

**EXTENDERS AND TAX REFORM:
SEEKING LONG-TERM SOLUTIONS**

HEARING

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE**

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

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EXTENDERS AND TAX REFORM: SEEKING LONG-TERM SOLUTIONS

TUESDAY, JANUARY 31, 2012

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:02 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Schumer, Cantwell, Nelson, Carper, Cardin, Hatch, Grassley, Snowe, Kyl, Crapo, Thune, and Burr.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Lily Batchelder, Chief Tax Counsel; and Tiffany Smith, Tax Counsel. Republican Staff: Jim Lyons, Tax Counsel.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Benjamin Franklin once said, "In this world nothing can be said to be certain except death and taxes." But today, not even our taxes are certain. There are currently 132 expiring provisions in the code. That number has more than tripled since 1998.

These policies, commonly known as tax extenders, expire every year or every 2 years. The lack of certainty about these tax incentives, I think, is not good for America, and it is not good for American businesses or for American families. It is bad for businesses looking to create jobs, and it is bad for our economy. It leaves businesses unable to plan ahead, unable to invest because year-to-year incentives are ineffective.

Many construction projects, for example, take at least 5 years to plan, finance, and build. When Congress passes an investment tax credit for only 1 year, there is no guarantee for a town, city, or developer to move forward with the 5-year project. But when Congress provides businesses with long-term incentives that cover their entire business plans, businesses can invest with confidence and our economy can grow.

Take the small wind investment tax credit as an example. In 2008, Congress provided more than 8 years of uninterrupted tax policy with this credit. The planning that Jenny Bryce of Belt, MT has been able to do thanks to the long-term nature of this tax incentive has helped her grow her business. Jenny owns Pine Ridge Products, a 15-year-old company with about \$800,000 of revenue per year.

Pine Ridge manufactures, services, and installs small wind turbines for farmers across Montana. A turbine installed by Pine Ridge costs about \$60,000, but has the ability to take a large farm entirely off the grid when the wind is blowing.

Sixty thousand dollars is a big capital investment for a farmer or a rancher. That is why Congress passed the small wind investment tax credit in 2008. It covers 30 percent of buying and installing a small wind turbine.

The long-term nature of this credit has helped create an industry that includes more than 80 small wind companies and thousands of American manufacturing jobs. For Jenny Bryce and Pine Ridge, it has led to a sustainable business.

But for other industries that rely on the tax code, the stop-and-start nature of year-by-year extenders has been disastrous. The biodiesel industry relies on a tax credit to help them compete against diesel fuel from petroleum. Originally created in 2004, the credit has been extended 3 times. In 2010, the credit lapsed for almost an entire year. That devastated the industry: more than 9,000 jobs were lost, 80 facilities shut down, and production dropped by more than 40 percent.

The industry is now trying to cope with another lapse in the credit. Companies are laying off workers and reducing production. This is unacceptable. We need to do better. For businesses to succeed, Congress must provide a stable and certain tax code.

And it is not just the biodiesel industry that is feeling the effect of lapse in tax extenders. Each year the number of extenders grows. Extending last year's provisions would have cost \$38 billion. Once in the tax code, very few provisions expire completely. They are added to the list of extenders, and the cost continues to grow.

We need to address these tax extenders to provide long-term certainty, and through tax reform we should evaluate each and every extender and determine whether it should be allowed to expire or be made permanent. We should either address each incentive's shortcomings and fix them, or we should let the incentive expire.

This process will take time, time that our recovering economy does not have. Each day that businesses do not know whether tax extenders will be in place this year means less American manufacturing, less production, and fewer jobs. In the meantime, we need to pass these tax incentives to help businesses and help business owners like Jenny Bryce in Belt, MT create jobs.

So as we work to pass tax extenders through this year, let us continue the hard work of tax reform. It will be very difficult, but very important. Let us consider whether we should retain these provisions or whether we should use the money to lower tax rates.

If we should retain them, let us consider how to reform them to get the most bang for the buck while making them permanent. Let us provide the certainty that our families, businesses, and economy need.*

[The prepared statement of Chairman Baucus appears in the appendix.]

The CHAIRMAN. Senator Hatch?

*For more information, see also, "Legislative Background of Expiring Federal Tax Provisions 2011-2022," Joint Committee on Taxation staff report, January 27, 2012 (JCX-6-12), <https://www.jct.gov/publications.html?func=startdown&id=4388>.

**OPENING STATEMENT OF HON. ORRIN G. HATCH,
A U.S. SENATOR FROM UTAH**

Senator HATCH. Well, thank you, Mr. Chairman. Mr. Chairman, there are not too many people outside, but, if they are willing to stand, we ought to let them in. There is a line-up out there.

The CHAIRMAN. Yes. I will look into that.

Senator HATCH. Yes, if you can. I would hate to see anybody not be able to attend if they want to.

I want to thank you, Mr. Chairman, for holding this hearing on tax extender provisions. It is difficult to find many people who argue that Congress can, or should, continue dealing with tax extenders in a business-as-usual manner.

The explosion of temporary tax provisions in recent years is a very notable and problematic trend. The number of temporary tax provisions has grown from 42 in 1998 to 154 in 2011. Even those tax extenders that are sound tax policy lose much of their power due to their temporary character. For example, Congress has recently allowed important temporary tax incentives, such as the Research and Development credit, to expire. Then, after business decisions have already been made, Congress has retroactively extended the tax provisions.

If a provision is worthy of being in the tax code, then it generally should be made permanent. For instance, the R&D credit is an extremely worthy provision, and it should be enhanced and made permanent, as Chairman Baucus and I proposed in a bill that we introduced in September 2011.

Certainty in the tax code is a very important factor in allowing businesses to plan their affairs, make investments, and create jobs. These job creators do not want bad certainty: they do not want to hear that their taxes are going up. Congress should provide this certainty by making permanent the provisions that are worthy of remaining in the law and eliminating those that are not.

Chairman Baucus and I agree, along with many of our colleagues, that the current tax code demands comprehensive reform, and I appreciate his leadership in this matter. In the meantime, before tax reform is accomplished, Congress needs to decide what to do about tax extender provisions that have expired. Now, that is the subject of this hearing, and I am interested in hearing the testimony of our excellent witnesses who are here today.

