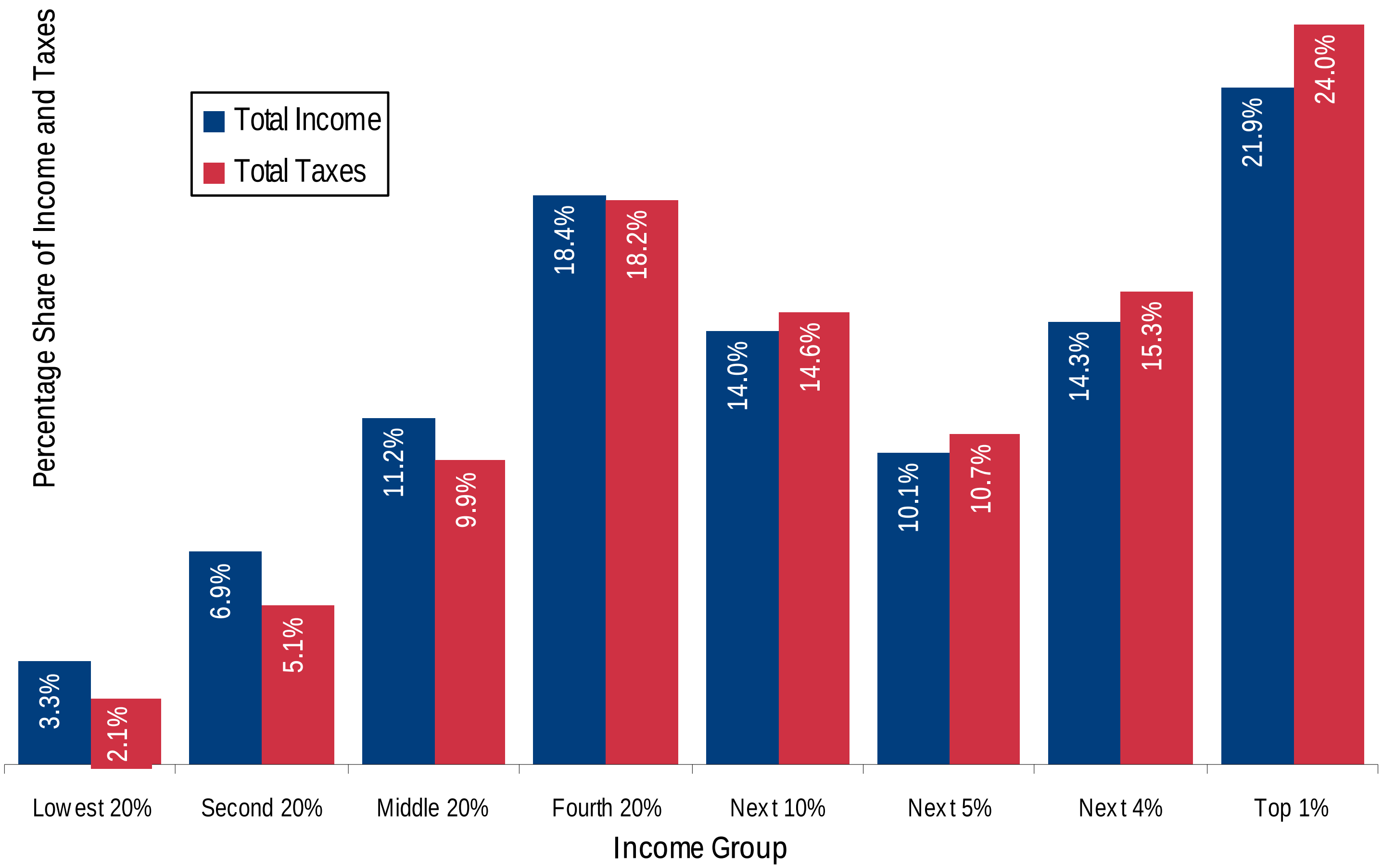
Our Tax System Is Just Barely Progressive



Source: Institute on Taxation and Economic Policy (ITEP) Tax Model, April 2013
Citizens for Tax Justice, April 2013.

