CTJ

Citizens for Tax Justice

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Congressman Rangel's Tax Bill Would Make the Tax Code Simpler & Fairer — and the Changes Are All Paid For

On October 25, House Ways and Means Chairman Charles Rangel introduced his proposal to address the Alternative Minimum Tax (AMT) problem and make the tax code simpler and fairer, without increasing the federal budget deficit.

On the individual tax side, the bill would entirely repeal the AMT and expand several tax provisions that particularly benefit low-income people. It would cover the $930 billion 10-year cost of the tax reductions by reducing the Bush tax cuts for the wealthiest Americans and by closing some unfair loopholes that primarily benefit the very well-off.

On the corporate tax side, the bill would sharply cut the top corporate tax rate, and pay for that by eliminating some inefficient and unfair corporate loopholes.

The entire bill, H.R. 3970, is unlikely to be debated by Congress this year. But the bill is designed so that certain provisions can be separated out and passed by Congress more quickly. These provisions include a $50-billion, one-year "patch" for the AMT and a $21-billion package of one-year extensions of an array of narrow-interest tax breaks. These would be paid for by enacting a few of the bill's loophole-closing provisions (which would cover the cost of the one-year tax reductions, albeit only over a 10-year period).

On balance, Citizens for Tax Justice supports the Rangel bill because it would make the tax code simpler and fairer without making our fiscal situation even more dire.

Looking at the bill as a whole, H.R. 3970 accomplishes three important goals:

- It makes the tax code a little simpler for individuals by repealing the AMT after 2007 and expanding the standard deduction, and a bit simpler for businesses, who will trade unnecessary tax breaks for a lower corporate tax rate. The bill's corporate loophole-closing measures would enhance the economy overall because fewer business decisions would be made for tax reasons (to exploit loopholes) rather than sound economic reasons.
- It makes the tax code fairer by providing a larger standard deduction and tax credits for low-income working people and by scaling back the Bush tax cuts for the wealthy.
- Finally, the bill stops the dangerous pattern of the Bush administration of cutting taxes more and more and putting the cost on the national credit card. Instead, the bill pays for the tax cuts it provides to the vast majority of Americans in a responsible way.

These three goals, while common sense to the average taxpayer, are controversial in the eyes of some members of Congress. It is our hope that with further discussion and education, members of Congress will come to see that this bill is a important step forward for tax reform.

Summary of Tax Changes in H.R. 3970

$-billions	10 year effect
INDIVIDUALS—	
Revenue Losses	
AMT repeal after 2007 & relief in 2007	$ –845.3
Other permanent changes	–86.2
One-year provisions ("extenders")	–5.7
Revenue Gains	
High-income surtax	+831.7
Other permanent changes	+97.7
Net Change for Individuals	**–7.8**
BUSINESS—	
Revenue Losses	
Reduce corporate top rate to 30.5%	$ –363.8
Other permanent changes	–21.9
One-year provisions ("extenders")	–15.5
Revenue Gains	
Repeal domestic manufacturing deduction	+114.9
Repeal LIFO inventory rules	+106.5
Multinational expense allocation (repatriation)	+106.4
Other permanent changes	+70.7
Net Change for Business	**$ –2.7**
Interactions among provisions	**+10.5**
TOTAL, ALL PROVISIONS	**$ +0.0**

Source: Estimates are from the House Committee on Ways and Means, Oct. 25, 2007.

Major Changes in the Federal Income Tax for Individuals

Repeal of the Alternative Minimum Tax

Cost of one-year AMT "patch": –$49.6 billion
Ten-year cost of AMT repeal: –$795.7 billion
Total 11-year cost: –$845.3 billion

Chairman Rangel's bill would provide a "patch" for the AMT (basically an extension of the increased exemptions from the AMT that keep most people from having to pay it) for 2007, followed by complete repeal of the AMT thereafter.[1]

[1]Without a "patch" provided by Congress, the exemption from the AMT reverts to $33,750 for single taxpayers and $45,000 for couples. The last patch enacted by Congress increased the exemption to $42,500 for singles and $62,550 for couples, for 2006 only. Chairman Rangel's bill would increase the exemption to $44,350 for single taxpayers and $66,250 for couples for 2007 and then repeal the AMT thereafter. Like other patches,

The AMT was enacted in 1969 to ensure that very wealthy Americans are not able to escape paying a reasonable amount in income taxes by using loopholes. Its reach has been expanded over the years, but it's still mostly a tax on the wealthy. Historically, large AMT exemptions have kept the vast majority from being affected by the AMT.

The Bush tax cuts increased the number of people subject to the AMT, and the Congress has failed to index the AMT exemptions for inflation on a permanent basis. As a result, 23 million taxpayers (17 percent of all taxpayers) will pay the AMT when they file their 2007 taxes if Congress does not act soon.[2] The sticking point has been how to find the enormous amount of money it will take to pay for scaling back or repealing the AMT.

