Testimony of

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Chairman Hatch, Ranking Member Wyden, Members of the Committee: Thank you for inviting me to share my views on the international aspects of business tax reform. Business tax reform is an important priority, and it should reflect the needs of our country. We need to raise revenue in a way that is simple, fair, and efficient. We can do this without resorting to increasing the budget deficit. And we can do this in a way that focuses on the needs of the American middle class.

In my testimony today, I will discuss several crucial issues related to good business tax reform. First, I will discuss the concept of competitiveness, the contribution of our business tax system to the nation's competitiveness, and other important features of national competitiveness. Second, I will address the issue of corporate tax base erosion, an issue that has plagued our business tax system. Third, I will suggest important priorities in business tax reform, discussing how the corporate tax can be modernized to make our tax system better suited to a globally integrated economy. Toward this end, our tax system must serve the interests of American middle-class workers, workers too often left behind in tax reform proposals.

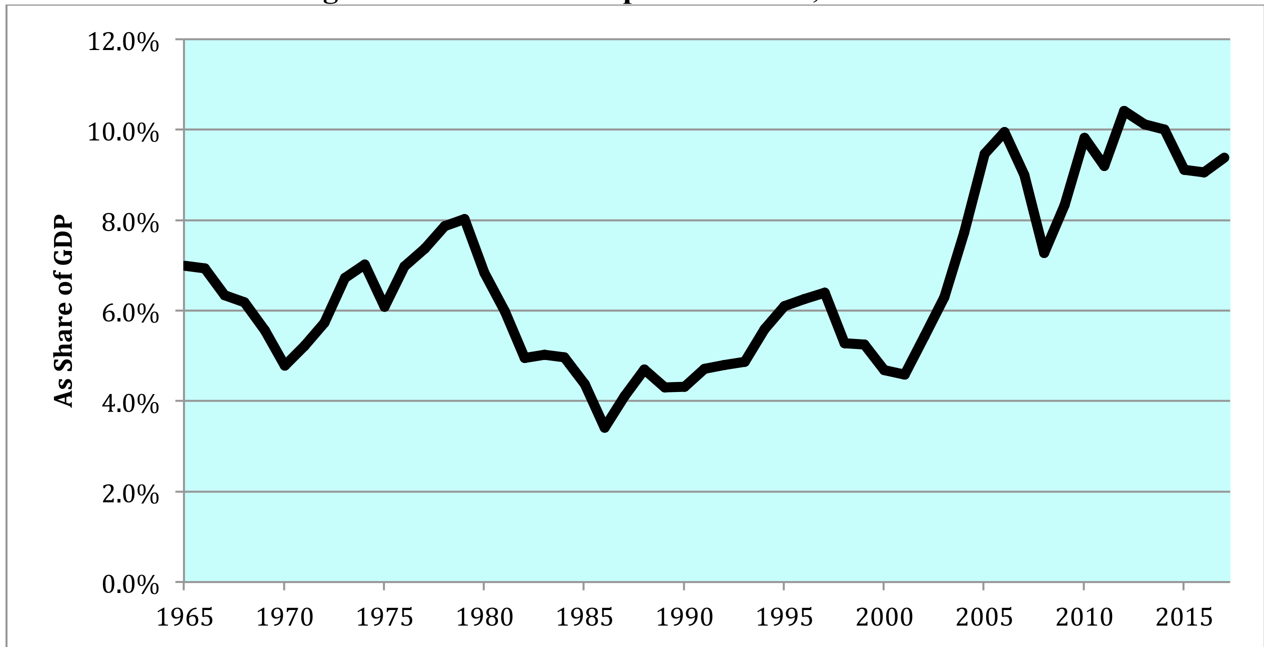
Are U.S. Companies Competitive?

By any broad measure, our nation's businesses are incredibly successful. Corporate profits are a higher share of GDP than they have been at any time in history, whether one considers corporate profits in before-tax or after-tax terms. Over the past ten years, after-tax profits have averaged 9.3% of GDP, whereas over the forty years before, they averaged 6.2% of GDP. In light of these clear facts, it is difficult to argue that our economy is being held back by a scarcity of after-tax profits. Indeed, our companies are awash in cash, but they are missing investment opportunities, due in part to the economic weakness of middle-class consumers. (See Figure 1.) Also, our companies dominate the Forbes Global 2000 lists of the world's most important companies. (See Figure 2.) While our economy is about one-fifth the size of the world economy (16% in purchasing power parity terms (PPP)[1] and 22% in U.S. dollar terms), we have larger fractions of

[1] PPP numbers adjust for price differences across countries. This makes the United States a smaller share of the world economy since price levels are lower in most developing countries.