Mr. Chairman, I appreciate you holding this hearing, so that is all I need to say.

The CHAIRMAN. Absolutely, Senator. Thank you very much.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. We will now begin with our first witness, who is Dr. Rosanne Altshuler. Dr. Altshuler is professor and chair of the Economics Department at Rutgers University. The second witness is Dr. Jason Fichtner. Dr. Fichtner is a senior research fellow at the Mercatus Center at George Mason University. The third witness is Caroline Harris, chief tax counsel for the U.S. Chamber of Commerce.

Unfortunately, our fourth witness, Mr. Calvin Johnson, cannot join us today. His flight was grounded yesterday in Texas due to mechanical reasons. I might say it is rather ironic that that hap-

pened today, because today we are hoping to finalize bringing up the FAA reauthorization bill, including new funds for NextGen, which is the next generation of air traffic control technology. I do not know if that has much to do with a mechanical problem on an airplane, but nevertheless, it is regrettable that Mr. Johnson is not here.

Your statements will automatically be included in the record, and I urge each of you to summarize your statements. Get right to the point, be pithy, precise. Do not pull any punches. Life is short. You cannot take this day back. Tomorrow, it will not be here anymore.

So, Dr. Altshuler, you are first.

**STATEMENT OF DR. ROSANNE ALTSHULER, PROFESSOR AND
CHAIR OF THE ECONOMICS DEPARTMENT, RUTGERS UNI-
VERSITY, NEW BRUNSWICK, NJ**

Dr. ALTSHULER. Thank you. Chairman Baucus, Ranking Member Hatch, and members of the committee, it is an honor to appear before you today to discuss tax extenders and tax reform.

The vast majority of extenders we are considering today were originally enacted to provide specifically limited incentives for certain activities or investments. However, unlike other tax provisions that provide targeted tax benefits, extenders have a limited shelf life. Much like the items in the meat and dairy sections of the grocery store, our tax code is littered with expiration dates, and the past-due inventory is quite large.

More than 60 temporary tax provisions expired at the end of 2011. Each was enacted with an expiration date and, only with some exceptions, every one of those dates subsequently has been extended. In most cases, these temporary provisions have been extended over and over again for just a couple of short years, or less.

In fact, the packages of tax extenders we are considering today are now referred to as “traditional” tax extenders, making it hard to argue that they are not fixtures of our tax code. I believe that extenders must be considered within the context of fundamental tax reform.

In my written testimony I address the desirability of maintaining a tax code that includes numerous unrelated temporary provisions that are routinely extended and the need for tax reform. I recommend that, instead of arguing about which provision should be included in an extenders package, we should instead devote our energy to building a tax code that will allow us to face the daunting fiscal challenges ahead.

For many taxpayers who are impacted by one of these extenders, the ritual of being on tax code death watch, only to be saved by last-minute clemency, or in instances like this year, resurrection, creates tremendous volatility. This volatility not only creates uncertainty and perceptions that our tax code is unfair, it reinforces the view that the current legislative process is dysfunctional and our elected representatives are unwilling or unable to choose among competing priorities.

It is important to recognize that, by making these provisions temporary, Congress reduces their benefit. Businesses, for example, are not likely to make long-term investments based on subsidies

likely to disappear. Temporary provisions, by their very nature, are more likely to present taxpayers with windfalls for undertaking certain investments. As a result, they are less cost-effective than they would be if they were permanent.

Why does Congress do this? I identify three reasons in my testimony. First, tax policy is sometimes used as a stimulus measure in response to an economic downturn or to provide targeted disaster relief. These provisions should be temporary.

Second, the expiration date on a provision can be seen as a mechanism to force policymakers to evaluate the special treatment at a certain date. This reasoning is compelling in theory but has been an absolute failure in practice, as no real systematic review ever occurs. The extenders are traditionally considered and passed in their entirety as a package without critical review.

Finally, temporary tax legislation may simply, but sadly, be the result of Congress playing a budget game. If, as past history would strongly suggest, temporary provisions are never allowed to lapse, then they effectively become permanent features of the tax code that are not accounted for in the revenue baseline, since CBO must project that baseline using current law.

Since almost all extenders involve tax cuts, the assumption that they will be terminated makes the CBO project a healthier revenue baseline than is likely to occur. By making provisions temporary, Congress can effectively pass tax breaks that do not worsen the budget picture.

Based on the reasoning I just explained, I believe the traditional tax extenders should not be carried forward from year to year as temporary provisions. They are not stimulus or disaster measures. We have not subjected them to systematic review, and hiding the true cost of a provision by giving it an expiration date that is likely to be subsequently extended is not good or responsible budget policy.

The traditional extenders should either be permanent fixtures of our tax code or should permanently expire. In deciding whether to let the traditional extenders expire, I suggest we take the following two steps. First, isolate provisions that are fundamental structural policies of our current tax code and make them permanent. Provisions that are more properly considered structural features of our tax system, like the active finance exception, should not be temporary. Second, admit that the remaining provisions, however well-intended, should be evaluated along with similar permanent provisions within the context of fundamental tax reform.

In practice, that review should be forthcoming, as building the case for tax reform is easy. The current system is riddled with tax provisions favoring one activity over another or providing targeted tax benefits to a limited number of taxpayers. These provisions create complexity, generate enormous compliance costs, breed perceptions of unfairness, create opportunities for manipulation of rules to avoid tax, and lead to an inefficient use of economic resources.

The sorry state of our current system reflects that we have forgotten the fundamental purpose of our tax system is to raise revenues to fund government. I recommend a reform that broadens the base. This would force us to decide which special provisions to

keep in the code and how best to design them. It involves consolidating and simplifying duplicative versions.

It forces us to think about what goals we should try to achieve in the tax code on the individual side and on the business side, and, as such, a base-broadening tax reform is the perfect vehicle in which to consider the traditional tax extenders. The process of tax reform is not easy, but it is necessary. We need to keep our eyes on the prize.

A tax reform that broadens the base by eliminating temporary and permanent provisions that distort economic activity will leave us with a system that is less costly to our economy and raises more revenue. We should be thinking about the traditional tax extenders within this context. A new system would be perceived as being fairer than the current system and would also have the benefits of being considerably less complex and easier to administer.

