

U.S. House Ways & Means Committee
Full Committee Hearing – First in a Series on:
“Fundamental Tax Reform”
Thursday, January 20, 2011, 9:00 a.m.

Members Present

Republicans	Democrats
Dave Camp (MI-4 th) – <i>Chairman</i>	Sander Levin (MI-12 th) – <i>Ranking Member</i>
Wally Herger (CA-2 nd)	Charles Rangel (NY-15 th)
Sam Johnson (TX-3 rd)	Pete Stark (CA-13 th)
Devin Nunes (CA-21 st)	Jim McDermott (WA-7 th)
Paul Tiberi (OH-12 th)	Richard Neal (MA-2 nd)
Geoff Davis (KY-4 th)	Lloyd Doggett (TX-25 th)
Dave Reichert (WA-8 th)	Mike Thompson (CA-1 st)
Dean Heller (NV-2 nd)	John Larson (CT-1 st)
Peter Roskam (IL-6 th)	Earl Blumenauer (OR-3 rd)
Jim Gerlach (PA-6 th)	Ron Kind (WI-3 rd)
Tom Price (GA-6 th)	Bill Pascrell Jr. (NJ-8 th)
Vern Buchanan (FL-13 th)	Shelley Berkley (NV-1 st)
Aaron Schock (IL-18 th)	
Chris Lee (NY-26 th)	
Lynn Jenkins (KS-2 nd)	
Erik Paulsen (MN-3 rd)	
Rick Berg (ND-AL)	
Diane Black (TN-6 th)	

Witnesses

- The Honorable Nina E. Olson – National Taxpayer Advocate, Washington, D.C.
- Robert A. McDonald – Chairman of the Board, President and Chief Executive Officer, The Procter & Gamble Company, Cincinnati, Ohio, testifying in his capacity as Chairman, Fiscal Policy Initiative of the Business Roundtable, Washington, D.C.
- Warren S. Hudak – President, Hudak & Company, LLC, New Cumberland, Pennsylvania
- Kevin A. Hassett, Ph.D. – Senior Fellow & Director of Economic Policy Studies, American Enterprise Institute, Washington, D.C.
- Martin A. Sullivan, Ph.D. – Contributing Editor, Tax Analysts, Alexandria, Virginia

Focus of the Hearing

The stated focus of the hearing was to “examine the economic and administrative burdens imposed by the current structure of the Federal income tax. It will explore the cost of complexity borne by American families, the cost of a corporate tax system that is increasingly out-of-step with the rest of the world, and the broader cost to the U.S. economy of a tax system that fails to maximize job creation and impedes economic growth.”

This was the first in a series of tax reform hearings expected to take place over the next several months.

Chairman Camp Opening Statement

Chairman Camp opened the hearing by affirming that he expects the tax reform discussion to be a long one – and one that he hopes will be bipartisan. He cited President Obama’s bipartisan National Commission on Fiscal Responsibility and Reform on which he and Ways and Means Committee Members Paul Ryan (R-WI-1st) and Xavier Becerra (D-CA-31st) served in order to measure the impact of tax expenditures in terms of higher tax rates. Chairman Camp stated that the Commission’s Bowles-Simpson report (released November 10, 2010) “makes clear that taxpayers foot the bill for those expenditures in the form of higher tax rates.”

Chairman Camp ended his remarks by emphasizing the difficulty in reforming the tax code, and the necessity of working together with colleagues across the aisle, in the Senate and in the Administration, as well as with the American people. He then turned over the hearing to the witnesses for their opening statements, asking them to focus on defining the problems of the current income tax system.

Witness Opening Statements

Nina E. Olson

Nine Olson’s testimony was based on the National Taxpayer Advocate’s 2010 Annual Report to Congress, in which she “identified the complexity of the tax code and the confusion and distrust it engenders as the number one most serious problem facing taxpayers – and the IRS.” She supported Chairman Camp’s avowal that any effective tax reform plan will require a sustained, bipartisan effort, with the support and engagement of the American public.

Ms. Olson made the following points in her testimony:

1. The current tax code imposes excessive compliance burdens on individual taxpayers and businesses;
2. The tax code is rife with complexity and special tax breaks;
3. Complexity obscures understanding and leads to lower levels of voluntary compliance;
4. Complexity is burdensome for the IRS;
5. The overwhelming majority of tax breaks by dollar value accrue to large segments of the taxpaying public;
6. For Congress to determine which tax breaks and IRS-administered social programs to retain and which to eliminate, they should utilize a “zero-based budgeting” approach (starting point for discussion would be a tax code without exclusions or reductions in income or tax; a tax break or IRS-administered social program would only be added if lawmakers decide that the public policy benefits outweigh the tax complexity challenges); and
7. Tax reform will have a better chance to succeed if it proceeds on a revenue-neutral basis and if decisions about whether and how much to adjust revenue levels are kept separate.