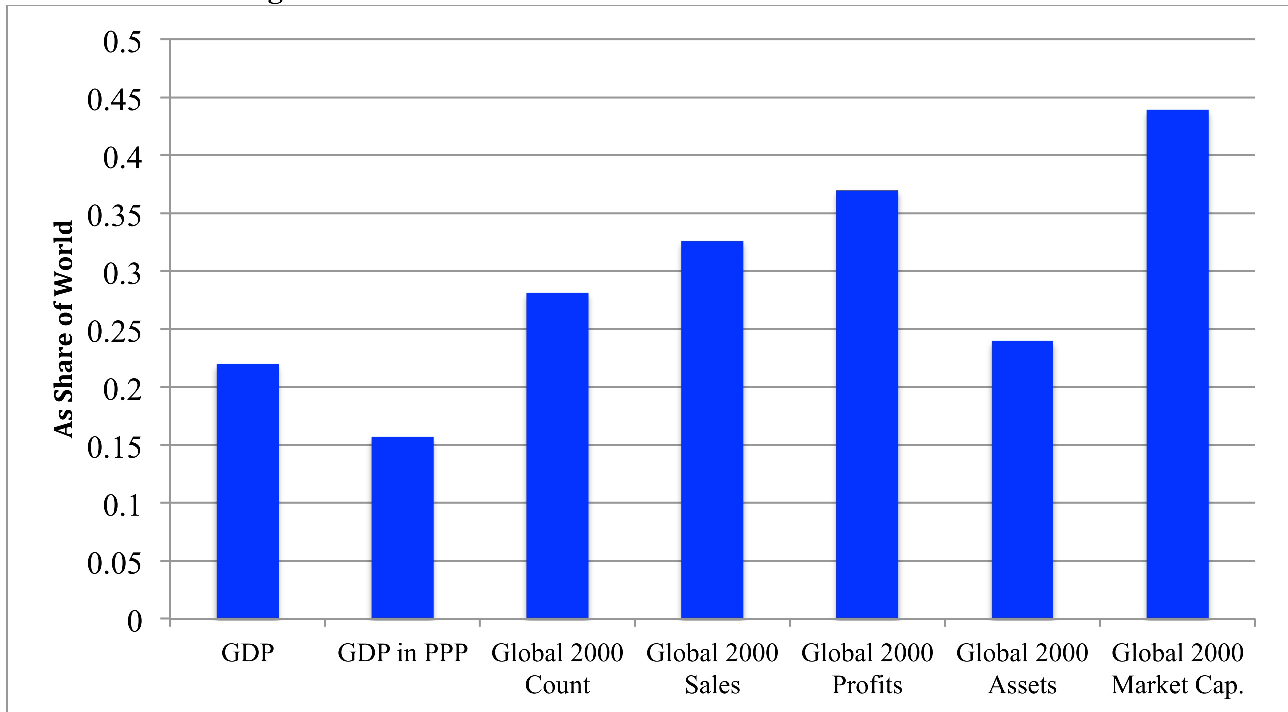
the world's top 2000 firms: 28% by count, 33% by sales, 37% by profits (consolidated), 24% by assets, and 44% by market capitalization.

Figure 1: After Tax Corporate Profits, 1965-2015



Source: U.S. Bureau of Economic Analysis

Figure 2: U.S. Share of Forbes Global 2000 Firms in 2016

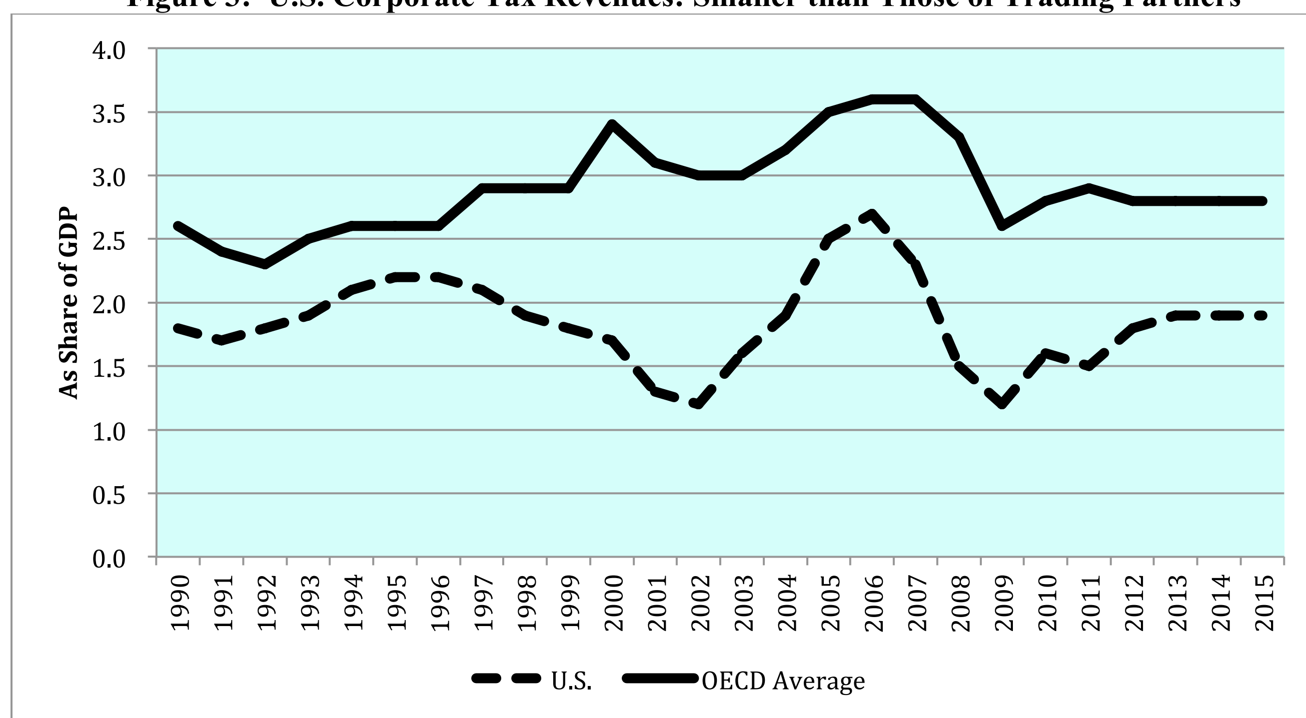


Source: Forbes Global 2000 Lists and World Development Indictors Data on GDP and GDP PPP.

Is the US Tax System Competitive?

While our corporate tax system certainly has problems, high tax burdens for multinational corporations are not one of them. Due to the aggressive use of corporate loopholes, many U.S. multinationals have effective tax rates in the single digits, far lower than the U.S. statutory rate.[2] And, our purportedly "worldwide" system of taxation generates no revenue from taxing foreign income, while our trading partners that use purportedly "territorial" systems of taxation frequently tax more foreign income than we do.[3] Further, U.S. corporate tax revenues are lower than the corporate tax revenues of our peer trading partners by about one percent of GDP. Part of the revenue shortfall is explained by profit shifting to tax havens, and there are also other reasons for weak U.S. corporate tax revenues.[4] These considerations do *not* mean that U.S. business taxation cannot be substantially improved; I make suggestions below.