Our Tax System Is Just Barely Progressive

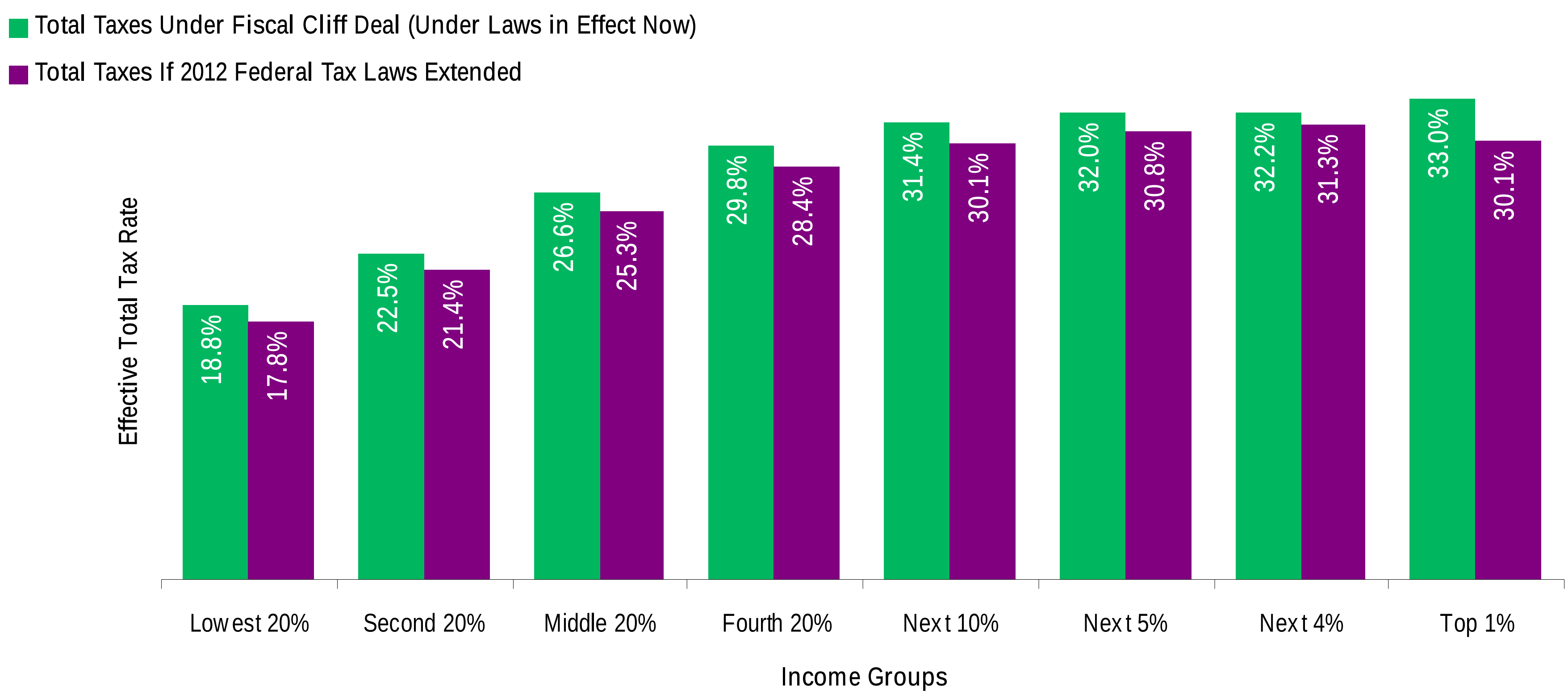
Shares of Total Taxes Paid by Each Income Group Will Be Similar to their Shares of Income in 2013



Source: Institute on Taxation and Economic Policy (ITEP) Tax Model, April 2013
Citizens for Tax Justice, April 2013.

This Fiscal Cliff Deal and New Tax Laws in Effect Now Do Not Change This Very Much

Effective Total Tax Rates (including Federal, State & Local Taxes) in 2013 Are Slightly Higher Under Fiscal Cliff Deal than They Would Be Under 2012 Federal Tax Laws



Source: Institute on Taxation and Economic Policy (ITEP) Tax Model, April 2013
Citizens for Tax Justice, April 2013.