Thank you. I would be happy to answer any questions you may have.

The CHAIRMAN. Thank you, Dr. Altshuler. That was a very good, comprehensive statement. I deeply appreciate it.

[The prepared statement of Dr. Altshuler appears in the appendix.]

The CHAIRMAN. Dr. Fichtner?

STATEMENT OF DR. JASON J. FICHTNER, SENIOR RESEARCH FELLOW, MERCATUS CENTER, GEORGE MASON UNIVERSITY, ARLINGTON, VA

Dr. FICHTNER. Good morning, Chairman Baucus, Ranking Member Hatch, and members of the committee. Thank you for inviting me to testify here today.

I would like to begin by first thanking Chairman Baucus and Senator Hatch for the leadership you provide this committee in ensuring that important public policy issues get the attention and debate they deserve, and also for ensuring that ideas and viewpoints from all sides are aired in a collegial and respectful manner. It is truly a privilege to be here testifying before you today.

There is no more important issue to discuss than tax reform. The most basic goal of tax policy is to raise enough revenue to meet the government's spending requirements with the least impact on market behavior. But the U.S. tax code has long failed to meet this aim.

By severely distorting market decisions and the allocation of resources, the tax code hampers job creation and impedes both potential economic growth and potential tax revenue. Many developed countries are both reducing their corporate tax rates and restructuring their corporate tax systems to make them simpler.

The United States appears to be taking the opposite approach. The very fact that we are here today to discuss the dozens of tax provisions that expired last year alone is evidence of the tax code's complex and temporary nature, two faults that increase both uncertainty and cost for American businesses.

While there appears to be widespread agreement on the need for tax reform, there is no consensus either between or within parties on specific elements of reform. To move the debate forward, policy-

makers need to know the goals of successful tax reform and what steps to take to achieve those goals.

Clearly, the Nation's increasingly dire economic and fiscal situation has increased the motivation and the urgency to reform the Federal revenue system, but what would an ideal tax code look like? Luckily, policymakers need not fly blind when it comes to defining the principles and goals key to a successful revenue system.

Academic research suggests that a successful revenue system should be, first of all, simple. The complexity of the tax code makes it difficult and costly to comply with. Congress should make the tax code as simple and transparent as possible so as to increase compliance and reduce compliance costs. It should be equitable.

Policies intended to benefit or penalize select individuals or groups riddle the tax code. These policies also result in immeasurable unintended consequences. Fairness is subjective, but tax fairness would at least reduce the number of provisions in the tax code that favor one group's economic activity over another. The government should not be in the business of picking winners and losers.

It should be efficient. Because the tax code alters market decisions in areas such as work, saving, investment, and job creation, it impedes economic growth and reduces potential tax revenue. An efficient tax system must provide sufficient revenue to fund the government's essential services, with minimal impact on taxpayer behavior.

It should be permanent and predictable. The negative effects of the current tax code result not just from what it does today, but also what it may do in the future. Such uncertainty deters economic growth. An environment that is conducive to growth—and thus increases revenue as a result of a larger economy—requires a tax code that provides both near- and long-term predictability. Temporary tax provisions should be avoided.

Instead of focusing on ways to increase revenue, focus should be directed on ways to increase economic growth, savings, and investment. A larger economy will result in larger tax revenue. We do not need just more revenue, we need a better revenue system.

Exhaustive economic research repeatedly proves the most basic effect: the more you tax capital or labor, the less you get. It also makes clear that incentives matter. One of the keys to successful reform is to move away from a spending system that depends heavily upon an easily manipulated income tax system.

Tax reform should lower rates, broaden the base, and eliminate loopholes. This will increase stability and lead to economic growth, added employment, and increased revenues.

For those who advocate for higher taxes on business, it is important to note two things. First, the United States' corporate tax rate is among the highest in the industrialized world. This increases businesses' flight to lower-tax countries, taking their jobs, money, and tax dollars with them. Second, a tax on corporations is actually a tax on labor. A Congressional Budget Office working paper finds that domestic labor bears slightly more than 70 percent of the burden of the corporate income tax. For economic efficiency, it is important that income be taxed once, and only once.

There is much concern today that those who report significant earnings from capital gains or dividends pay a lower tax rate than those with ordinary income, but this fails to accurately reflect the incidence of a corporate income tax.

One of the reasons why we currently have a lower tax rate for individuals on capital gains is to account for the fact that capital gains income received by an individual was first taxed at the corporate level, up to 35 percent. Hence, if a corporation first pays a maximum statutory tax rate of 35 percent on each \$1 profit, leaving 65 cents of retained profit to be distributed, then combining the individual's 15-percent tax rate yields a combined tax rate of 44.75 percent.

As you consider which tax provisions to extend or which ones should remain expired, promote provisions that level the playing field so everyone plays by the same rules, and also promote those provisions that move toward fundamental reform over provisions that discriminate. The United States has an infamously dense and complicated tax code that is in dire need of simplification. Temporary tax provisions only further the day of reckoning and postpone the tough choices that need to be made.

Thank you again for your time and the opportunity to testify today. I look forward to your questions.

The CHAIRMAN. Thank you very much, Dr. Fichtner.

[The prepared statement of Dr. Fichtner appears in the appendix.]

The CHAIRMAN. Ms. Harris, you are next.

**STATEMENT OF CAROLINE L. HARRIS, CHIEF TAX COUNSEL
AND DIRECTOR OF TAX POLICY, U.S. CHAMBER OF COMMERCE,
WASHINGTON, DC**

Ms. HARRIS. Good morning. My name is Caroline Harris, and I am testifying on behalf of the U.S. Chamber of Commerce.

Mr. Chairman, Ranking Member Hatch, I want to thank you and the rest of the Senators for your time and the attention you are giving to tax extenders today. I also want to thank you for your continuing efforts towards fundamental tax reform.

Today I urge you to act immediately to extend all of these provisions. While we are continuing down the road to fundamental tax reform, we simply are not there yet, and you need to extend these provisions in the meantime without delay.

Businesses' reliance on these provisions is both rational and reasonable. Many of these are longstanding pieces of the code. For example, the active finance exception has been in the code for 91 of 102 years of its existence. The R&D tax credit has been in code for 30 years. Despite their expiration dates, they are not construed as temporary.