Figure 3: U.S. Corporate Tax Revenues: Smaller than Those of Trading Partners



Source: OECD Revenue Statistics. Data are for collections by all levels of government.

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[2]The U.S. statutory rate is high relative to peer nations, but this is not the relevant measure of corporate tax burdens since most companies pay effective tax rates that are far lower than the statutory rate. See footnote 5 for evidence.

[3] Under the U.S. system, some types of foreign income are more lightly taxed. For example, foreign tax credits can be used to shield royalty income from taxation. Also, other countries often have tougher base-erosion laws, and their adoption of the OECD/G20 BEPS guidelines will continue this trend. See Joint Committee on Taxation JCX-42-11. In addition to tough CFC laws, many territorial countries have other provisions aimed at countering corporate tax base erosion, including thin capitalization (earnings stripping) rules, which are widely used. Beyond these measures, there are also new anti-base erosion measures such as the European Union Anti-Tax Avoidance Directive and Australia's anti-avoidance law.

[4] Much business income is earned by pass-through organizations; this is discussed below. Beyond that, the U.S. tax base is notoriously narrow and there are important distortions within the corporate tax code. For example, debt-financed investments are tax-favored relative to equity-financed investments. This increased leverage creates financial vulnerability for the U.S. economy.

Broader Notions of Competitiveness

In discussions about the "competitiveness" of U.S. multinational firms, corporate interests often emphasize tax burdens as a determinative influence. Yet, for many companies, the U.S. statutory rate and our purportedly "worldwide" system have more bark than bite, and multinational firms are often able to achieve very low *effective* tax rates.[5] In terms of the ability to generate after-tax profits and market dominance, U.S. multinational companies are already quite competitive.

But broader notions of competitiveness emphasize the fundamentals that determine the health and well-being of our broader economy. Are workers well-educated, and do they have the skills required to earn high wages in the global economy? Are customers economically secure and sufficiently prosperous that they are not overleveraged? Are standards of living for the middle class rising at a pace that is consistent with societal expectations and a healthy middle class? Is our infrastructure sound? Are our political and economic institutions stable? Are we avoiding fragility in our financial system and other weak spots that could lead to recessions or crises?

While we often take such things for granted, they are essential to the success of U.S. businesses and the workers within them. In short, the attractiveness of a particular country as a location for production depends on much more than the corporate tax environment. And many crucial ingredients for a competitive economy require government revenue to finance investments in education, infrastructure, and essential services. The investments in our economy that make the middle class prosperous will also make our businesses successful.

Corporate Tax Base Protection

Offshore profit shifting has become a huge problem. My research suggests that this problem has increased dramatically over the past 20 years, and profit shifting to tax havens now costs the U.S. government more than $100 billion each year.[6]

Figure 4 shows the dramatic increase in the revenue lost to profit shifting in recent years, and Figure 5 shows that most profit shifting is artificially directed toward tax havens. Indeed, the income booked in low-tax havens is implausibly high by any reasonable metric. In 2010, U.S. affiliate firm profits were many multiples of island havens' entire GDP: over 16 times GDP in Bermuda and over 20 times GDP in the Caymans.[7] Further, estimates indicate that U.S. multinational firms have accumulated over $2.6 trillion in permanently reinvested earnings in tax havens, over $1 trillion of which is held in cash.

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[5] See Matthew Gardner, Robert S. McIntyre, and Richard Phillips. "The 35 Percent Corporate Tax Myth." ITEP Report. March 2017. See also these studies on effective tax rates: Congressional Research Service: https://fas.org/sgp/crs/misc/R41743.pdf, General Accounting Office: https://www.gao.gov/products/GAO-16-363, Treasury: https://www.treasury.gov/resource-center/tax-policy/Documents/Report-Responsible-Business-Tax-Reform-2017.pdf, and the appendix of this academics letter: https://americansfortaxfairness.org/files/24-International-Tax-Experts-Letter-to-Congress-9-25-15-FINAL-for-printing.pdf.

[6] See Clausing, Kimberly A. "The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond." 2016. *National Tax Journal*. December. 69(4). 905-934. Similar facts regarding the scale of the problem are reported by many sources, including Keightly (2013), Dowd, Landefeld, and Moore (2017), and Guvenen, Mataloni, Rassier, and Ruhl (2017). These practices also hurt our trading partners, as discussed in Clausing (2016).

[7] See Jane Gravelle. "Policy Options to Address Profit Shifting: Carrots or Sticks?" *Tax Notes*. 4 July 2016.

Figure 4: Estimated Revenue Loss to U.S. Government from Profit Shifting[8]