Many High-Income Individuals and Profitable Corporations Pay Too Little

- In October 2011, CTJ director Bob McIntyre told TIME that Mitt Romney's effective tax rate was likely around 14%, touching off a major debate about taxes throughout the presidential campaign.
- Wealthy investors like Romney will pay *somewhat* more as a result of the fiscal cliff deal and the health tax that CTJ proposed and which was enacted as part of health care reform.
- In November 2011, CTJ published a report examining most of the Fortune 500 corporations that had been consistently profitable for three years, finding 30 that paid nothing over that period and finding that the average effective tax rate was just 18.5 percent.
- Congress has done nothing to address this problem.

Preview of New CTJ Data Shows Corporations Still Avoiding Taxes

A Few Examples of the Many Corporations That Paid Far Less in Federal Income Taxes than Average Americans in 2012 and/or over the Past Five Years

	2012			2008-12 Totals			Industry
$-millions	US profit	Fed Tax	Rate	US profit	Fed Tax	Rate	
Apache	$ 1,606	$ –153	–9.5%	$ 7,595	$ –169	–2.2%	Oil & gas exploration & production
Facebook*	1,062	–429	–40.4%	3,871	92	2.4%	Web-based social media
FedEx**	2,706	–135	–5.0%	6,953	–98	–1.4%	Delivery services
General Electric	7,903	651	8.2%	27,518	–3,054	–11.1%	Conglomerate (finance, aerospace, etc.)
Interpublic Group	372	–3	–0.8%	1,362	–28	–2.0%	Advertising and marketing services
Pepco Holdings	480	–76	–15.8%	1,743	–575	–33.0%	Electric utility
Principal Financial	919	–137	–14.9%	3,875	269	6.9%	Investment management
Ryder System	230	–5	–2.3%	1,073	–51	–4.7%	Truck rentals and services
Southwest Airlines	673	–45	–6.7%	2,142	156	7.3%	Airline
Tenet Healthcare	323	–3	–0.9%	905	–51	–5.6%	Health care services
Totals these 10 corps.	**$ 16,275**	**$ –335**	**–2.1%**	**$ 57,036**	**$ –3,508**	**–6.2%**	

*2010-12 for 2008-12 totals (no data for previous years).
**2011 in 2012 columns and 2008-11 for 2008-12 totals (2012 10-K annual report not yet filed).

Source: Corporate 10-K Annual Reports

Opponents of Higher Personal Income Taxes or Corporate Taxes Often Argue that They Are Not Really Progressive

- Opponents claim that increasing the personal income tax on investment income (capital gains, stock dividends, etc) discourages investment and job creation — and thus ends up hurting low- and middle-income Americans and *reduces* revenue. This has been disproven by history. (See CTJ report from 9/20/2012.)

- Opponents claim that the corporate income tax is ultimately borne by workers, because the tax causes investment to leave the U.S. to the detriment of American workers.

- Researchers from the Congressional Budget Office, Congressional Research Service, and Tax Policy Center, conclude the vast majority of the corporate tax is borne by capital (by the owners of stocks and other business assets.

- At a more basic level, corporations would not bother to lobby for lower taxes unless they believed that their shareholders were ultimately paying them.

CTJ Believes that for Tax Reform to be Worth Enacting, It Must Do the Following:

- Raise revenue.
- Raise it from both the personal income tax *and* the corporate income tax.
- Raise it in progressive ways.
- Reduce, rather than expand, tax incentives to shift jobs and profits offshore.

Many Republicans and Democrats in Washington Have Different ***Revenue*** Goals Than CTJ

- Dave Camp, Republican chairman of the House Ways and Means Committee, wants to reduce or eliminate "tax expenditures" and use all the revenue savings to offset reductions in tax rates.

- President Obama would limit tax expenditures in the personal income tax to raise revenue. But in the corporate income tax, he would reduce or eliminate tax expenditures and use the savings to offset rate reductions.