Ms. Olson concluded by saying that fundamental tax reform must be made a priority, and it is possible to accomplish this goal. “Based on all the comments we receive every year in the Taxpayer Advocate Service and our experience in handling nearly 300,000 taxpayer cases a year, lowering rates in exchange for broadening the tax base seems like an excellent bargain. I am confident that in the end, public support for a simpler code will be strong and deep.”

Robert A. McDonald

Robert McDonald, Chairman of the Board, President and CEO of Procter & Gamble, testified on behalf of the Business Roundtable (BRT), highlighting the importance of corporate tax reform to competitiveness, U.S. investment and U.S. job growth. He spoke of the hyper-competitive international environment in which American companies operate today, exacerbated by having one of the least competitive tax systems among developed countries in the world. “Once a leader in promoting innovation, the U.S. now ranks 24th out of 38 OECD and advanced emerging economies in terms of the competitiveness of its R&D tax incentives.”

Mr. McDonald emphasized the multiple disadvantages of an uncompetitive U.S. corporate tax system:

1. The tilted playing field created by the U.S. tax system hurts the competitiveness of American companies in the world’s markets both at home and abroad;
2. High taxes imposed on American companies that bring foreign earnings back to the U.S. discourage use of these funds to expand U.S. operations;
3. A high U.S. corporate tax rate on domestic profits discourages investment in America by both U.S.-based companies and foreign-based companies; and
4. The highest price paid for the uncompetitive U.S. corporate tax system is paid by the American worker.

Today’s global economy is much more competitive than the market was during the last comprehensive reform of corporate taxes, which took place over 25 years ago (The Tax Reform Act of 1986). Mr. McDonald strongly urged the Committee to “develop bipartisan proposals for a competitive corporate tax system consistent with the realities of today’s global markets.”

Warren S. Hudak

Warren Hudak’s business, Hudak & Company, provides a full-range of tax services for small businesses. He is also a member of the National Federation of Independent Business (NFIB). With perspective gained from these two positions, Mr. Hudak provided testimony on the particular challenges that small

businesses face when complying with the tax code. There are two general principles: (1) the business and the business owner cannot be separated, and (2) the tax code is too complicated.

Regarding the first principle – The majority of small businesses are organized as pass through entities, with nearly 75 percent choosing a pass through business structure; therefore, Mr. Hudak said that the tax implications of choosing a pass through entity should play a major role in the tax reform debate. “Keeping in mind the importance of the individual tax rates that most small businesses pay should be part of any debate about tax reform.”

Regarding the second principle – The complicated tax code places an extra burden on small business owners. “Unlike a larger business, small businesses generally do not have a finance department or a staff of accountants and lawyers to focus on the nuances and changes in the tax law. Ultimately, this leads to additional costs and takes money away from the day-to-day business operations or investing in and expanding the business.”

Mr. Hudak concluded by reemphasizing that the tax code must be simplified. “By improving our tax system, Congress can address a constant concern of small businesses, reduce the cost of doing business, and create a tax system that will support economic growth.”

Kevin A. Hassett

Kevin Hassett, Senior Fellow and Director of Economic Policy Studies at American Enterprise Institute, began his testimony with discouraging data: “According to a study last summer by Carmen and Vincent Reinhart (2010), absent significant policy changes, we shouldn’t expect the economy to fully rebound for quite some time.” He used this to frame his discussion of the many reasons that tax reform should – and must – have priority in Congress this year. His motivation included:

1. The tax system should be streamlined to improve taxpayers understanding and remove distortions that hamstring economic growth.
2. America’s corporate tax is a worldwide outlier:
 - a. Within the OECD countries, the U.S. has the highest statutory rate of taxation at the national level.
 - b. Dr. Hassett’s analysis found that even when scored with effective tax rates (which take into account tax offsets, the present value of depreciations, and other deductions), America’s performance in the global economy does not look much better.
3. Although America has one of the highest corporate tax rates in the world, the share of revenues from corporate capital is not higher in the U.S. than in other OECD economies; Dr. Hassett’s analysis found that a reduction of the corporate tax rate in the U.S. would increase corporate tax revenue.

