2013

Tax Reform in the 113th Congress: Insights and Analysis

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Keynote Address
College of William & Mary's 59th Annual Tax Conference
November 8, 2013

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What is Driving Tax Reform?

1. **Lack of Growth in Investment in the U.S. Economy**. Individuals, pension funds, U.S. businesses, entrepreneurs, financial institutions, and foreign investors are reluctant to take additional risks in the U.S. market due to uncertainty regarding the long-term effective tax rate on U.S. profits.

2. **The Need to Encourage Individuals to Work More**. Lower marginal tax rates will encourage individuals to enter the work force and work more hours.

3. **International Competition**. U.S. businesses face two layers of tax on their overseas profits – they are taxed at home and in the country where the income is earned. All other developed countries impose a tax only on home country profits.

4. **The Need to Reduce the Tax Gap**. A simplified code would help the U.S. reduce its estimated $400 billion annual tax gap.

5. **The Need to Accelerate Economic Growth**. Comprehensive tax reform can facilitate both short-term and long-term economic growth, bringing the annual increase in GDP closer to 4% rather than the 2% the U.S. is currently experiencing.

What Would Business Tax Reform Look Like?

1. **Lower Statutory Tax Rates**. Ways & Means Chairman Dave Camp wants to reduce the corporate rate from 35% to 25%.

2. **Territorial International Tax System**. Tax reform would likely move from our worldwide system toward a territorial system. Along with that change would be stricter rules on intra-company loans and rules to prevent companies from shifting profits from intellectual property offshore.

3. **Reduction or Elimination of Tax Expenditures**. In order to reach a corporate rate of 25%, lawmakers would have to do several of the following:

    a. Eliminate the ability to defer tax on foreign profits
    b. Reduce depreciation deductions
    c. Curtail the domestic manufacturing deduction
    d. Trim the deductibility of interest expense

What Might Individual Tax Reform Look Like?

1. **Fewer Tax Brackets and Reduced Rates**. The number of brackets would be reduced from the six to just a few. The top rate would be reduced below 35%.

2. **Simplified System**. Elimination of the alternative minimum tax will make tax liability easier to calculate.

3. **Reduction or Elimination of Tax Benefits for High-Income Americans**. The most valuable tax benefits for many high-income Americans are the capital gains rate and the deductibility of state and local income taxes. If tax reformers do not want to redistribute tax burden, these two items must be substantially modified.

4. **Modification of Middle and Lower Income Tax Benefits**. Broadening the tax base might include caps on itemized deductions and elimination of tax credits, exclusions and deductions that are not economically efficient. Low-income Americans claiming the earned income tax credit, refundable child credit and the new health care exchange tax credit would likely see tougher eligibility requirements.

What Are The Obstacles to Tax Reform?

1. **Trust Factor**. The recent government shutdown illustrated the difficulty in reaching and implementing hard decisions even when action was absolutely necessary. Tax reform, which is not mandatory, makes decision-making even more difficult.

2. **The Clock**. Early next year, attention will turn toward the 2014 elections and significant endeavors such as tax reform will be put on hold.

3. **Complexity and Industries Reliant on Specific Tax Provisions**. Once a comprehensive bill begins to move, organizations will intensively lobby for changes important to their industry or taxpayer group.

4. **Determination of Required Revenue Impact**. Most Republicans want revenue-neutral tax reform. Most Democrats want the legislation to result in increased revenues to reduce the deficit.