Some members of Congress have suggested the AMT should be repealed without replacing the revenue. They argue that the AMT revenue should not be replaced because it was never "intended" to be collected. But that's not true. The reality is that the Bush Administration intentionally declined to address the AMT when it designed its tax cuts in order to make the cost of those tax cuts look smaller.[3] Indeed, President Bush's latest budget assumes that the AMT will expand its reach to tens of millions more families after 2007.

Recently, one Senator recently went so far as to argue that AMT relief should not be paid for because the AMT presents an "emergency" that justifies deficit-spending, much like catastrophes such as Hurricane Katrina or the September 11, 2001 terrorist attacks.

Of course, no reasonable person would equate a scheduled change in tax rules with a terrorist attack or a natural disaster. Moreover, the AMT is not particularly threatening to the average American. Even if Congress does nothing (which is extremely unlikely) about 60 percent of the AMT would be paid by the richest 5 percent of taxpayers.[4] In other words, if there was ever a good reason to borrow gigantic sums and have to pay that back with interest later, this is *not* it. Repealing the AMT without paying for it would cost more than $800 billion over a decade under current law (and would cost $1.5 trillion if the Bush tax cuts are extended).[5] That's why we're extremely glad to see Chairman Rangel insisting that the cost of repealing the AMT be paid for.

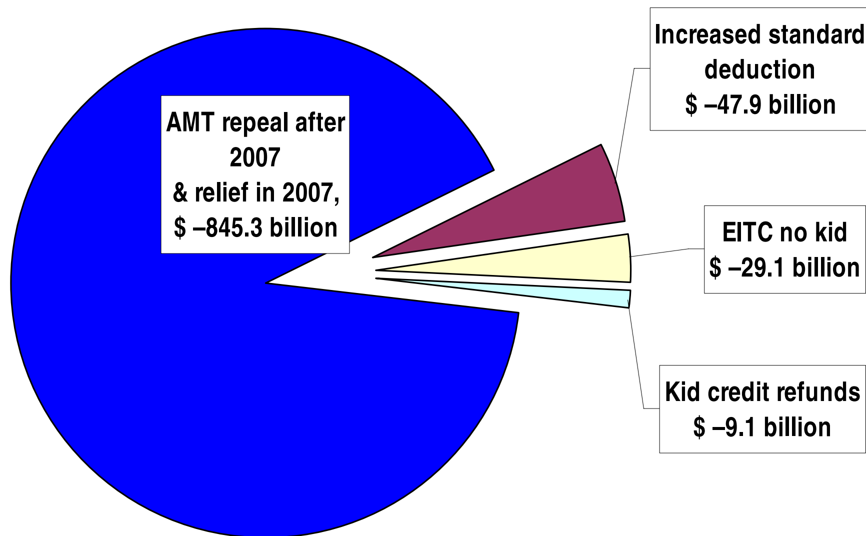
Chairman Rangel's provisions for one-year AMT relief would also allow non-refundable credits to be taken against the AMT.

[2]Citizens for Tax Justice, "Taxpayers Likely to Pay the AMT in Tax Year 2007, Under Current Law, By State," April 9, 2007, http://www.ctj.org/pdf/amt2007states.pdf.

[3]See Robert S. McIntyre, "Tax Complexification," American Prospect, June 2002 at http://www.ctj.org/taxonomists/taxonomist20020615.pdf.

[4]Citizens for Tax Justice, "A Progressive Solution to the AMT Problem," December 14, 2006, http://www.ctj.org/pdf/amtsolution.pdf.

[5]Leonard E. Burman, "Statement of Leonard E. Burman, Director, Tax Policy Center, Senior Fellow, the Urban Institute, Before the United States Senate Committee on Finance," Tax Policy Center, June 27, 2007, http://www.taxpolicycenter.org/UploadedPDF/901092_Burman_AMT.pdf.



Increase in the standard deduction

Ten-year cost: –$47.9 billion

AMT relief mostly helps people at the higher end of the income ladder. To balance that, the bill includes several provisions to help middle- and low-income people, too.

One of these provisions is an increase in the standard deduction. This is the deduction that taxpayers can take instead of itemizing their deductions (for expenses such as mortgage interest, state and local taxes, etc.). For most taxpayers, the standard deduction is the better deal. According to the Congressional Joint Committee on Taxation (JCT), only a third of all taxpayers itemize. That leaves two-thirds who take the standard deduction.[6]

The propensity to itemize is closely related to income: three-quarters of taxpayers with incomes above $75,000 itemize, while only a sixth of taxpayers making less than $75,000 do so.

Currently, the standard deduction is $10,700 for married couples, $7,850 for single parents and $5,350 for singles without dependents (indexed every year for inflation). The Rangel bill would boost the standard deduction by 8 percent, to $11,550 for couples, $8,475 for single parents and $5,775 for singles without dependents (in 2007 dollars). This change would reduce taxes for about 53 million couples and singles by an average of $81 a year. Virtually all of the benefits would go to people making less than $100,000.