Dr. Hassett summed up his testimony by saying that “given the significant headwinds that the economy faces, the indefensible state of the current tax code, the horrifyingly high U.S. corporate tax rate both statutory and effective, and the consensus that the economic impact of a fundamental tax reform would be positive, opposition to tax reform this year would be difficult to comprehend.”

Martin A. Sullivan

A contributing editor for Tax Analysts (based in Alexandria, Virginia), Martin Sullivan’s testimony focused on a component of the U.S. tax system that he deemed to be particularly in need of reform: the corporation income tax. In his discussion he made the following points:

1. Reduction in the corporate tax rate is a necessity. “Just last month, the Japanese government announced its intention to reduce its corporate tax rate by 5 percentage points, effective April 1 of

this year. This will leave the U.S. with the dubious distinction of having the highest statutory corporate tax rate in the world.”

2. Severe budget pressures suggest revenue-neutral corporate reform. “In order to put the nation’s finances on a sustainable path – that is, just to get our debt-to-GDP level to stabilize (far short of balancing the budget) – will require annual deficit reductions of approximately \$500 billion.”
3. International tax rules favor foreign over domestic job creation. “U.S. tax law provides a large tax advantage for building and moving factories to low-tax countries...Whatever the positive effects of foreign operations may be on domestic employment, they have not offset the job losses. U.S. multinational corporations are not net domestic job creators.”
4. Profit shifting to tax havens results in large revenue loss. “Over the last decade, the transfer pricing problem has gone from bad to worse. From 1999 through 2007, foreign profits of U.S. multinationals have increased by 163 percent, while over the same period, traditional indicators of economic activity have increased on average by only 97 percent.” Dr. Sullivan added that transfer pricing should be front and center of any discussion of tax reforms.
5. Profit shifting turbo-charges the incentive for foreign job creation. “Irrespective of your views about whether the U.S. should move to a territorial system or not, we should all be able to agree that the inefficiency of subsidies, provided through aggressive transfer pricing, is a drag on economic growth and job creation.”
6. Multinational competitiveness is not U.S. competitiveness. “Promoting overall – or ‘standard of living competitiveness,’ as the Joint Committee on Taxation labels it – is the superior policy objective.”

Dr. Sullivan concluded by saying that “when we start broadening the tax base to pay for corporate rate reduction, we should cut incentives for foreign investment before we cut incentives for domestic investment.”

Question & Answer Session

Representative Herger addressed the concern that Mr. Hudak expressed about expiring tax provisions and the uncertainty that creates. Herger stated that this has long been a concern of his, as well. He asked Mr. Hudak to elaborate on how the uncertainty of temporary tax provisions affects some of the businesses to which he provides services. Mr. Hudak responded that the U.S. tax code causes businesses to think tactically rather than strategically. “Often times we miss the mark because of the complexities of the tax code. It’s important that businesses think strategically instead.”

Representative Johnson asked Mr. McDonald, “To what extent has our corporate tax system adversely affected investment in job creation in America?” Mr. McDonald replied that the issue is the corporate tax rate – both the rate itself as well as the worldwide system, which disadvantages the American corporation. “On average [Procter & Gamble] pays about 2 percentage points higher in corporate tax than those international competitors. This is a disincentive for any company to invest in the U.S.”

Representative Neal asked Mr. McDonald if he believed that it was possible to focus on growth and keep the initiative revenue neutral. Mr. McDonald answered that he thinks it is best to first focus on creating a competitive system. Representative Neal emphatically stated that there is no reassurance that domestic job creation will occur as a direct result of repatriation, and asked Mr. McDonald for his reaction. Mr. McDonald reiterated that the BRT’s main focus is on setting up a competitive system; the BRT encourages its members to work not on one-time repatriation but on moving to a territorial system and creating better competition.

Representative Roskam shared an observation that he has made through his conversations with constituents. Many people in the Chicago area who work for worldwide companies do not have a sense of clarity that their employment depends on the success of their company in overseas markets. He encouraged everyone to communicate this fact more effectively.

Representative Jenkins asked any of the witnesses to try to prioritize what they would change in the tax structure. Mr. McDonald answered “getting to a competitive tax system” and Dr. Hassett said that the “corporate rate has to come down.”

Representative Kind recommended getting the co-chairs of the fiscal commission to testify before another tax reform hearing. He then thanked Ms. Olson for her testimony, and said that he hopes Congress heeds her warning not to lose track of the individual. “I hope we can marry the issues of corporate reduction along with the individual rate” Representative Kind said.