Many Republicans and Democrats in Washington Have Different ***<u>Progressivity</u>*** Goals Than CTJ

- President Obama proposes to limit many personal income tax expenditures for the rich, but would leave untouched the very most regressive — the preferential rates for capital gains and dividends.

- Mitt Romney and Paul Ryan's plans would limit tax expenditures but reduce rates so much that millionaires would pay hundreds of thousands of dollars less in taxes even if they had to give up *all* of their tax expenditures. (See CTJ reports from 8/29/2012, 10/24/2012, and 3/13/2013.)

- Rep. Kevin Brady, Republican member of the Ways and Means Committee and chairman of the Joint Economic Committee, issued a report attempting to gut the term "progressivity" of any meaning. (Described in his May 5 WSJ op-ed.)

Many Republicans and Democrats in Washington Have Different Goals Regarding ***<u>Offshore Issues</u>*** Than CTJ

- President Obama would not eliminate the corporate tax expenditure that encourages corporations to shift jobs and profits offshore — “deferral” — but his proposals would limit its worst abuses.

- Dave Camp proposes to expand “deferral” into an even larger break for corporate profits characterized as “offshore.”

- This will be explained in more detail.

Debate Over Tax Reform Has Focused on Tax Expenditures

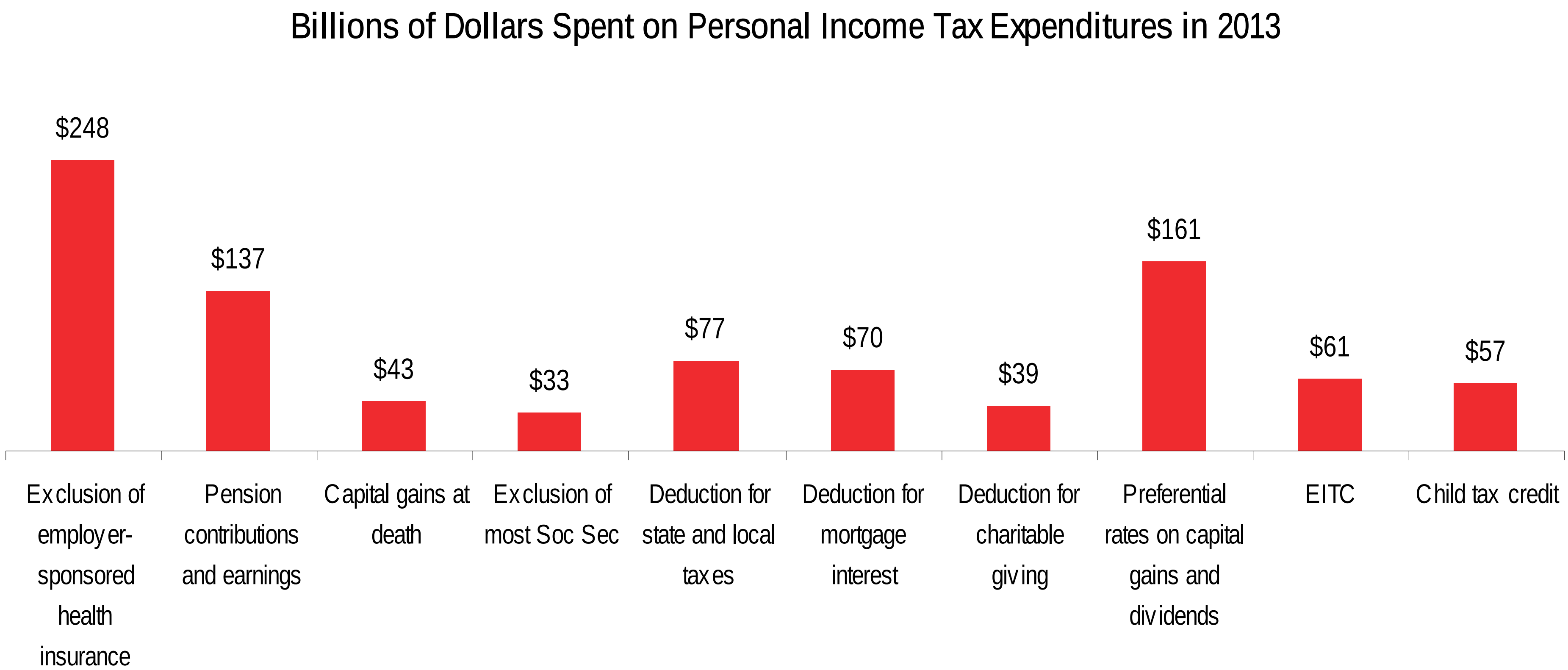
- The personal income tax has a basic rule that income is subject to tax at progressive rates.