Inaction on these provisions has real consequences. Businesses need certainty and predictability. Retroactive tax policy simply does not achieve these goals. At times, the failure to extend these provisions hurts the very purpose for which they were enacted. This is particularly apparent with provisions intended to incentivize certain behaviors. When Congress fails to act, provisions such as the wind production tax credit, the Energy Efficient Appliance Credit, and the Biofuel Credit do not operate efficiently.

Industries that are in their infancy are damaged because the code provisions they need to rely on to build up are not there. The damage is real, as products are not developed and projects are not undertaken. The damage of not acting to extend these provisions is not limited to new industries.

Provisions that strive to ensure competitiveness are also damaged. The active finance exception ensures that the passive nature of the financial services sector income does not result in immediate double taxation that comes under our worldwide tax system. This brings that industry into parity with other American worldwide companies and allows it to vie with foreign competitors.

The CFC look-through rules assure that American companies can operate and structure their foreign operations without a second layer of tax. This also allows them to compete against foreign competitors.

Finally, the R&D tax credit, which I briefly mentioned before, added to the code 30 years ago—we were the first country to do that. Now we rank 17th in a recent survey. When we lose the R&D incentive, we lose the jobs and markets that come with it.

The global economy is going around us, and we simply must give our companies the tools to compete. It is not just global competitiveness, it is on a national level also. Extending the deduction for State and local sales tax is necessary to bring into parity the treatment of States that rely on the sales tax as opposed to States that use an income tax for the income source. The damage to competition, both locally and globally, is real.

Finally, I would like to suggest that inaction also hurts the ability of businesses to grow and compete. Provisions targeted towards quicker cost recovery, which put cash in the pockets of businesses so they can create jobs and expand, are also hindered. Provisions such as the 15-year restaurant and retail provisions, the section 181 Film Production Credit, as well as the Railroad Track Maintenance Credit, are all necessary to provide businesses access to capital so they can grow.

Congress must act now to extend these vital provisions. The policies that underlie them—ensuring competitiveness, allowing proper cost recovery, companies seeking predictability and certainty—are the exact policies you should be looking at as you strive towards fundamental tax reform. But we are just not there yet. So in the interim, so businesses can succeed, you need to extend these vital provisions.

Thank you for your time, and I am happy to take any questions.

The CHAIRMAN. Thanks, Ms. Harris.

[The prepared statement of Ms. Harris appears in the appendix.]

The CHAIRMAN. I would like to ask each of the three of you if the framework on how to deal with these makes sense or not. I am struck with the quite stark difference in views that you have.

Ms. Harris, you would extend them all, if I heard you correctly, and maybe Dr. Altshuler would get rid of them all, or at least postpone, do not pass them this year and look at them in the context of tax reform for perhaps next year. Clearly, many talked about simplifying the code, to broaden the base, lower the rate.

By definition, when you broaden the base, you have to get rid of some of the expenditures, tax expenditures, in order to lower the

rate. I presume, Ms. Harris, you are in favor of broadening the base and lowering the rate as a principle.

Ms. HARRIS. That is correct.

The CHAIRMAN. But it is hard to do when we keep all our current tax expenditures. That makes it hard to lower the rate at the same time. So I am going to ask you, does this framework make sense? That is, we should look at each of these extenders and try to determine whether they are worth retaining. Some are probably worth more than others. That is, it is probably worth retaining if the value to the economy is greater than the increase in the marginal rates necessary to pay for them.

Congress decided that the Ethanol Tax Credit was not worth it anymore. That is, the industry is doing just fine and did not need a \$5-billion credit. That may apply to other credits, exclusions, and deductions. To some degree, we are confining this hearing to so-called traditional extenders, but there are many other tax expenditures where that framework could be applied.

So I am asking you, the three of you, is that a good way for us to look at this issue? I think the code is way too complex. I think there are too many extenders. I think we should get rid of a good number of them. I think that they should, as much as possible, be permanent, or they should be repealed.

But in order to make that determination, to the degree that anybody agrees with me around here, we have to look at each and try to find some objective criteria that make some sense. I am suggesting that the criteria should be, is it worth retaining? That is, is the value to the economy of this particular provision greater than the increase in marginal rates? Obviously these can be tailored to this, so this is not a black-and-white, either/or question.

But I will start with you, Dr. Altshuler.

Dr. ALTSHULER. Thank you. Actually, what I recommended is to take two steps and, first, to isolate any provisions that really should be structural features of the tax code but that somehow, for revenue reasons, ended up being extenders.

As an example, I pointed out the active finance exception. The point is, if the tax system is going to provide deferral for active business income of U.S. corporations earned abroad, then it should provide deferral for all active business income. And there may be other extenders that should be structural features of the tax code and for some reason we are just carrying them along as extenders.

Now the rest that are not structural features of the tax code—yes, in theory, it is a great idea. Let us go through each one of those, all 59, 58, and do a cost/benefit analysis, look at whether or not they are good for the economy, they are doing what we want them to do. But let us face it. I am very skeptical that we are actually going to do that.

The CHAIRMAN. Skeptical because?

Dr. ALTSHULER. I think we do not have the resources.

The CHAIRMAN. Therefore, what should we do?

Dr. ALTSHULER. Let me just—

The CHAIRMAN. I am pushing you because there are two other witnesses, and I do not have a whole lot of time here.

Dr. ALTSHULER. Yes. But then I have another question: why do those and not look at the other provisions that we have, the other

special tax provisions that we have in the tax code? Why are we not reexamining all of the cost recovery system instead of looking at cost recovery for racetracks or cost recovery for restaurants?

The CHAIRMAN. All right. That is a fair point.

Dr. Fichtner?

Dr. FICHTNER. So, Mr. Chairman, in general I agree with you. It would be great to go through and say, where we are today, we want to do fundamental tax reform. We cannot do it today, we cannot do it this month, can we do it next year? If that is the case, what extenders should keep going forward so businesses have some certainty, at least for this year, for their tax planning?

But, if you go through those lists, it is important to be very transparent to the public about which ones you are extending because you think they are going to be wrapped into fundamental tax reform and which ones are not. If you find ones that are not going to be wrapped into fundamental tax reform, the question is, why do you keep them there?