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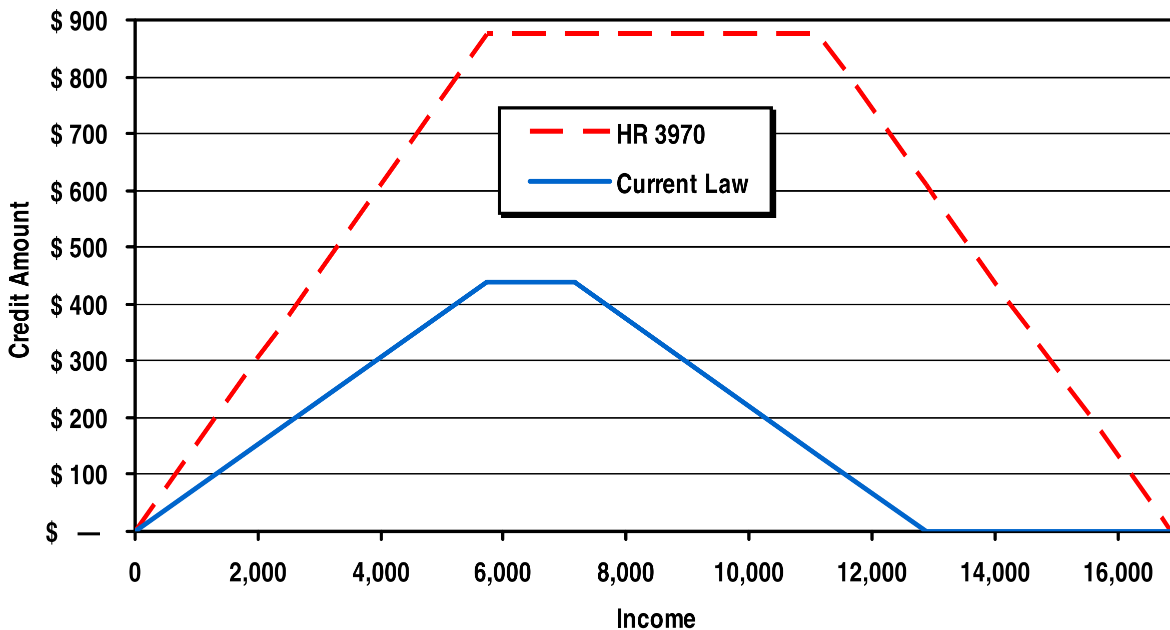
[6] Congressional Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for Fiscal Years 2007-2011," September 24, 2007, http://www.house.gov/jct/s-3-07.pdf.

Expanded Earned Income Tax Credit for childless workers
Ten-year cost: –$29.1 billion

Low-income workers between ages 25 and 64 who are not raising children are currently eligible for a small Earned Income Tax Credit (EITC), equal to 7.65% of their earnings up to $5,590 this year. (The credit is indexed for inflation.)

This year, the maximum benefit of the childless EITC is $428. The average benefit for the fewer than 5 million childless people who get the credit is only $230, because the credit starts to phase out at $7,000 in earnings and is completely gone when earnings reach $12,600. (For childless married couples, the phase-out starts at $9,000 this year, and the credit is eliminated at $14,600.)

H.R. 3970 would double the credit rate to 15.3% starting in 2008. This would double the maximum benefit in 2008 from $438 to $875. The income level at which the benefit begins to phase out would be increased from $9,200 to $13,200 for childless couples and from $7,200 to $11,200 for childless singles. Thus, the credit won't begin to phase out for singles until their income exceeds the poverty line, which in 2008 is expected to be about $10,400.



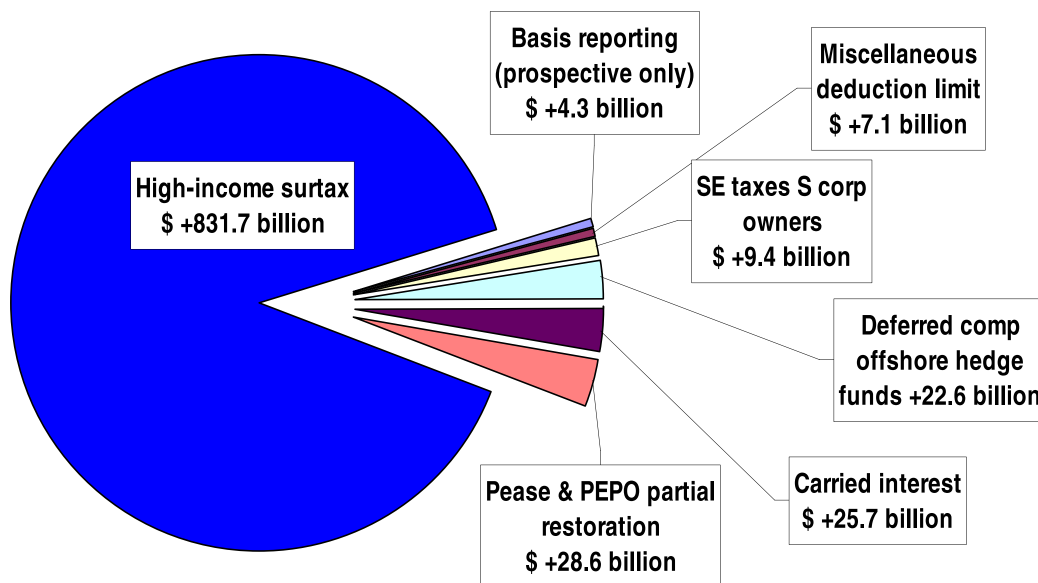
Expansion of the Child Tax Credit
Three-year cost: –$9.1 billion

First enacted during the Clinton administration, the Child Tax Credit was significantly expanded as part of the Bush tax cuts. It is now worth up to $1,000 for each child under age

17. But many low-income families do not benefit at all from the child credit, and many others get only partial credits. That's because the credit is unavailable to families with earnings below $11,750 (indexed for inflation), and the credit is limited to 15 percent of earnings above that amount. In other words, a working family making less than $11,750 this year is too *poor* to get any child credit. (For a family of three, the poverty line is $17,170 this year.)

