

The Honorable Orin Hatch
The Honorable Ron Wyden
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

April 15, 2015

Dear Mr. Chairman and Ranking Member:

Attached is a paper explaining the infeasibility of creating a pro-growth, stand-alone, static-revenue-neutral corporate tax reform that pays for reduced tax rates solely by eliminating so-called corporate tax expenditures. Either the potential jobs and income growth from the rate reductions will be destroyed by eliminating good provisions that offset double taxation and other errors in measuring income, which would make capital more expensive, or the static revenue will fall short.

Tax reform should embrace business reforms that cover both the corporate and the pass-through sectors, move to a less-distorting tax base as well as reducing tax rates, factor in the revenues regained by economic growth, and be paid for in part by trimming spending.

A comprehensive tax reform plan would do each of the following:

1. Competitive Tax Rates for All Businesses
2. Allow Full and Immediate Expensing of All Business Investment
3. Integrate the Corporate and Individual Tax Code to Eliminate Double Taxation
4. Allow Deferral of Taxes on All Saved Income
5. Shift to a Territorial Tax System

Growth Objective

Additional essential considerations in any successful pro-growth reform effort are summarized below, with links to studies backing up the assertions. Growth should be the key objective, as the economy and household incomes are about 15 percent below long term trend and potential. Correcting inadequate income and job growth are more important than increasing federal revenue and spending to new highs.

Scoring and Procedure

In designing a reform, the Committee needs information on the economic growth consequences that various changes to the tax system will have for the public (via jobs, wages, small business income, and retiree incomes from pensions, dividends and capital gains), as well as for the federal budget.

- If economic gains from a beneficial tax change return some revenue to the Treasury, that revenue reflow would reduce the need for budget offsets. If certain revenue offsets reduce GDP, they will offset some of the potential growth, and will not bring in the expected revenue. If other offsets do minimal damage to GDP, or even reduce sheer waste, they should be preferred as revenue options.
- If revenue offsets do more damage to the economy than reductions in certain areas of government spending, then the Committee should consider recommending spending cuts instead of revenue offsets.

- If the net revenue losses are temporary or modest, and the implication for the deficit is transitory or small, the Committee should consider whether a net tax reduction might be acceptable to smooth the reform effort.

It is important that the Committee explore these attributes while the reform is being considered, to guide the exercise, not after the final package is assembled.

Additional suggestions about scoring and analysis follow.

Essential Elements of a Pro-Growth Tax Reform

The Correct Tax Base

Recognize that the income taxes are biased against growth and job creation, and take steps to move toward a more economically efficient, saving-consumption neutral tax base.

It is not enough to reduce tax rates. The correct tax base is essential too. Reform must eliminate double and triple taxation of saving and investment, and end the current practice of overstating income by undercounting costs of investment in plant, equipment, and inventory. These corrections require:

- Movement toward expensing of all investment outlays and other costs of doing business. Expensing improves upon and replaces accelerated depreciation, LIFO, and all cost recovery treatments or subsidies in the traditional and experimental energy sector.
- Integration of corporate and individual income taxes so that the combined tax rates on C-corporation earnings at the business and shareholder level, and the tax rates on pass-through income, are closely equivalent. The choice of business form should not be impacted by tax treatment.
- Deferral of taxes on all income saved, not just the amounts in retirement or tuition plans; alternatively, eliminate taxation of the returns to saving done with after-tax income.

Visible, Uniform, Simple Taxation

Taxes should be imposed where people can see them, not buried in the business sector to be passed on in hidden costs.

They should be uniform across activities, goods, and services to be non-distorting.

Subsidies and credits should be enacted as spending programs and not encumber the tax code, tax compliance, or tax enforcement.

Lowest Marginal Tax Rates Consistent with Essential Spending

With a visible tax system, taxpayer/voters will be better able to judge how much spending they want. Tax rates should be set accordingly.

Taxation of Domestic, Not Foreign, Economic Activity

Lastly, the tax system should be territorial, not global.

Please don't hesitate to contact us if you should have any questions.

Sincerely,

Scott A. Hodge
President

Stephen Entin
Senior Fellow