The CHAIRMAN. Ms. Harris?

Ms. HARRIS. Yes. I think the changes to the code should only be made in fundamental tax reform, but I do completely agree with you that we need to broaden the base, lower the rate, and simplify. When I can list off just three provisions off the top of my head that impact cost recovery, certainly we can come up with a system that ensures proper cost recovery but does it in a more simplistic manner that does not require industry-specific rules like that.

I think those changes, however, should only be made in fundamental tax reform, for the reason that businesses plan outside a 1-year period and have relied on the assumption that these provisions will be in place.

The CHAIRMAN. So you are saying, extend them now but, in tax reform, look at them all very, very carefully.

Ms. HARRIS. Exactly.

The CHAIRMAN. Get rid of a good number.

Ms. HARRIS. Exactly. That is correct, Mr. Chairman.

The CHAIRMAN. All right.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

Now, this question is for the whole panel. Over the course of last year, numerous executives, small business owners, and academics alike stressed the need for tax reform. Now, I happen to agree with their position. We desperately, in my opinion, need to reform our tax system to make it more efficient, more competitive internationally, as well as domestically.

So my question is simple. Does it make sense to extend some or all of these temporary provisions ahead of tax reform? I will start with you.

Dr. ALTSHULER. I think I will say what I said before: some of them should be structural parts of the tax code. Isolate those. Then—this is a difficult thing to do, but maybe this is what will force tax reform: they have already expired. Keep them expired.

Senator HATCH. All right.

Dr. Fichtner?

Dr. FICHTNER. Senator, I think my feeling is, and you have stressed the importance, as has Chairman Baucus, about the need

for fundamental reform. We really need them before that, but looking at the tax extenders, especially with small businesses and some pass-through treatment, I am concerned that, if we do not extend those at least, we are not going to have a level playing field.

Some of those extenders for businesses are actually meant to level the playing field with our foreign trading partners because we have a worldwide tax system, not a territorial one. And I think we should keep those but make it clear we are moving towards a system that is going to lower rates, broaden the base, and move more towards a territorial tax system, because our worldwide tax system basically is a tax on our exports. So, when we have those tax extenders now that level that playing field and treatment, I think we should keep those as we go towards fundamental tax reform.

Senator HATCH. Thank you.

Ms. Harris?

Ms. HARRIS. Thank you, Mr. Hatch. I would recommend that we extend all the provisions, as I stated previously. I think that businesses, whether the provisions have expired or not, are relying on these, and it is only fair that we continue these and absolutely have a discussion in fundamental tax reform about what we do and do not need in the code.

Senator HATCH. Well, thank you.

The last 2 times the tax extender package has been enacted, it was done nearly a year after the tax extender provisions had expired. In my opinion, that is not a way to run a railroad. Can you talk about the impact of uncertainty of whether certain tax provisions will be extended and what effect the uncertainty has on job creation, retention, and investment in the U.S. economy? Dr. Altshuler?

Dr. ALTSHULER. Uncertainty is bad for business decisions, for individual decisions. But the fact that you are extending these retroactively means that you are giving windfalls. The decisions have already been made. But uncertainty does breed perceptions of unfairness. It makes it very difficult to make decisions. It is a terrible thing to be imposing on the American people because we cannot decide what we want to do with tax reform and what we want to—

Senator HATCH. Do you other two agree to that?

Dr. FICHTNER. Generally, yes. But what I would add to that is, it is very important, whatever extenders you are going to extend, do them now, because of the uncertainty. What you do not want is getting to the last minute on December 31 and trying to do them retroactively. One, it does create a windfall, but there are still businesses at the margin that might say, maybe I should not make this investment in the United States because I am not sure if Congress will pass the extension. So whatever we are going to do, we should do it sooner rather than later.

Senator HATCH. All right.

Ms. HARRIS. I would agree. I think the damage is real. Things like the wind production tax credit, for example. That goes to the end of 2012. If you do not have that in place by April of this year—there is an 8-month build-out period for those projects. They simply will not get done. Biofuels is another example.

The chairman, in his opening statement, hit on the fact that we did not do that until the end of 2010. You saw about a 40-percent

drop in projects. I think you see the same thing in the energy-efficient appliance arena. You see companies that just do not develop the products because those incentives are not in place.

Senator HATCH. Well, the chairman and I have both been strong proponents of permanently extending the R&D tax credit. We call it the Research and Development Tax Credit. It has sunset more than 13 times in the last 30 years. Most R&D credit projects are typically planned for and budgeted for years in advance.

Thus, at the time of planning and budgeting of an R&D credit, much of the time of the project will be for periods that the credit, under law, will not exist. Now, the point of the credit is to incentivize R&D that would not happen but for the credit's existence.

Now, however, most significant R&D projects are planned years in advance. That is, the budget for them may be determined many years in advance. However, if the credit is scheduled to expire soon, or already has expired as is the case now, then the incentive effect on companies from the credit would seem to be greatly diminished.

Now, on the other hand, perhaps it is the case that the high-tech firms are getting so used to the credit expiring and being extended, that they in fact do take it into account when creating their R&D budgets, figuring that Congress will eventually get around to extending it anyway. Now, what is your view on this? How much is the incentive effect undermined by not having a permanent credit?

Dr. ALTSHULER. I am not sure how a business would be treating a provision that has been continuously extended. It was allowed to expire one year. We have the credit because we think the social returns are greater than the private returns for research. The question is, with a credit like this, are we looking at the right research?

Are we incentivizing the research that has the social returns that are greater than private returns? At this point, it is not clear that the credit is not just an after-thought that the tax group does when they are doing their returns. So, in other words, it is not clear that it is incentivizing anything. Yes, to be short, by having a temporary provision, we are greatly reducing any incentive effects.

Dr. FICHTNER. I think I would add to that, Senator, again, that having things temporary would not only reduce the incentive effects, but you add uncertainty. So you will have businesses at the margin looking at, do I really want to do this, not knowing if Congress is going to extend this, repeal it, let it expire.

I cannot quantify to you how much that is, but just common sense would say that would affect a business decision. Right now in this economy, the last thing we need is more uncertainty. Where we can have certainty, we should have it.