H.R. 3970 would lower the child credit's earnings threshold from the current $11,750 to $8,500 and would no longer increase the threshold every year for inflation. This change would benefit some 6.5 million families and about 10.7 million children, by an average of $380 a year per family. Families whose wages are not keeping up with inflation would not have to face a reduction or loss of the Child Tax Credit since the earnings threshold would no longer rise with inflation.

As noted, the Rangel bill builds on the Bush expansion of the child credit enacted earlier in this decade. Because the Bush tax cuts expire after 2010, the Rangel bill's further expansion of the child credit would be in effect for only three years, 2008 to 2010.



Scaling back the Bush tax cuts for those with incomes above $200,000

Ten-year revenue gain: +$831.7 billion

By the year 2010, when the Bush tax cuts are fully phased in, more than half of the benefits will go to the richest one percent of all taxpayers — those making more than $500,000 a year. Chairman Rangel's bill would require the members of this elite group to pay for repeal of the Alternative Minimum Tax. The bill accomplishes this by applying a surtax of 4 percent on adjusted gross income (AGI) above $200,000 ($150,000 for singles) and 4.6 percent on AGI above $500,000 ($250,000 for singles). Like the AMT, this surtax would be paid primarily

(about 80 percent) by married couples. Because AGI is calculated before itemized deductions and personal exemptions are subtracted, the surtax would limit the benefits of those deductions by wealthy people, albeit to a much more limited extent than does the current AMT.

Notably, while the AMT generally does not apply to capital gains and dividends, the proposed surtax would. As a result, for those affected by the surtax, the current top marginal tax rate on capital gains and dividends of 15 percent would be increased to 19.6 percent. This would be a step in the right direction because there is no good reason for the lower tax rate for capital gains and dividends in the first place. CTJ recently published data from the IRS showing that the tax break for capital gains and dividends cost $92 billion in 2005 alone and that almost three-fourths of the benefits went to the richest 0.6 percent of all taxpayers.[7]

Finally, it's important to note that even though people making less than $500,000 (but more than $150,000) would pay a small portion of the new surtax, repeal of the AMT will cut their taxes by more than that. Chairman Rangel points out (and CTJ calculations confirm) that almost all families with incomes under $500,000 would pay lower taxes under his bill than under current law.

Restoration of the "PEPO and Pease" provisions
Three-year revenue gain: +$28.6 billion

The 1990 deficit-reduction bill, signed by President George H.W. Bush, disallowed a portion of itemized deductions and phased out personal exemptions for higher-income people. The itemized deduction limitation is nicknamed "Pease" for the Ohio Congressman, Don Pease, who first proposed it. The personal exemption phase-out is commonly referred to by its acronym, "PEPO."

As part of the 2001 Bush tax cuts, the Pease and PEPO provisions are now being phased out, creating a windfall for high-income families, almost all of whom have incomes over $200,000 and over half of whom are millionaires.[8] The Rangel bill would reinstate the Pease and PEPO provisions and therefore end this windfall. This change will affect only the years 2008 to 2010, after which the Bush tax cuts are already scheduled to expire under current law.

Elimination of the "carried interest" tax loophole
Ten-year revenue gain: +$25.7 billion

Under current law, managers of leveraged buyout funds (a.k.a. "private equity") can earn hundreds of millions or even billions of dollars a year and yet still pay a lower tax rate than

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[7]Citizens for Tax Justice, "New IRS Data Pegs Cost of Special Low Tax Rates on Capital Gains and Dividends at $92 Billion in 2005 Alone," August 10, 2007, http://www.ctj.org/pdf/cgdiv.pdf.

[8]Robert Greenstein, Joel Friedman, and Aviva Aron-Dine, "Two Tax Cuts Primarily Benefitting Millionaires Will Start Taking Effect January 1," Center on Budget and Policy Priorities, December 28, 2005, http://www.cbpp.org/12-28-05tax.htm.

middle-income people.[9] The fund managers are currently allowed to pay only the low capital gains rate of 15 percent on the compensation that they call "carried interest." The low capital gains rate was (ostensibly) intended to encourage people to invest, but these fund managers are actually managing other people's money rather than investing their own. The bill would require that these fund managers now pay regular income taxes on their carried interest.

Closing this egregious loophole would be appropriate even if Congress did not need the money to offset tax reductions.