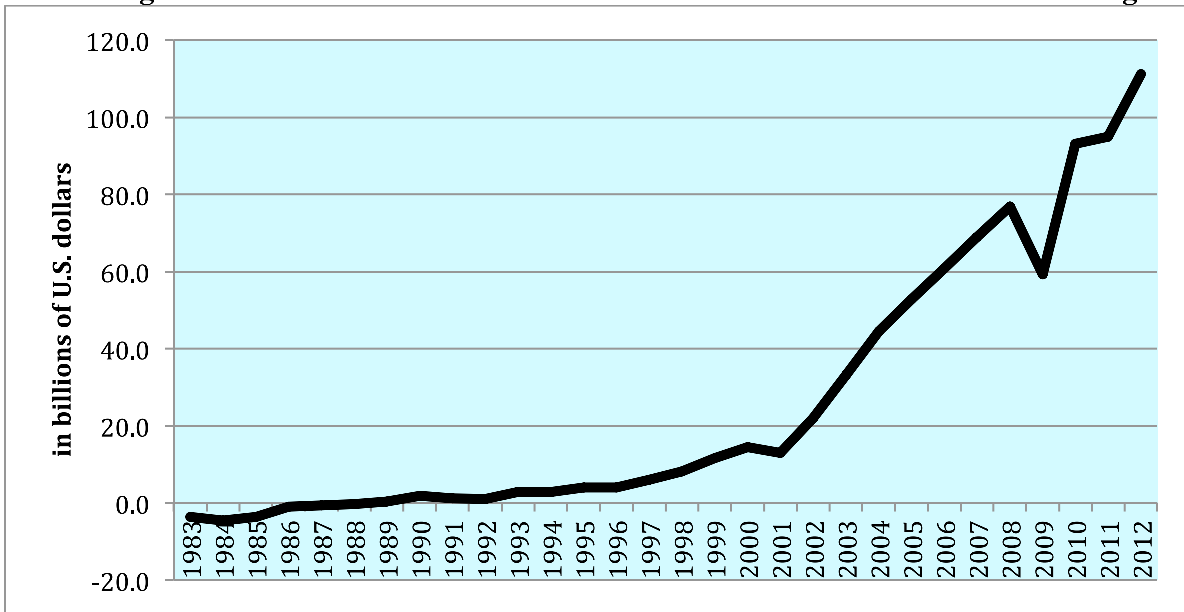
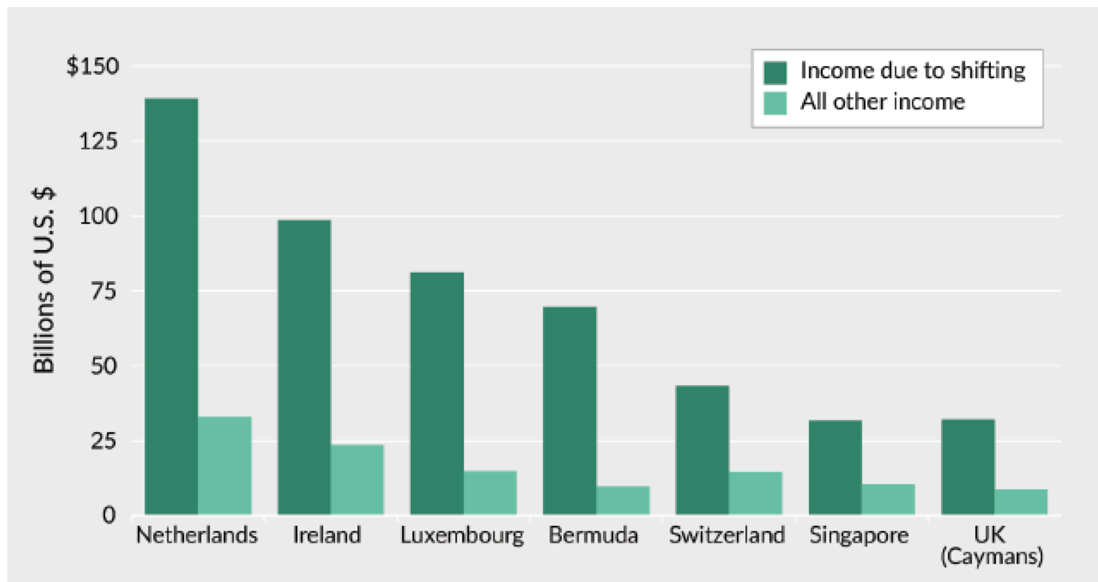


Figure 5: Main Destinations for Profit Shifting

Seven key profit-shifting locations by U.S. multinationals

Income reported by U.S. multinational corporations in low-tax countries, in billions of U.S. dollars



The tax havens that are destinations for profit shifting abroad have extremely low effective tax rates, often less than 5%. My research suggests that 82% of our profit shifting problem is with just 7 tax havens, the ones shown in Figure 5. And 98% of the profit shifting occurs with

[8] For the full analysis behind Figures 4 and 5, see Kimberly Clausing, *The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond*, 69 NAT'L TAX J. 905, 905-934 (2016).

countries that have effective tax rates that are less than 15%. These facts clearly show that lowering the corporate tax rate is not enough to stem this type of tax avoidance. Absent tough measures to combat tax base erosion, haven tax rates under 5% will remain big magnets for internationally mobile income, even if the U.S. corporate tax rate declines substantially.

More Base Erosion: The Problem of Favorable Pass-Through Taxation

While multinational companies almost always operate in corporate form, in part due to the benefits of deferral of US taxation on foreign income until income is repatriated, much domestic business activity has moved from corporate to pass-through form. Pass-through income is now over half of business income. For domestic companies, tax burdens are often far lower in pass-through form, and tax avoidance is a big problem. Pass-through businesses often feature opaque organizational forms that facilitate tax avoidance. The average federal rate on pass-through income is 19%, a rate lower than the rate on corporate income, and the movement of business income into pass-through form has reduced corporate tax revenues by about $100 billion each year.[9]

Providing a tax preference for pass-through income risks more tax base erosion. Rates below the top personal rate will open up massive new opportunities for tax avoidance, as (typically high-income) individuals with discretion will be tempted to reorganize their income as business rather than personal income. This type of tax avoidance was endemic in Kansas after their experiment with lower pass-through rates, and in general, it is very difficult to combat without adding immense complexity to the tax system. While some small businesses are the sorts of endeavors that are easily romanticized in these types of committee hearings, pass-through organizational form is also popular among very wealthy individuals, including President Trump, who owns many pass-through businesses. According to estimates from the nonpartisan Tax Policy Center, an astonishing 85% of a pass-through tax cut would accrue to those in the top 1% of the income distribution.[10]

Why is it Important to Protect the Corporate Tax?

1. Revenue. As demonstrated in Figure 3, U.S. corporate tax revenues are lower than those of peer nations, due to both profit shifting and the importance of the pass-through sector. In the wake of record high corporate profits in recent years, the low, flat trend of our corporate tax revenues is particularly noticeable. Protecting the corporate tax base would help ensure adequate government revenues in a time when the labor share of income is steadily shrinking.[11] Revenues are particularly important to finance urgent priorities that are important for the competitiveness of our economy and the economic health of the middle class: priorities like infrastructure, education, and research and development.