Ms. HARRIS. I think it does impact business decisions, and I think one of the things, particularly with R&D, we need to think about is the fact that the global economy is moving forward with the incentives they offer, so the company is, as you said, going to make a multi-year decision about R&D investment. It becomes a matter of, is this incentive here in place or do we go overseas with this? So I think it is incredibly important, in a global economy, for the U.S. to maintain and somehow figure out how to seamlessly extend the R&D tax credit.

Senator HATCH. Thank you.

Senator Cardin, you are next.

Senator CARDIN. Thank you, Mr. Chairman. And let me thank our witnesses. There is no question that I agree with the point of Dr. Altshuler, that we pay a price for the uncertainty and it reduces the benefit when we have these temporary extensions.

I think there is more consensus here that we should either make these provisions permanent, we should eliminate them, or we should have a finite reason as to what the termination date is, and we should not have an extender list.

I mean, I think that is where we need to be. I strongly support tax reform, but I want to point out the urgency for us to act on many of these provisions. Tax reform is uncertain. The consequences of failure to act on extenders is known, and we need to take action. I am going to talk a little bit about the predictability, and also the difficulty of doing this retroactively, and I would appreciate any comments from our witnesses.

We have an energy crisis in this country, and I think we all agree that we have to encourage all of the options, including alternative energy. The consequences of failure to act on many of these energy credits will have major impact.

Mr. Chairman, I want to point out to our witnesses that it is not just the list that legally expired at the end of last year. There are other examples, particularly with the production tax credit for wind and trash facilities—one expires at the end of this year, one at the end of next year—that effectively have expired, and they need to be on our list.

I could give you an example. In my home State of Maryland, a trash facility is being proposed in a brownfield site, and it is unlikely it could be put in service until the first quarter of 2014. Well, the production tax credit, for all intents and purposes, has expired. If we want to encourage this type of energy supply, we have to act now.

The wind industry—Senator Cantwell is here. She has been a leading proponent of expanding that tax credit. Let me just quote from *The Energy Daily*, which says, “Wind industry not crying wolf over expiring tax provisions. Industry officials Thursday warned in unusually stark terms that their industry faces catastrophic contraction if Congress fails to extend a renewable electricity production credit by the end of March.” Now, that may not be formally on our list, but effectively the production tax credits are no longer available. We need to act.

And let me just talk a little bit about the issue of retroactivity, because some of us say, all right, we can wait a couple more months, we will do it later this year, we will do it when other issues are before us. But let me just tell you that that will not work for many of our credits. Let me talk, if I might, about the transit issue that expired at the end of last year.

If someone on my staff commuted from Shady Grove Metro stop in my home State of Maryland to Union Station, and they commuted during rush hour each way, 5 days a week, they would spend about \$200 a month in Metro fares. Last year they could get the tax benefits of that \$200. Effective January, with the reduction to \$125, they now are finding themselves \$75 out of pocket.

Many of those people are going to just do the math and say, I get free parking here, I might as well drive, adding to the congestion, adding to the energy consumption, adding to all the challenges that we have. That cannot be fixed retroactively. Those decisions are being made now. We cannot wait for tax reform to get that done.

So I guess my point is, Congress needs to act, and it needs to act as soon as possible. And yes, we all agree we should have a finite tax policy in this country. I would just welcome your thoughts as to the need for action now and not waiting for retroactive fixes in December, perhaps.

Dr. ALTSHULER. My response is, it is all just very depressing. I was depressed about the tax code before coming to this hearing, and, in preparing for this hearing and looking at all the temporary tax provisions that we have, I got even more depressed, which I thought was impossible.

So now what we are saying, we all agree that we need a tax reform, we need to broaden the base. There is—

Senator CARDIN. Well, I guess my point is—and my time is running out.

Dr. ALTSHULER. The time is running out. I am one of those commuters. I have been impacted by that. I had to go through a lot of paperwork to do all of the things. I got a transit card. I have all of that. Now it is worth a lot less. I also have a car I may start driving, yes. But what this ends up doing, we have to understand, we are adding a bunch of special provisions, we are picking winners and losers. We are not facing the fiscal challenges that we have ahead. We are constricting the tax base.

Senator CARDIN. And I agree with your point. But the transit provisions were aimed at equalizing the breaks that we are already giving for subsidizing parking, et cetera.

Dr. ALTSHULER. We have to go back and think about whether—with all due respect, we have to go back and think about whether or not we want that in the tax code.

Senator CARDIN. Absolutely.

Dr. ALTSHULER. And I do not know how we are going to tie all of our hands to do this, but this is not how we do a fair, simple tax code that Americans can understand and have faith in. We need to think about where we should be putting special provisions, and I think we should wipe the slate clean.

Senator CARDIN. If I could just give Ms. Harris a chance to respond, because I think she wanted to respond. Very briefly, because I have run out of time. The ability to retroactively fix later this year, there is a price to that.

Ms. HARRIS. There is absolutely a price. First of all, the Chamber is very supportive of immediate action on the transit provision. We also do believe, as you mentioned earlier, that there are real ramifications of retroactivity, things like the wind production tax credit, not seeing those things undertaken. The Energy Efficient Appliance Credit, I mentioned.

The area you mentioned, energy incentives, is extremely sensitive to this retroactivity, and it is because these industries are in their infancy. They need these provisions in the code to get up and

running and become fully operating markets, so we absolutely are very aware of retroactivity and its ramifications.

Senator CARDIN. Thank you for your patience, Mr. Chairman.

Senator HATCH. Thank you.

Senator Grassley?

**OPENING STATEMENT OF HON. CHUCK GRASSLEY,
A U.S. SENATOR FROM IOWA**

Senator GRASSLEY. To the panel and to my colleagues, I prefer to make a statement as opposed to asking questions.

There are almost 60 provisions that expire at the end of 2011, and there are even more that expire at the end of 2012. There is general agreement that all of these extenders need to be reviewed in the context of comprehensive tax reform. As we begin to consider what such reform would look like, it is important to discuss what, if any, goals or objectives other than revenue collection the tax code should accomplish.

The provisions that expired at the end of last year have various objectives. The non-revenue policy objectives vary from energy independence to job creation, from encouraging donations to charity to incentivizing capital investment and research.