Closing a loophole for offshore deferred compensation schemes by private equity fund managers

Ten-year revenue gain: +$22.6 billion

The tax code allows employees to defer paying taxes on money that they or their employers put into "qualified" retirement savings plans, such as 401(k)'s, until they take money out during retirement. But contributions to such "qualified" plans are limited, to no more than $30,000 a year depending on the type of plan. That's the sort of plan most Americans can get — if they're lucky. Highly-paid corporate executives, however, often get to go a giant step farther. They can set up "non-qualified" deferred compensation plans, which are not taxable to the executives until they take the money out, but which are not deductible by companies until then either. Currently, there is no limit on how much money executives can defer taxes on through these plans. But the corporations who pay them also have to defer the deduction they take for whatever they pay into the deferred compensation plan, so in theory there is only a small loss to the Treasury (and to the rest of the taxpayers).

But private equity fund managers have managed to create an approach to deferred compensation that goes even farther, and does impose a substantial cost on the rest of the taxpayers. Private equity fund managers often have an "unqualified" plan into which is paid an unlimited amount of deferred compensation. But they arrange the payments to be technically made by an offshore corporation in a tax haven country that has no corporate tax, or a very low one, so the loss of the deduction is not an issue. Of course, this is done with paper transactions. No one is actually working in the tax haven country, so this is really just a scheme to increase the amount of deferred compensation that can be paid to these already highly-compensated fund managers without being taxed right away.

H.R. 3970 would close this tax-avoidance scheme by requiring fund managers to pay taxes on the earnings of their deferred compensation plans as it accrues.

Other individual income tax changes

Ten-year net revenue gain: +$15.1 billion

Other proposed changes to the individual income tax include: requiring stockbrokers to report their clients' capital gains to the IRS (for newly acquired stocks only); requiring owners of S

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[9] Citizens for Tax Justice, "Myths and Facts about Private Equity Fund Managers — and the Tax Loophole They Enjoy," July 19, 2007, http://www.ctj.org/pdf/privateequity071907.pdf.

corporations to pay self-employment taxes on their earnings (current law is murky); and further limitations on "miscellaneous" itemized deductions for very high income people. These three provisions would raise $20.8 billion over 10 years.

In addition, the bill includes one-year extensions in a collection of narrow individual income tax breaks, such as the deductions for state and local sales taxes, college tuition in limited cases, and $250 each for K-12 teachers. Altogether, extending these provisions for another year will cost $5.7 billion.

Effects of the Rangel Tax Plan in 2008

Income group	# of tax units (000)	% of all tax units	Average income	Total tax change $-billion	Average tax change
Less than $10K	10,131	7.1%	$ 5,700	$ –1.2	$ –118
$10-20K	22,800	16.0%	15,210	–3.6	–156
$20-30K	21,581	15.2%	24,770	–1.8	–83
$30-40K	16,898	11.9%	34,760	–1.3	–77
$40-50K	12,540	8.8%	44,690	–1.1	–92
$50-75K	22,508	15.8%	61,570	–3.7	–164
$75-100K	13,651	9.6%	86,510	–8.7	–638
$100-200K	16,140	11.3%	133,490	–31.9	–1,979
$200-500K	4,349	3.1%	288,410	–23.1	–5,314
$500K-1 million	812	0.6%	679,020	+7.1	+8,758
$1 million +	454	0.3%	3,279,330	+46.0	+101,335
ALL	**142,245**	**100.0%**	**$ 70,940**	**$ –23.4**	**$ –164**

Estimates include 2008 effects of the major individual tax changes in H.R. 3970. These include: tax reductions from the repeal of the AMT, the increased standard deduction, the expanded EITC for childless taxpayers and expanded child credit refunds; and tax increases from the high-income AGI surtax, the partial restoration of the itemized deduction disallowance and the personal exemption phase-out and a stricter limit on miscellaneous deductions for high-income taxpayers.

The estimates do not include: capital gains basis reporting (which has little effect in 2008), clarification of the self-employment tax rules for S-corporation owners, changes to the taxation of "carried interest," and restrictions on deferred compensation tax breaks for offshore hedge fund employees.

Income for grouping tax units (couples and singles) is total cash income, including income not reported on tax returns. The small number of tax units with negative income are not included in the lowest income group, but are included in the totals.

Source: ITEP Tax Model, Nov. 2, 2007 (preliminary)