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[9] See Cooper, Michael, et al. 2016. "Business in the United States: Who Owns It and How Much Tax Do They Pay?" *Tax Policy and the Economy*. 30(1). 91-128.
[10] See http://www.taxpolicycenter.org/sites/default/files/publication/141541/2001271-options-to-reduce-the-taxation-of-pass-through-income.pdf.
[11] See Kimberly Clausing, "Labor and Capital in the Global Economy." *Democracy: A Journal of Ideas.* 43. 2017. http://democracyjournal.org/magazine/43/labor-and-capital-in-the-global-economy/

Business tax reform that is not (at least) revenue neutral increases the government budget deficit. The deficit is already scheduled to increase by about 2% of GDP over the next decade due to our aging population and our important commitments to Social Security and Medicare. Debt held by the public is now about 75% of GDP. Further increasing our indebtedness at this moment in time is unwise. When another recession occurs, and unfortunately recessions *do* always come, we will need room for the natural increases in budget deficits that occur as the economy collects less tax revenue and spends more on unemployment. Our current levels of indebtedness already provide little wiggle room. Also, monetary policy will have limited ability to respond to the next recession since interest rates are already quite low. This is a bad time for tax cuts.

Deficit financed tax cuts increase tax burdens on our children and grandchildren. Also, government budget deficits reduce any growth-enhancing effects of tax cuts, since they either raise interest costs (due to greater government borrowing) *or* they pull in foreign sources of financial capital, which have the advantage of keeping interest rates lower, but result in future repayments of debts abroad, lowering standards of living at home during that period.

The nonpartisan Tax Policy Center has calculated that base broadening can only finance a limited revenue-neutral corporate rate reduction. Ignoring deferral, if you eliminate every single business tax expenditure (some of which are very popular), it only pays for a rate reduction to 26%, a far higher rate than those in the news lately.[12]

2. A Fair Tax System. Any proposed business tax plan follows several decades of dramatically increasing income inequality, sharply declining shares of GDP that go to labor, sharply increasing shares of GDP that go to corporate profits, and middle class wage stagnation. Tax policy should work to counter, not reinforce, such trends.

Business taxation has an important role to play in the progressivity of the tax system. As already noted, 85% of pass-through tax rate cuts accrue to the top 1% of the income distribution. And, aside from the estate tax, the corporate tax is our most progressive tax. All conventional models of corporate tax incidence assign the vast majority of the burden of the corporate tax to capital or shareholders, including models used by the Joint Committee on Taxation, the Congressional Budget Office, the U.S. Treasury, and the nonpartisan Tax Policy Center.[13] Given the strong advocacy by shareholders and the business community for corporate tax cuts, it should not be surprising that these groups are the ones who would benefit from the tax cuts. They understand their own economic interests.

Those concerned about the well-being of workers might usefully advocate for tax cuts on taxes that workers pay: economists agree that workers bear the burden of the payroll tax and the labor

[12] TPC Staff. "The Tax Reform Tradeoff: Eliminating Tax Expenditures, Reducing Rates." 13 September 2017. Of course, ending deferral would enable further rate reduction; however, a move toward a territorial system is likely to worsen erosion.

[13] For JCT, see https://www.jct.gov/publications.html?func=startdown&id=4528. For CBO, see https://www.jct.gov/publications.html?func=startdown&id=4528. For Treasury, see https://www.ntanet.org/NTJ/66/1/ntj-v66n01p239-62-distributing-corporate-income-tax.html. (This was previously available at https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/TP-5.pdf, but it was mysteriously pulled from the Treasury web site in recent weeks.) For the TPC, see http://www.taxpolicycenter.org/publications/how-tpc-distributes-corporate-income-tax.

income tax. For *corporate* tax cuts to benefit workers, the resulting increase in corporate after-tax profits needs to fuel new investments, those new investments need to increase the productivity of labor, and the higher productivity needs to boost wages. Why rely on such indirect mechanisms to help workers when we have far more direct tools? If the aim is to help workers, then policymakers should go straight to the taxes that fall on them.

Further, much of the U.S. corporate tax base at present is excess profits, which are profits above the normal level accruing due to intangible sources of economic value and market power. U.S. Treasury economists now calculate that three quarters of the corporate tax base is excess profits, often in the hands of very few superstar companies.[14] Giving a tax cut to this part of the tax base just makes excess profits even larger, without stimulating capital investment or wages.

Finally, if burgeoning corporate after-tax profits were the key to investment and wage growth, then the previous 15 years should have already been a paradise of wage growth, as after-tax profits in recent years have been about 50 percent higher than in decades prior (as a share of GDP), and higher than at any point in the past half-century.

I would urge the committee to focus on the distribution tables when designing tax law changes, relying on the well-regarded, nonpartisan economists at the Joint Committee on Taxation and the Congressional Budget Office to estimate the effects of tax and budget changes. The ultimate test of whether tax legislation will help American workers is the distribution analyses. In these analyses, it is important to consider the tax system as a whole: business taxes, individual income taxes, and estate taxes should all be considered together.

3. An Efficient Tax System. Taxing corporate income helps make the tax system function better. Without the corporate tax, individuals could use the corporate form itself as a tax shelter. The corporate tax is also our only effective tool for taxing capital income. In my recent research with Leonard Burman and Lydia Austin of the Tax Policy Center, we show that only about 30% of U.S. equity income is taxed at the individual level by the U.S. government; the rest is earned in tax free accounts, in non-taxable endowments, or by foreign investors.[15]

Taxing all types of income at the same rate of taxation is a good ideal for tax policy. After the last great tax reform (that emerged from this very body) in 1986, both capital and labor income were taxed at the same rate. This sort of uniformity is consistent with the latest research on the ideal efficient tax policy design.[16] Taxing different types of income at the same rate also cuts down on the many gimmicks and shenanigans that litter our tax system when tax rates differ.

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[14] See http://www.ntanet.org/NTJ/69/4/ntj-v69n04p831-846-excess-corporate-returns-increasing.pdf for evidence on excess profits.