This committee has held numerous tax reform hearings in the past 2 years, yet we have not discussed what we should do about the numerous non-revenue policy objectives included in the current tax code. This has also been ignored by various witnesses who have come before our committee over the past 2 years, including those here today.

In his written testimony, Mr. Johnson, who could not attend, whimsically picked winners and losers by focusing on revenue impact, but failed to address the non-revenue reasons for many of the expired provisions. He says they should remain dead; however, he does appear to support a movement to alternative fuels "because we import oil from troubled spots in the world and because fossil fuels pollute and lead to global warming."

However, he believes the existing regime of tax incentives should be eliminated because movement to alternative fuels is better accomplished through a carbon tax. He believes that the oil industry is under-taxed. While I appreciate his support for alternative energy, his statements ignore the need to consider whether tax provisions should be a part of a domestic energy policy that includes oil drilling.

Ms. Sherlock, a witness at the December 14, 2011 hearing on energy tax extenders, noted in her written testimony: "The income tax code has long been used as a policy tool for promoting U.S. energy priorities." The oil and gas industry have received massive permanent tax breaks for over 100 years.

In contrast, tax incentives for alternative energy have existed only a few decades and have always been temporary. These incentives first appeared in the 1970s in direct response to the oil crisis, and they helped to incentivize renewable fuels. Yet discussions on incentives for the oil industry and for alternative energy often fail to consider that a key reason to support renewable energy sources should be energy independence.

The United States sends more than \$400 billion each year overseas to buy foreign oil. Now more than ever the United States needs to ramp up domestic production of traditional energy, including oil, natural gas, and coal and expand alternative fuels and renewable fuels, including wind, solar, hydropower, biomass, and geothermal.

The U.S. Treasury pays out an average of \$84 billion a year to defend the shipping lanes by which foreign oil reaches the United States. I do not see these costs in discussions of cost-effectiveness of energy tax incentives.

Aside from energy independence, it is also important to consider the number of domestic jobs supported by the energy sector. Clearly, in the short term Congress should extend tax incentives for alternative energy sources. With the economy still sputtering, we cannot afford the job losses that occur from pulling the rug out from under the industries, like biodiesel and wind, that are still developing.

I will take up where Senator Cardin left off. The biodiesel credit, when it lapsed 2 years ago, 23,000 jobs were lost. When the wind credit lapses—the credit will not lapse, but the production of components will end—in about March, 4,000 jobs just in my State of Iowa will come to an end.

In the long term, however, we need to consider whether a permanent and comprehensive energy tax policy is appropriate, and such a policy should be developed in the context of comprehensive tax reform. For sure, we need a tax system that is less complicated, fairer, and will make us more competitive in the global economy. However, we need to consider whether and how to balance these principles against non-revenue policy objectives of our priorities. Energy independence is only one such objective.

Thank you for your time.

Senator HATCH. Well, thank you, Senator.

Let us go to Senator Burr.

Senator BURR. Thank you, Mr. Chairman.

What strikes me is not the compelling reason that any one of these extenders should be acted on versus another, it is the fact that this hearing probably should be about comprehensive tax reform and not on the extension of these special benefits.

Let me ask all of you for just a really quick answer. If we did comprehensive reform, would we have a need for tax extenders?

Dr. ALTSHULER. As I said in my testimony, we may have a reason to have stimulus measures and special provisions for when there is an economic downturn or when there is some sort of a disaster, but otherwise, no, we would not.

Senator BURR. Dr. Fichtner?

Dr. FICHTNER. Senator, I would say the same thing: no. If the general idea is, if we can do fundamental tax reform that lowers the corporate tax rate to, say, 25 percent or less, broadens the base, and gets rid of most of these extenders, you would not need them.

As Dr. Altshuler said, there may be some extraordinary times that come about, disaster relief, when you would have to do something, but then it would really be a temporary measure for a temporary condition. The fact that we now have what I call a perma-

ment temporary tax policy is unfortunate and actually drives a lot of bad business—

Senator BURR. Does the Chamber agree with that?

Ms. HARRIS. I would absolutely agree. In an ideal world, we need permanent provisions, except for the reasons of disaster relief or things like that. Yes.

Senator BURR. In a short answer, set aside the current debate on tax extenders. Is our tax code too complicated?

Dr. ALTSHULER. Absolutely.

Dr. FICHTNER. Yes. The fact that we are here today talking about 59 provisions that expired last year alone is an indication of the complexity of the tax code.

Ms. HARRIS. I would completely agree with both of them.

Senator BURR. Dr. Fichtner, let me go to something in your written testimony that you did not give in your verbal. You said that to increase employment and expand their economies, most developed countries are both reducing their corporate tax rate and restructuring their corporate tax system to make it simpler.

The United States appears to be headed in the opposite direction. The very fact that we are here to discuss the dozens of tax provisions that expired last year alone is evidence of our tax code's complex and temporary nature, two faults that increase both uncertainty and costs for American business.

Would you like to expand on that at all?

Dr. FICHTNER. Senator, right now we have the second-highest corporate tax rate in the OECD, and, if Japan lowers their rate as they are expected to this coming spring, we will have the highest corporate tax rate in the OECD.

Businesses, just like people, respond to taxes. Higher taxes reduce capital and reduce investment, and businesses will flow to lower-tax organizations. The complexity we have here in the U.S. tax code is a cost for businesses, and, when costs are high, businesses relocate. We are seeing with other countries, as they lower their tax burden and lower the complexity, business thrives there.

So, if we want to increase our competitiveness, we have to move away from a worldwide system and more towards a territorial tax system while not taxing our exports, and also reducing complexity so that businesses want to create jobs here.

Senator BURR. I think we have bipartisan agreement in the country that the number-one challenge is to get an anemic economy growing and, more importantly, that we get jobs created out of it. So let me go to another area of your written testimony that was not in the verbal. You said one thing we should not do is raise taxes. There is much research to support the negative consequences of raising rates on economic growth.