Major Changes for Business

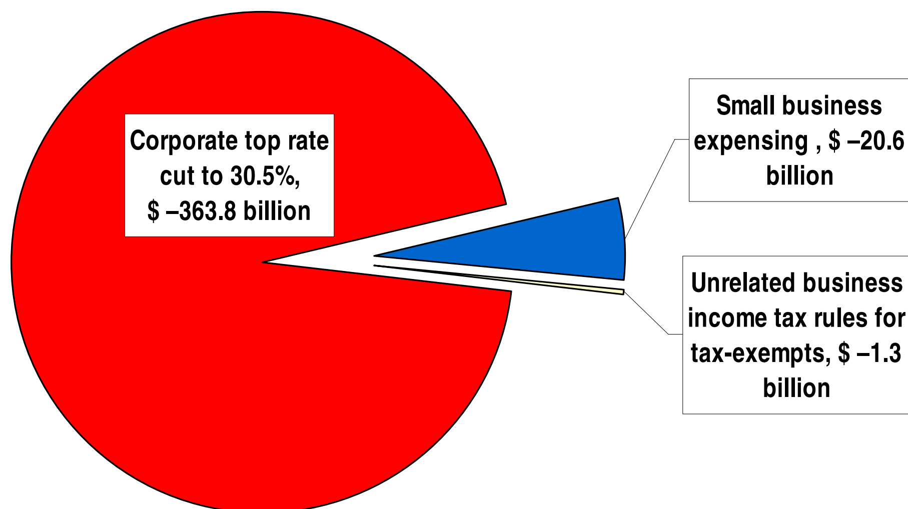
Reduction in the corporate tax rate
Ten-year cost: –$363.8 billion

The bill reduces the corporate rate from the current 35 percent to 30.5 percent and replaces the revenue lost from this change by eliminating certain corporate loopholes, as explained below.

Corporations should consider themselves lucky to be offered this lower rate. CTJ has argued that Congress should close corporate tax loopholes, but use the new revenue for deficit reduction or to address our country's many needs.[10]

It's often said that the U.S. corporate tax rate of 35 percent is among the highest in the world. But the effective rate — what companies actually pay — is much lower because of the plethora of corporate loopholes. In fact, the United States collects less in corporate taxes as a percentage of GDP than all but two OECD countries.[11] Because the Rangel bill leaves total corporate tax payments where they are under current law, it does not correct this problem.

Composition of Revenue Losses from H.R. 3970
Permanent Provisions for Business



[10]Citizens for Tax Justice, "Bush Administration Gets It Half Right on Corporate Tax Reform," August 9, 2007, http://www.ctj.org/pdf/bushcorporatetaxproposal.pdf.

[11]Citizens for Tax Justice, "United States Remains One of the Least Taxed Industrial Countries," April 27, 2007, http://www.ctj.org/pdf/oecd07.pdf.

Permanent extension of enhanced small business expensing
Seven-year cost: –$20.6 billion

When a business buys machinery or other assets that will eventually wear out over time, the business is allowed to gradually write off the cost as the assets wear out. The amount written off each year is a "depreciation" expense. With proper write-off rates, this deduction is entirely appropriate in computing a business's net income.

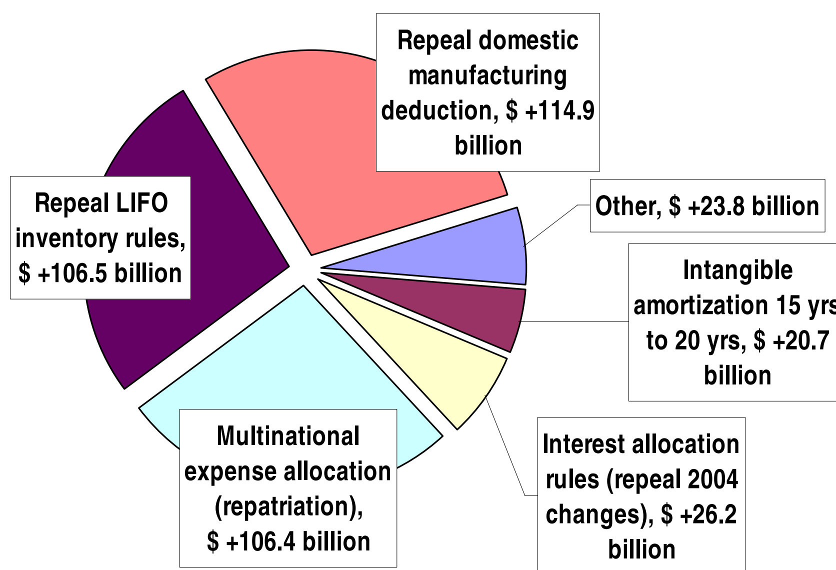
In contrast, when businesses buy things that are used up immediately (such as raw materials, paper, lawyers' service, etc.), these costs can be immediately deducted or "expensed."

Section 179 of the tax code allows "small businesses" to pretend that assets such as machinery, furniture and computers (but not real estate) wear out right away. Currently, up to $125,000 in such costs (adjusted upwards each year for inflation) can be deducted in full in the year of purchase. "Small business" is liberally defined as a company whose equipment purchases do not exceed half a million dollars a year. (Above that, the tax break is phased out, and ends at $625,000 in annual purchases.)

Small business expensing was initially established as a simplification measure for truly small companies, and until recently, the maximum that could be written off immediately was $25,000 a year (phased out above $100,000). The current, much higher write-offs are scheduled to expire after 2010, when the law will revert to the $25,000 limit.

Sadly, Chairman Rangel proposes to make the higher limits permanent.

Composition of Revenue Gains from H.R. 3970
Permanent Provisions for Business



Eliminating the deduction for domestic manufacturing
Ten-year revenue gain: +$114.9 billion

After the World Trade Organization found that a fairly narrow U.S. tax break for exporters was illegal under our international trade agreements, Congress replaced it with a much broader and more costly tax break for all U.S. manufacturers.

