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Hatch Statement at Finance Hearing on Corporate Integration

WASHINGTON – Senate Finance Committee Chairman Orrin Hatch (R-Utah) today delivered the following opening statement at a hearing to examine corporate integration, and specifically, how allowing corporations to deduct dividends could create a more efficient and fairer system of taxation of corporate profits:

I'd like to welcome everyone here this morning.

Even a cursory examination of the business tax system demonstrates clearly the problems that arise from our out-of-step corporate tax, which contributes significantly to our anti-competitive business climate and leads sophisticated tax planners to engage in costly efforts – which some would call gamesmanship or tax avoidance – to either minimize their taxes or manage competitive tax pressures from abroad. Without significant reforms to the corporate tax system, we will continue to see an erosion in our overall tax base along with diminished growth and investment.

Among the most significant – and inexplicable – inefficiencies in our business tax system is the fact that a significant portion of U.S. business income is taxed more than once. Under the current system, income earned only once by corporations – on behalf of its shareholders – is taxed twice, thanks to a fiction created in the law that treats a business and its owners as two separate, taxable entities.

Specifically, when a corporation turns a profit, those earnings are taxed under the corporate income tax system, generally at a rate of 35 percent. When the corporation distributes a portion of those earnings to its shareholders in the form of dividends, we tax those earnings a second time at the individual level, with a maximum dividend tax rate approaching 25 percent. This, put simply, is a problem.

We have this problem, in large part, due to the fact that rules for taxing corporations were written without taking into account the rules for taxing individuals, and vice versa. A

better, more efficient system would be one that integrated the taxation of corporate and individual income.

That's what we're here to discuss today.

The current system of double taxation has resulted in a number of unintended economic distortions that wouldn't exist under a more integrated system. I'll discuss just a few of those distortions here this morning.

For example, the current system creates a bias in the choice of business entity, disfavoring the corporate model versus others. Of course, businesses – small and start-up businesses in particular – should have the flexibility to determine how to organize themselves. But, our tax code shouldn't punish ANY particular business with double taxation simply because it was organized a certain way.

Double taxation also discourages savings and investment and is a major factor in our current domestic savings and investment shortage. Savings and investment are essential to capital formation, increased job productivity, wage growth, and adequate retirement savings. Yet, we've created a system that essentially punishes those who save and invest.

In addition, the current system explicitly favors debt-financed investment over equity-financed investment. In the U.S., corporations can deduct interest paid to bond-holders, but no similar deduction exists for dividends paid to stockholders. Now, in some situations, there may be strong reasons for a company to opt for debt-financing, but there is no real reason why the tax code should favor debt over equity.

Double taxation also contributes to the problem of lock-out – that is, it discourages businesses from bringing income earned overseas back into the U.S. As many have already noted, with the highest corporate tax rate in the developed world, American multinational companies are often loathe to repatriate their foreign earnings and subject them to U.S. taxes on top of the taxes they've already paid in foreign jurisdictions. And, their shareholders rarely demand that they do so because those earnings will be taxed again if and when they are ever paid out as dividends. As a result, experts estimate that U.S. corporations have over \$2 trillion in earnings that are locked out of the U.S. due, in large part, to our tax system.

These problems – and there are many others – have been observed for years. And, as a result, many have argued for the elimination of double taxation and in favor of integrating the individual and corporate tax systems. We're going to continue that discussion here today.

In any discussion of an integrated system, the fundamental design choice that has to be made is whether the single instance of taxation should fall on the corporation or the shareholders. Given the substantial burdens our corporate tax system already imposes on U.S. businesses, coupled with the relatively high-mobility of corporate residence in the age of globalization, as illustrated by the recent wave of inversions and foreign takeovers, some have

questioned the wisdom of collecting the tax on the corporation side.

Another method of integrating the two systems would be to impose a single layer of tax at the shareholder level by allowing companies to deduct any dividends they pay out. As I see it, there are a number of benefits to this approach. I'll mention just a few.

First, a deduction for dividends paid would allow businesses to cut their own effective tax rates. There is bipartisan agreement on the need to bring down corporate tax rates. A dividends-paid deduction could accomplish the same goal without many of the trade-offs associated with a reduction in the statutory tax rate.

Second, this type of deduction would create greater parity between debt and equity. As I noted earlier, current law generally allows corporations to deduct earnings paid out as interest on debt obligations. A dividends-paid deduction would provide similar tax treatment for earnings paid out as dividends to investors, allowing companies to make debt-vs.-equity decisions after considering market conditions instead of simply referencing biases in the tax code.

Third, a dividends paid deduction could help with some of our international tax problems by reducing the pressure on companies to invert and greatly reducing the lock-out effect.

To hopefully take advantage of these and other benefits, I've been working for over a year now on a tax reform proposal that would eliminate double taxation of corporate income by providing this type of deduction. While I plan to unveil that proposal here in the next several weeks, I'm hoping we can inform this ongoing effort by having a more detailed discussion of these concepts and others during the course of today's hearing.

Before I conclude, I want to acknowledge that some groups – including tax-exempt entities and retirement plans – may have some concerns with a dividends paid deduction. However, at the end of the day, I believe we can craft a system where these parties will be treated in a manner that is comparable to current law, in fact, in many cases will likely be better off. And at the same time, our overall tax system will, in the opinion of many, be very much improved.

Still, I want everyone to know that, as I am preparing my integration proposal, I am aware of the concerns that these and other groups might raise and I am studying them very closely. Today, and going forward, we seek your comments and suggestions.

With that, I just want to say that I appreciate this fine panel of witnesses being here today, sharing their knowledge and expertise with the committee. I think this is going to be a very informative hearing.

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