- Exceptions to this are “tax expenditures” or “tax subsidies.”

- Similarly, the corporate income tax has a basic rule that most corporate profits are taxed at a rate of 35 percent.

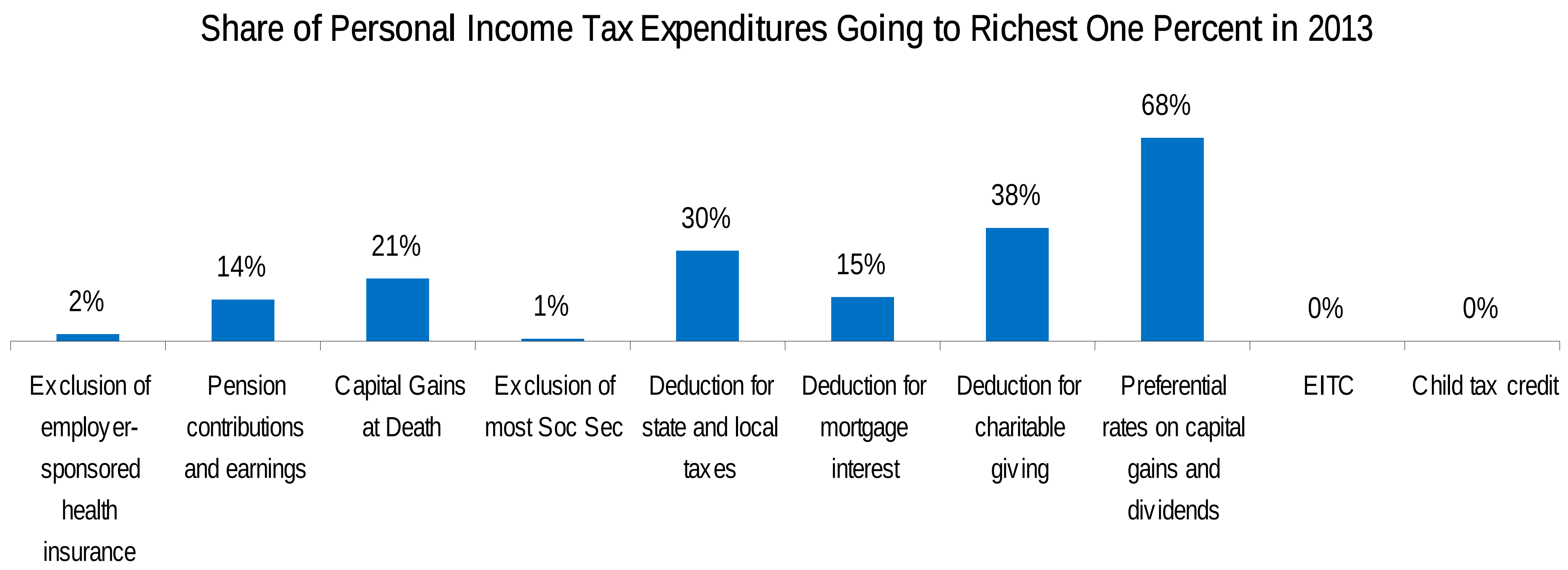
- Exceptions to this are corporate “tax expenditures” or “tax subsidies.”