[15] Leonard Burman, Kimberly Clausing, and Lydia Austin. "Is U.S. Corporate Income Double-Taxed?" *National Tax Journal*. September 2017.

[16] As examples, see Diamond, Peter, and Emmanuel Saez. 2011. "The Case for a Progressive Tax: From Basic Research to Policy Recommendations." *Journal of Economic Perspectives* 25: 165–90; Farhi, Emmanuel, Christopher Sleet, Ivan Werning, and Sevin Yeltekin. 2012. "Non-Linear Capital Taxation Without Commitment." *Review of Economic Studies* forthcoming: 1–25; Piketty, Thomas, and Emmanuel Saez. 2012. "A Theory of Optimal Capital Taxation." *National Bureau of Economic Research Working Paper No. 17989*, April; Piketty, Thomas, and Emmanuel Saez. 2013. "A Theory of Optimal Inheritance Taxation." *Econometrica* 81 (5): 1851–86.

Finally, since the vast majority of the corporate tax base is excess profits, this also has efficiency implications. Taxing excess profits does not distort capital investment or hiring decisions, and excess profit taxes are far more efficient than taxes that target capital or labor.

Implications for Business Tax Reform

1. First, Do No Harm: A Toothless Territorial System Heads in the Wrong Direction

Many in the multinational community use the notion of "competitiveness" to suggest that that the United States should adopt a territorial system of taxation. Yet, as noted above, multinational firms already face low effective tax rates that are comparable to those of firms headquartered in other countries, and very little tax is presently collected on foreign income. Indeed, a well-designed territorial system could easily *raise* the tax burden on foreign income, as noted by many observers.[17]

So, presumably, those that push for adoption of a territorial system under the guise of competitiveness concerns truly have in mind a "toothless territorial" system that would lower the tax burden on foreign income. A toothless territorial system, without serious and effective base erosion protection measures, risks worsening an already large corporate tax base erosion problem. Exempting foreign income from taxation would relax the remaining constraint on shifting income abroad, the potential tax due upon repatriation. This turbocharges the already large incentive to book profits in low-tax havens, likely generating large revenue losses.

2. Cutting Business Rates Below Personal Tax Rates Risks More Tax Base Erosion

Discrepancies between the top personal rate and the business rate will create new avoidance opportunities as wealthy individuals seek to earn their income in tax-preferred ways, reducing their labor compensation in favor of business income. Companies would be inclined to tilt executive compensation toward stock-options and away from salary income, and high-income earners would be inclined to earn income through their businesses in pass-through form. Thus, serious tax revenue leakage in the personal income tax system is also likely.

3. Much Ado About Repatriation… Why Give Windfalls for Income Already Earned?

U.S. multinational companies have accumulated over $2.6 trillion in offshore profits, sitting in countries with very low effective tax rates, typically less than 5%. Companies are able to borrow against these funds, and even invest these funds in U.S. financial markets, but they are not able to distribute the funds to shareholders in the form of dividends and share repurchases without triggering U.S. tax on the repatriated funds. As a consequence, companies have left funds piling up offshore, in the hope that Congress will give them a special holiday rate again (as in the 2004 American Jobs Creation Act), or even enact permanently favorable treatment of foreign income.

Company decisions about when to pay dividends and repurchase shares are distorted by these tax incentives. However, it is unlikely that repatriation tax is reducing U.S. investment. The companies that have accumulated these earnings abroad are the most credit-worthy companies on the planet, and they can easily borrow to finance worthy new investments in the United States. In

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[17] Robinson, Leslie. 2014. "Testimony of Leslie Robinson Before the United States Senate Committee on Finance." presented at the Hearing on International Corporate Taxation, Washington, DC, July 22; Gravelle, Jane G. 2012. "Moving to a Territorial Income Tax: Options and Challenges." Washington DC: Congressional Research Service.

fact, borrowing achieves the equivalent of a tax-free repatriation, since the funds abroad accumulate interest income that offsets the interest deduction on funds borrowed at home, giving companies the same access to financial capital at no tax cost.

Despite the hopeful title of the legislation, the 2004 American Jobs Creation Act's repatriation tax holiday did not create jobs or spur investment.[18] Instead, it was effectively a tax windfall to shareholders based on companies' past tax avoidance. The only effect was a substantial increase in share repurchases and dividend issues.

Further, preferential rates on income that has *already been earned* and that is stashed in tax havens makes no economic sense from either an efficiency or equity perspective. Giving shareholders a tax windfall on income they have already earned does not encourage job creation or investment. Instead, it merely enriches those at the very top of the income distribution. We have *far* more effective tools to encourage new investment, job creation, and the prosperity of the middle class.

4. Tackling Base Erosion

Congress should focus on a revenue neutral (or revenue-increasing) business tax reform that reduces the statutory corporate tax rate and eliminates the major corporate tax expenditures *including deferral*, taxing accumulated offshore earnings in full. Eliminating deferral would eliminate the incentive to earn income in low-tax countries, by treating foreign and domestic income alike for tax purposes. Pairing that reform with a lower corporate tax rate need not raise tax burdens on average, although it would create winners and losers among corporate taxpayers. A more fundamental reform would require worldwide corporate tax consolidation; this would align the tax system with the reality of globally-integrated corporations.[19] These reforms should be combined with anti-inversion measures such as better earnings stripping rules and an exit tax.

Taxing foreign income currently also eliminates the incentive to build up large stocks of unrepatriated foreign income, now estimated at $2.6 trillion. Settling the future tax treatment of foreign income should be a key goal of reform efforts.

In terms of more incremental reforms, even a per-country minimum tax would be a big step toward reducing profit shifting toward tax havens and protecting the corporate tax base. A minimum tax would currently tax income earned in the lowest tax countries. 98% of the profit shifting out of the United States is destined for countries with foreign tax rates below 15%.[20] However, a "global" minimum tax is a far less effective step. Since companies could use taxes paid in higher-tax countries to shield income booked in tax havens from the minimum tax, there

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[18] See Gravelle, Jane G., and Donald J. Marples. 2011. "Tax Cuts On Repatriation Earnings as Economic Stimulus: An Economic Analysis." R40178. Congressional Research Service. This paper provides an extensive review of several papers, all of which show no jobs or investment stimulus resulting from the repatriation tax holiday.