The new tax break allows manufacturers to reduce their taxable income by 6 percent this year, rising to 9 percent by 2010. The effect is similar to reducing the 35 percent top corporate tax rate on manufacturers to 32.9 percent this year, and to 31.9 percent by 2010.

The definition of "manufacturing" is quite broad, and includes such things as movie-making and oil and gas extraction. (The energy bill recently passed by the House would eliminate this deduction for oil and gas companies and raise $11.4 billion over ten years.)

In light of his proposal to reduce the top corporate tax rate to 30.5 percent for all big companies, Chairman Rangel would eliminate the domestic manufacturing deduction as superfluous.

Scrapping the "last-in, first-out" (LIFO) method of tax accounting
Ten-year revenue gain: +$106.5 billion

Normally we think that profit is what you get when you buy something for $30 and sell it for $50, and that your profit is $20 (ignoring any other expenses). But corporations, notably oil companies, use an accounting method that doesn't fit this picture. They might buy oil for $30 a barrel, and when the price rises they might buy some more for $45 a barrel. But when they sell a barrel of oil for $50, they get to assume that they sold the very last barrel they bought, the one that cost $45. That means the profit they report to the IRS is $5 instead of $20.

This "last-in, first-out" rule (LIFO) has been in place for decades, but critics have recently called for its repeal.[12] It's so hard to defend that even the then-Republican-led Senate tried to repeal it for oil and gas companies in a tax bill. (The provision was dropped from the tax bill in conference, so oil companies still get to use LIFO.)

H.R. 3970 would repeal the LIFO tax accounting method.

Defer deductions related to unrepatriated foreign income
Ten-year revenue gain: +$106.4 billion

Corporations are allowed to defer paying taxes on the profits of their offshore subsidiaries until those profits are brought home (repatriated). But many of the expenses a corporation incurs to earn offshore profits are deductible against their U.S. taxable income right away.

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[12] Friends of the Earth, "Big Oil, Bigger Giveaways: Ending Tax Breaks, Subsidies and Other Handouts to the Oil & Gas Industry," http://priceofoil.org/wp-content/uploads/2007/01/FOE%20oil%20giveaways%20analysis.pdf.

Chairman Rangel argues that this tax subsidy gives companies a perverse incentive to move operations offshore.

The Rangel bill would change the rules so that corporations that defer paying taxes on offshore profits will also have to defer taking deductions for expenses associated with those profits. That way, when and if the profits are repatriated, both the income and the deductions will be appropriately matched together.

Repeal the 2004 change in international interest allocation rules

Ten-year revenue gain: +$26.2 billion

Suppose a multinational corporation borrows money and uses it to support its foreign operations, such as by building a plant in a foreign country. In such cases, the interest paid on the loan ought to be treated as a foreign expense, and should not be deducted from U.S. taxable income.

For many years, however, our tax rules have let multinationals take U.S. tax deductions for some of their interest expenses that are really foreign. Very recently, in 2004, Congress actually expanded this loophole, a change that is scheduled to take effect starting in 2009.[13]

H.R. 3970 would reverse the 2004 expansion of the interest misallocation loophole. This is a useful first step towards fuller reform of the rules in this area.

Reduction in write-offs for intangible assets

Ten-year revenue gain: +$20.7 billion

When companies purchase physical assets such as machinery, they can deduct the cost of such assets over time as the assets wear out. This makes sense (although the write-offs allowed by current law are much too generous). In the mid-1990s, however, corporations successfully lobbied to get similar write-offs for certain purchases of "intangible" assets, such as patents, copyrights, trademarks and even "good will." These "intangible" assets typically don't lose value over time, and may actually go up in value. Yet current law sometimes allows companies to write off their cost over 15 years (i.e., at about 6.7 percent a year).

Chairman Rangel's bill would extend the write-off period for intangible assets to 20 years (i.e., a 5 percent annual write-off). This would reduce, although not eliminate, a tax break that many have argued provides an unwarranted subsidy for mergers and acquisitions.

Other Business Tax Reforms

Ten-year revenue gain: +$23.7 billion

The Rangel bill makes several other changes to the tax code affecting business.

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[13]Corporate lobbyists have argued that the U.S. should allow companies this tax break because in some cases foreign countries won't let them deduct the interest. But that's a problem that the companies have with foreign tax systems, not with the U.S. And why do we want to subsidize offshore operations, anyway?

One reform would prevent multinational companies with foreign subsidiaries in multiple countries from exploiting international tax treaties to avoid taxes. (This is a modified version of a provision included in the farm bill passed by the House last summer that has not been enacted.)

Another reform would clarify and strengthen the "economic substance" doctrine, a somewhat murky court-made rule that disallows tax benefits from transactions entered into only to avoid taxes. The Rangel bill would require at least a "substantial" non-tax-avoidance purpose for a transaction to generate tax benefits. A stronger rule, requiring that the primary purpose of the transaction is not tax avoidance would be much better, but the change is a step in the right direction.

Several other smaller business tax reforms are also included in the bill.