Personal Income Tax Expenditures: Keep the Progressive Ones, Target the Regressive Ones



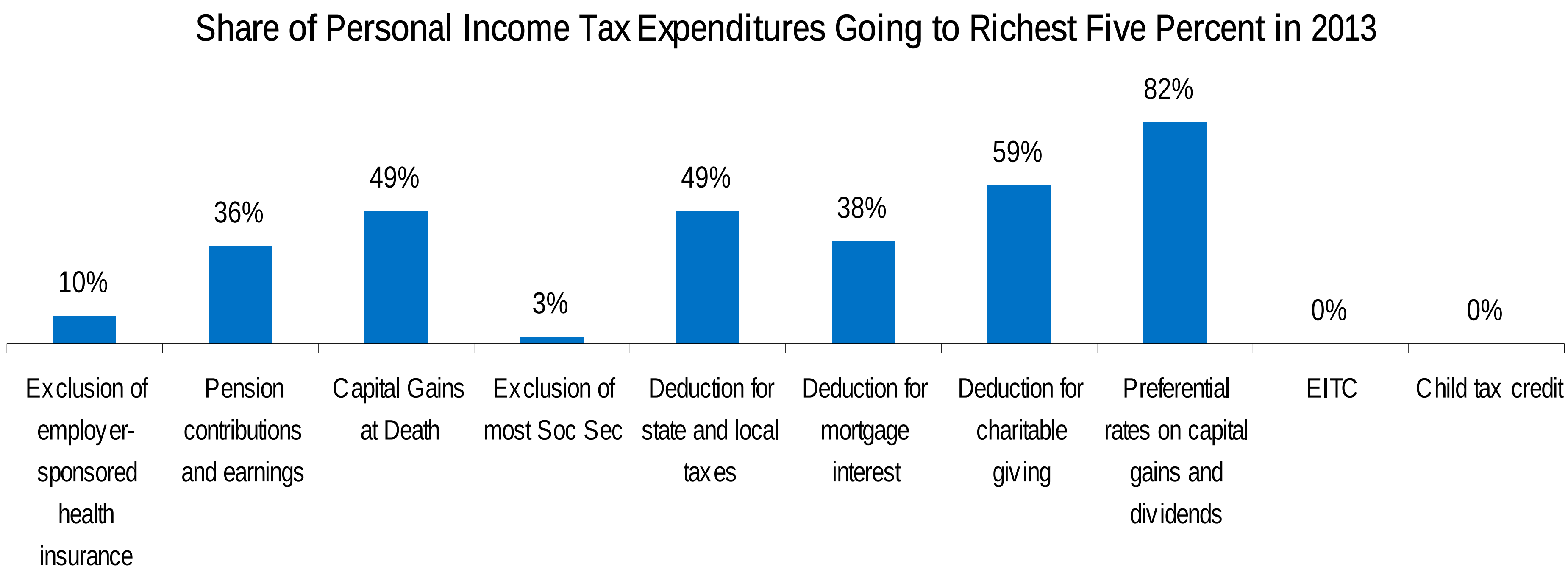
Source: Congressional Budget Office, May 2013

Personal Income Tax Expenditures: Keep the Progressive Ones, Target the Regressive Ones



Source: Congressional Budget Office, May 2013

Personal Income Tax Expenditures: Keep the Progressive Ones, Target the Regressive Ones



Source: Congressional Budget Office, May 2013

Corporate Income Tax Expenditures: Accelerated Depreciation

- When a business buys inventory (which will be sold quickly), it gets to deduct the cost from its revenue when calculating its taxable income.

- After a business makes a capital investment, it continues to hold onto something of value for many years, so the cost is deducted over several years.

- Accelerated depreciation allows the business to deduct the costs of capital investments more quickly than they wear out and lose their value.

- A 2012 report from the Congressional Research Service reviews efforts to quantify the impact of the provision and explains that “the studies concluded that accelerated depreciation in general is a relatively ineffective tool for stimulating the economy.”

Corporate Income Tax Expenditures: Deferral

- U.S. corporations are allowed to indefinitely “defer” paying U.S. taxes on their offshore profits, which creates terrible incentives for corporations to:
  - move operations (jobs) to a lower tax country
  - shift profits offshore — in other words, tell the IRS that profits generated in the U.S. are actually generated in a low-tax/no-tax country (an offshore tax haven).