[19] One proposal for worldwide consolidation is within Kleinbard's proposal for a Dual BEIT: Kleinbard, Edward D., Business Taxes Reinvented: A Term Sheet (September 25, 2017). Tax Notes, Vol. 156, 2017. Another fundamental reform worthy of long run consideration is formulary apportionment. See Avi-Yonah, Reuven S., and Kimberly A. Clausing. 2008. "Reforming Corporate Taxation in a Global Economy: A Proposal To Adopt Formulary Apportionment."

[20] *See* Kimberly Clausing, *The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond*, 69 NAT'L TAX J. 905, 905-934 (2016).

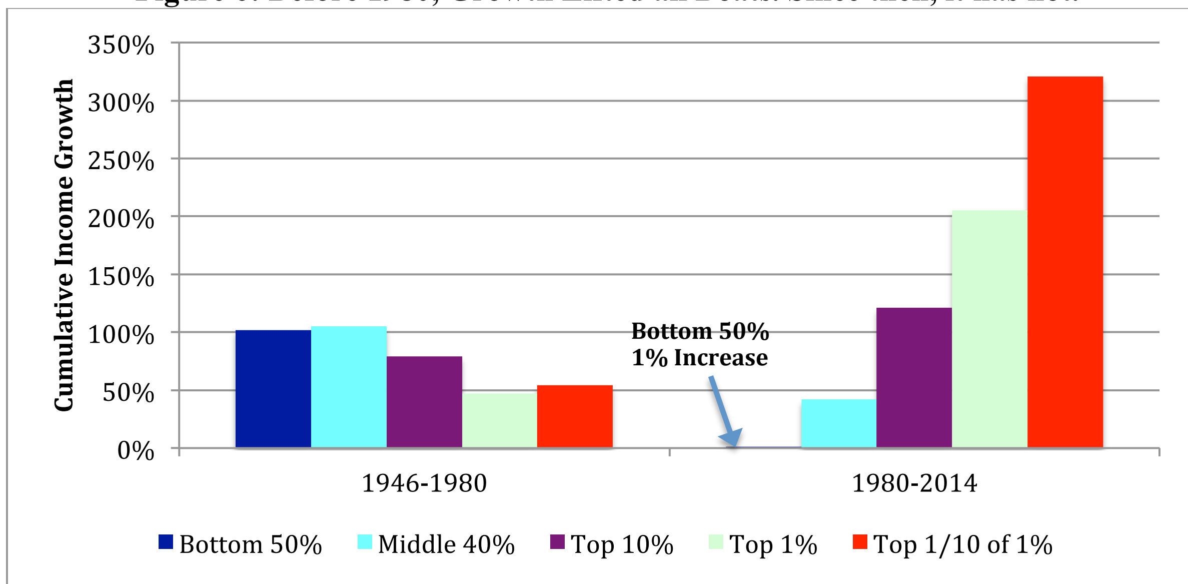
would still be a very substantial incentive to earn income in tax havens. The playing field would be more tilted toward both haven income and other types of foreign income; the two streams of income would work together to reduce tax burdens.

In general, making our tax system compatible with the global economy is an important goal. We need a simplified corporate tax system that actually collects the tax that is due. As it is, too many people waste their careers pursuing tax-related gimmicks and shenanigans. Profit shifting costs the U.S. government over $100 billion each year. Simple reforms like a per-country minimum tax – or better yet, ending deferral – would address that problem and make our corporate tax system more compatible with the global operations of multinational firms.

5. Paying Attention to the Middle Class

The truth is in the distribution tables. Any tax law changes should not worsen income inequality. The tax plans of this committee follow decades of dramatically increasing income inequality, sharply declining shares of GDP that go to labor, sharply increasing shares of GDP that go to corporate profits, and middle class wage stagnation. Our tax policy should be working to counter these trends, making sure that all American workers benefit from the gains in national income that steadily increase our GDP.

Figure 6: Before 1980, Growth Lifted all Boats. Since then, it has not.



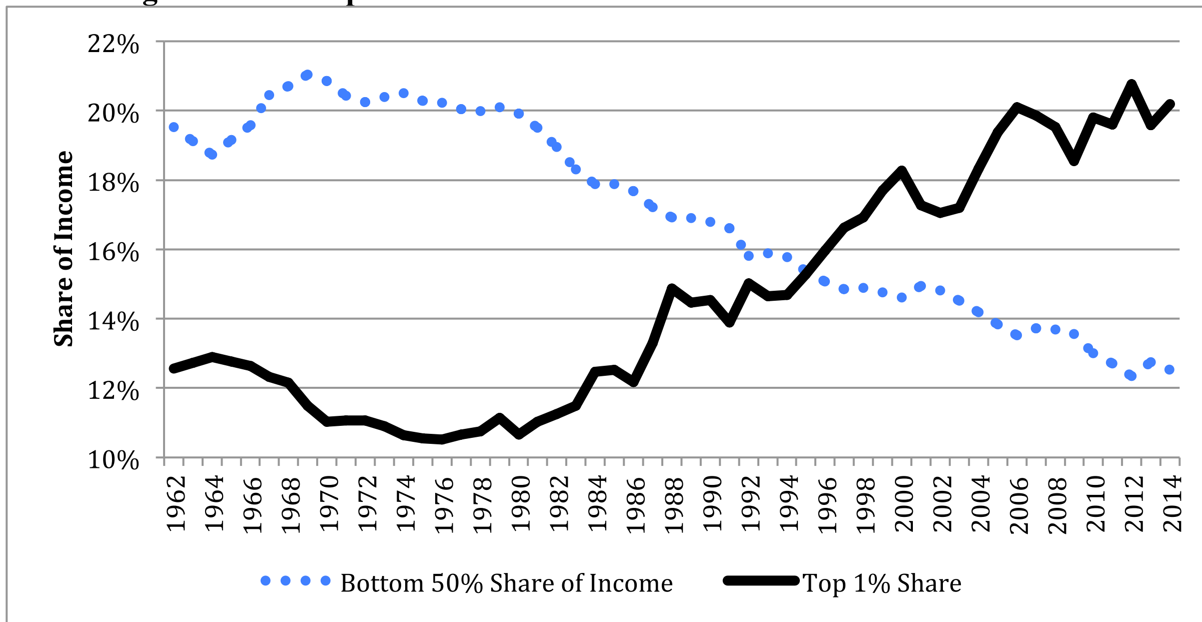
Note: Figures compiled based on data from Piketty, Saez, and Zucman (2016).[21]