Business Tax "Extenders"

One-year cost: –$15.5 billion

There is a growing list of narrow-interest business and individual tax breaks that Congress has enacted on a supposedly "temporary" basis, but then extends just as they are about to expire. This routine has become so predictable that congressional insiders call the package the "extenders."

On the business side, H.R. 3970 includes one-year "extenders" for about 20 tax breaks, for restaurant owners, railroads and race car track owners, among others.

The biggest of the tax extenders is the research and experimentation (R&E) tax credit, which the bill extends for one year at a cost of $9 billion.

The R&E credit was invented during the early Reagan administration, and has been the subject of many tax scandals as companies have tried, often successfully, to treat activities that are obviously not scientific research — such as hamburger recipes or accounting software development — as qualified R&E. Indeed, early in the Bush administration, the Bush Treasury Department tried to redefine "research and experimentation" to require neither. That effort didn't quite succeed, but in 2004 Congress enacted a major, albeit "temporary," expansion of the R&E tax credit.

The R&E credit has a curious following among politicians who normally style themselves as free-market advocates, but who nevertheless maintain that big business needs to be subsidized to do research. The fact that the tax breaks from the R&E credit are narrowly concentrated on a relative handful of very large corporations probably explains the intensity of the lobbying to keep extending this tax break, and perhaps the enthusiasm in Congress for doing so.

Revenue Effects of H.R 3970, "The Tax Reduction and Reform Act of 2007"

$-billions	10 year effect	Years in estimate	Notes
INDIVIDUALS—			
Permanent (with exceptions) changes:			
AMT repeal after 2007 & relief in 2007	$ –845.3	11	Revenue estimate assumes Bush tax cuts expire after 2010.
Increased standard deduction	–47.9	10	
EITC childless workers	–29.1	10	
Kid credit refunds	–9	3	In effect for 2008-10 only. Expires after 2010.
Basis reporting (prospective only)	+4.3	10	
Miscellaneous deduction limit	+7.1	10	
SE taxes S corp owners	+9.4	10	
Deferred comp offshore hedge funds	+22.6	10	
Carried interest	+25.7	10	
Pease & PEPO partial restoration	+28.6	3	Assumes Bush repeal of these provisions expires after 2010.
High-income surtax	+831.7	10	
Subtotal	**–2.0**		
1 year extensions:			
Sales tax deduction	–3.6	1	
Tuition deduction	–1.4	1	
IRA charitable donations	–0.5	1	
Teacher deduction	–0.2	1	
Conservation donations	–0.1	1	
EITC combat pay	–0.0	1	
Mortgage insurance deduction	–0.0	1	
Subtotal	**–5.7**		
INDIVIDUALS, TOTAL	**$ –7.8**		
BUSINESS—			
Permanent changes:			
Reduce corporate top rate to 30.5%	$ –363.8	10	
Small business expensing	–20.6	7	Extends write-offs past 2010.
Unrelated business income tax rules for tax-exem	–1.3	10	
Related party capital gains	+0.1	10	
C corps, no special accrual rules	+0.2	10	
Gains on spin offs	+0.2	10	
S corps & ESOP stock options	+0.6	10	
Repeal rest of DISC	+0.9	10	
Economic substance rule	+3.6	10	
Dividends received deductions	+4.6	10	
Treaty shopping deductions	+6.4	10	
Repeal lower of cost or market inventory	+7.2	10	
Intangible amortization 15 yrs to 20 yrs	+20.7	10	
Interest allocation rules (repeal 2004 changes)	+26.2	9	2004 changes take effect starting in 2009 under current law.
Multinational expense allocation (repatriation)	+106.4	10	
Repeal LIFO inventory rules	+106.5	10	
Repeal domestic manufacturing deduction	+114.9	10	
Subtotal	**+12.8**		

Revenue effects of H.R. 3970, continued	10 year effect	Years in estimate	
1 year extensions:			
R&E credit	–9.0	1	
15-year deprection for leaseholds & restaurants	–3.5	1	
New markets credit	–1.3	1	
Computer equipment donations	–0.2	1	
Brownfields	–0.2	1	
Railroad track maintenance credit	–0.2	1	
Veterans mortgage bonds	–0.2	1	
DC tax breaks	–0.2	1	Includes small individual component.
Zone academy bonds	–0.2	1	
Indian depreciation	–0.1	1	
Puerto Rico manufacturing deduction	–0.1	1	
Rum tax	–0.1	1	
Food inventory donations	–0.1	1	
Regulated Investment Company rules	–0.1	1	
Indian employment credit	–0.1	1	
S corp charitable donations	–0.1	1	
Books inventory donations	–0.0	1	
Race track (cars) cost recovery	–0.0	1	
Tax exempts' rents, etc.	–0.0	1	
American Samoa credit	–0.0	1	
Subtotal	**–15.5**		
BUSINESS, TOTAL	**$ –2.7**		
Interactions among provisions	**+10.5**		Not spelled out in published Ways & Means figures.
TOTAL, ALL PROVISIONS	**$ —**		

Source: Estimates are from the House Committee on Ways and Means, Oct. 25, 2007.