Congressional Republicans and Many Democrats Want to Expand Deferral into an ***Exemption*** for Offshore Corporate Profits

- If allowing corporations to defer U.S. taxes on their offshore profits encourages them to shift jobs and profits offshore, then exempting the offshore profits from U.S. taxes will logically increase those terrible incentives.

A ***Permanent Exemption*** for Offshore Profits Is Often Called a "Territorial" Tax System

- Dave Camp argues that a territorial system can have provisions that prevent offshore tax avoidance.
- But the IRS is already unable to determine whether or not subsidiaries of a corporation in different countries are undercharging and overcharging each other to make profits appear to be generated in tax havens.
- In other words, it's already impossible for the IRS to enforce "transfer pricing rules" that require subsidiaries of a corporation to deal with each other at "arm's length," as if they were unrelated companies.
- This is especially true when intangible property is what's being transferred between them. (What is the patent for Apple's latest invention worth? Who knows?)
- It's impossible to believe that this can be easier in a territorial system which increases the incentives to make U.S. profits appear to be generated offshore.

A ***Temporary Exemption*** for Offshore Profits Is Often Called a "Repatriation Holiday"

- Some corporations instead lobby Congress to repeat the tax amnesty for offshore profits (often called a "repatriation holiday") that was enacted in 2004.

- Another temporary tax amnesty for repatriated offshore corporate profits would increase incentives for job offshoring and offshore profit shifting.
  - One reason why the Joint Committee on Taxation concluded that a repeat of the 2004 "repatriation holiday" would cost $79 billion over ten years is the likelihood that many U.S. corporations would respond by shifting even more investments offshore in the belief that Congress will call off most of the U.S. taxes on those profits again in the future by enacting more "holidays."

- The Congressional Research Service concluded that the offshore profits repatriated under the 2004 tax amnesty went to corporate shareholders and not towards job creation.
  - In fact, many of the companies that benefited the most actually reduced their U.S. workforces.

Instead of Adopting a Territorial System or Repatriation Amnesty, We Should End Deferral

- Repealing deferral would ***not*** mean corporate profits would be double-taxed.

- U.S. corporations receive a credit against their U.S. taxes for taxes they pay to another country, and this would not change.

Comparing Potential Revenue Sources

- This table is from a 2012 CTJ report exploring revenue-raising options.
- The three most significant are the capital gains break, deferral, and accelerated depreciation.
- It's easy for lawmakers to say they want to close tax expenditures (whether to raise revenue or lower rates) but very few want to talk about repealing or limiting these.

Policy Options to Raise Revenue

Policy Option	10-Year Revenue Impact ($billions)
Repeal Capital Gains Break Tax capital gains at same rates as other income under the personal income tax.	$533*
Repeal "Deferral" End rule allowing U.S. corporations to "defer" U.S. taxes on offshore profits.	$583
Eliminate Accelerated Depreciation End rules in corporate and personal income taxes allowing deductions for investments faster than assets wear out.	$569**
Repeal Domestic Manufacturing Deduction End section 199 deduction that is ostensibly to encourage manufacturing in the U.S.	$163
Enact Buffett Rule Senator Whitehouse's legislation to require millionaires to pay at least 30 percent of income in federal taxes.	$171
Repeal LIFO & LCM Bar "last-in, first-out," and "lower cost or market" methods of manipulating inventory accounting.	$98
Bank Fee Enact Obama's proposed fee on riskier assets of the largest banks.	$61
Repeal Fossil Fuel Tax Subsidies Repeal deduction for "intangible" drilling costs, percentage depletion, amortizing oil search costs, and breaks for "dual capacity" taxpayers.	$38
Close Stock Options Loophole Close the loophole allowing corporations to deduct more for tax purposes for stock options than they report to shareholders.	$25
Close Carried Interest Loophole Require compensation paid to fund managers to be taxed at same rates as other income from work rather than capital gains rates.	$21
Close Payroll Tax Loophole for S Corporations Close loophole used by Newt Gingrich and John Edwards to characterize earned income as unearned to avoid Medicare tax.	$11

*At least $533 billion, depending on behavioral effects. See appendix.
**Ending depreciation breaks would raise less revenue after this decade.