In earlier decades, the middle class did better. Figure 6 shows that pre-tax income growth over the period 1946 to 1980 exceeded 100% for the bottom 90% of the population, and income growth was actually lower for the top shares of the population. However, between 1980 and 2014, the growth of the bottom 50% is literally invisible in the chart, at 1%. Growth in incomes for the middle 40% is 42 percent, and it accelerates from there. As a result, there has been an increasing concentration of national income at the top of the income distribution. The top 1%

[21] See Thomas Piketty, Emmanuel Saez, and Gabriel Zucman. "Distributional National Accounts: Methods and Estimates for the United States." December 2016.

now have a fifth of national income, 50% more income than the bottom half of the income distribution. (See Figure 7.)

Figure 7: The Top 1% and Bottom 50% Trade Places in the Last 35 Years



Note: Data from World Top Incomes Database. Accessed 14 March 2017.

These figures help explain why typical American households are not content with the pace of economic progress. The standard expectation that every generation would be better off than the prior generation has been disappointed. Nearly 90% of children born in the 1940s out-earned their parents, but that share has fallen steadily. For children born in 1970, only 60% out-earn their parents; for those born in the 1980s, only half do.[22]

Our tax system needs to reflect these changing realities by making sure that tax cuts are directed to those that are *not* in the top 1%, focusing instead on the bottom 80% of the population that has been frustrated by our prior record of economic progress. The tax system can better serve American workers by expanding the earned income tax credit, by providing wage insurance for workers who have lost their job due to technological disruption or due to competitive pressures, and by making sure that tax cuts are larger for the middle class than for the rich. We also need to work to solidify the economic fundamentals of our economy. This requires responsible tax legislation that gives us the revenue we need for vital investments in education, infrastructure, healthcare, and other urgent priorities.

6. Fund the IRS. They need more resources to do their job.

In order to administer the tax system in a way that is fair to taxpayers and that meets the needs of the country, the IRS needs adequate resources and technology.

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[22] See Raj Chetty et al. "The Fading American Dream: Trends in Absolute Income Mobility Since 1940." *NBER Working Paper No. 22910*. December 2016.

7. Finally, a new revenue source can make tax policy trade-offs less vexing.
Whatever happens with tax policy in the months and years ahead, we will likely aim for more ideal tax policy in the future. To do this, we'll need a planet that is fit for habitation. Climate change is a real and pressing problem, but it is also an opportunity for efficient taxation. Normally, taxes burden things we actually want to encourage, like work or savings. But carbon dioxide emissions are wreaking havoc on the world's climate, and a tax on carbon is an ideal way to counter them, without resorting to burdensome regulations. A carbon tax raises a *lot* of revenue; a tax of $25/per metric ton is estimated by the Congressional Budget Office to generate about a *trillion* dollars in revenue over ten years.[23] And, unlike most sources of revenue, a carbon tax makes the economy *more* efficient by discouraging something that the market, left to its own devices, over-produces.

A carbon tax can help keep other tax rates lower than would otherwise be necessary. Several very prominent Republican economists have recently suggested a novel way to tax carbon in their "Conservative Case for Climate Action".[24] They propose simply refunding the carbon tax to ordinary Americans in equal amounts. This is a masterful policy that will help workers in the bottom 70% of the income distribution (since they will receive more from the rebate than they pay in tax).[25] The large revenue source keeps overall tax burdens much lighter for those Americans who have struggled the most in recent decades. It will lead to new investments and new jobs in cleaner technologies *and* a healthier planet. A very good idea indeed.

Thank you again for inviting me to testify today. I look forward to your questions.

Further Reading

This testimony draws on several other works by the author, including those below. In some cases, sections of text are excerpted. Interested readers are referred to the following articles by the author for more detail on these arguments.

- "Strengthening the Indispensible U.S. Corporate Tax." Washington Center for Equitable Growth. August 2016. http://equitablegrowth.org/report/strengthening-the-indispensable-u-s-corporate-tax/
- "The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond." 2016. *National Tax Journal*. December. 69(4). 905-934. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2685442
- "Competitiveness, Tax Base Erosion, and the Essential Dilemma of Corporate Tax Reform." 2016. (6) *BYU Law Review*. 1649-1680. http://digitalcommons.law.byu.edu/cgi/viewcontent.cgi?article=3075&context=lawreview
- "Labor and Capital in the Global Economy." *Democracy: A Journal of Ideas.* 43. 2017. http://democracyjournal.org/magazine/43/labor-and-capital-in-the-global-economy/
- "Is U.S. Corporate Income Double-Taxed?" (with Leonard Burman and Lydia Austin). September 2017. *National Tax Journal*. 70(3). 675-706.

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[23] This tax rate is lower than many estimates of the tax rate that would truly cause market participants to find the ideal level of carbon dioxide emissions, but it would be a sizable step in the right direction, and the tax rate could be increased over time. Arguably, the rate should be about twice as high, eventually.

[24] See Martin Feldstein, Ted Halstein, and Greg Mankiw. "A Conservative Case for Climate Action." *New York Times.* 8 February 2017. https://nyti.ms/2kMKE4u

[25] See https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-115.pdf