Research by Christina Romer, the former chair of President Obama's Council of Economic Advisors, and David Romer suggests "a tax increase of 1 percent of GDP reduces the output over the next 3 years by nearly 3 percent." Further, according to research by Harvard University economist Jeffrey Miron, both macro- and micro-economic perspectives suggest that the higher taxes slow economic growth by limiting the scope for revenue gains. To regain the competitiveness, the U.S. tax rate should be reduced to at or below the 25-percent average rate of OECD countries.

Now, are you suggesting in that that it is impossible for us to restart the economy to the growth rate that we need without comprehensive tax reform being part of that?

Dr. FICHTNER. Senator, first of all, I thank you for reading the written testimony that I submitted. Generally, I think it is not impossible, but it is very, very, very difficult to restart this economy and put us on a long-term path for growth if we do not fundamentally reform our corporate tax system. It is broken. If we do not fix it, we are just shooting ourselves in the foot.

Senator BURR. Are the consequences of not acting on tax reform the same as the consequences of not acting on the tax extenders?

Dr. FICHTNER. I think you would have to look at that holistically, Senator. I think one of the questions is, if we keep doing tax extenders on a temporary basis but keep doing it permanently so we have a permanent temporary tax policy, that is detrimental to our economy.

Senator BURR. Well, I think Dr. Altshuler, in her testimony, alluded to the fact that every year we get less value for the benefits from tax extenders, in part because of the way we do them and in part the choice of where we make the extensions.

My time has expired. I thank the witnesses, and I thank the chair.

Dr. FICHTNER. Thank you, Senator.

Senator HATCH. Thank you, Senator.

Senator Carper, you are next.

Senator CARPER. Thank you, Senator Hatch.

Welcome. It is nice to see all of you. About 12 miles due east of Rehoboth Beach, DE is the Atlantic Ocean. There is a place out there, for reasons that are not altogether clear to me, where the wind blows pretty well all the time.

It reminds me a little bit about the story of Goldilocks: the porridge that was too hot, was too cold, and the porridge that was just right. The wind 12 miles east of Rehoboth Beach blows just right most of the time in order to enable us to deploy off-shore windmill farms and to turn that wind into electricity.

As you know, we are seeing introduced a whole generation of new vehicles in this country. Back at the Detroit Auto Show, again about a month ago, instead of seeing big gas-guzzler vehicles, large trucks and SUVs and Humvee-like vehicles, we were just seeing very energy-efficient vehicles, hybrids, plug-in hybrids, and so forth, made here in this country and other places.

Some day we are going to have millions of those vehicles make their way around this country, especially in the northeast corridor, and we have the opportunity to reduce our independence on foreign oil by fueling them with electricity that we derive off of our shores, much like people in Europe do and other places around the world.

There are a couple of provisions in the tax code that are designed to encourage and incentivize the creation of electricity by wind. For the most part, they have helped to grow an on-shore wind capability, and that is, I think, perceived quite nicely. Even though there are a lot of windmill farms off the coast and in the water around Europe, there are none here.

We have two provisions in the tax code: one is an investment tax credit, a 30-percent tax credit for deployment of offshore wind to

help buy down the cost and incentivize folks to invest in it, and the other is a production tax credit.

I hosted, along with Senator Coons and some others, a summit about 2 months ago for what we have to do in this country to actually get into the offshore wind business, and it turned out that the production tax credit does not do much for us because you have to have the windmill farms out there working in order to actually produce some electricity.

What we heard from folks throughout this country, not just from the windmill companies and the wind companies, not just from the utilities, not just from the folks in the environmental crowd, not just from financiers all over the world, they said, you have to have an investment tax credit to actually build some. That is the key single most important thing if we are going to realize this potential.

Senator Snowe—I do not know if she has been here today—and I have introduced a bill that would somewhat modify, but extend, the investment tax credit that we have in place now. What we suggested is not a 30-percent investment tax credit that would be extended for a year or 2 or 3. What we suggested is that the tax credit would inure to companies that realized the first 3,000 megawatts of electricity generated using the tax credit. That might be a couple years, 2 or 3 years, but it would not be just like a year.

The idea is to say, this is it. The dial can go up to 4,000 megawatts or go down to 2,000 megawatts, but that is what we are suggesting. I very much want us to realize this potential as other nations in Europe are doing. I think it makes a lot of sense for our country for reasons that I think are probably clear.

I would just welcome your thoughts on the provision that Senator Snowe and I have offered. As we look beyond this year, the investment tax credit expires at the end of this year. So, please.

Dr. ALTSHULER. I think that energy tax policy reform should be part of tax policy reform. If we decide that a provision like that is cost-effective and should be in the code—doing that, taking into account the revenue costs and what that means for the corporate tax rate, what that means for the base, if we decide we want to do that—it should be permanent.

Senator CARPER. Thank you.

Dr. FICHTNER. I would add, Senator Carper, one of the ways an economist looks at tax policy is how the government involvement changes market decisions on supply, demand, and investment, and what I try to avoid when I look at policies is having government pick winners and losers.

But, as Senator Grassley pointed out, and you as well, energy policy is a little bit different. Energy policy has national security implications for this country. So I agree with Dr. Altshuler that we should look at energy policy reform in the context of fundamental tax reform.

When we can start looking at things in the context of, what are we doing with energy policy to make sure it is part of national security, that changes how you might view a tax policy provision. So supporting those provisions may make good sense.

Senator CARPER. All right. Thanks so much.

Ms. HARRIS. I would agree that you should look at energy tax provisions in the context of fundamental reform. I also think that your suggestion that this provision should be more than a year or 2 years, we should absolutely strive for permanency in the tax code as well, as it provides businesses certainty and predictability.

Senator CARPER. All right. Thanks.

What we have in mind is not something that would be permanent, but actually be there long enough to actually encourage the kind of investments that are needed. All right. I think my time has expired. I just wanted to have the opportunity to get that on the table. I appreciate your comments and the opportunity to raise the issue. Thanks so much.

Senator HATCH. Well, thank you, Senator Carper.

Senator SCHUMER, you are next.

Senator SCHUMER. Thank you, Mr. Chairman.

I am going to focus a little bit on one of the tax extenders that matters a great deal to me, which is the transit benefit and its time-sensitive nature. I believe, of all the extenders that expire, this is the one that is hardest to go back and do retroactively, and we should not wait for the end of the year.

It faces unique challenges with respect to retroactive enactment. In addition to the technical challenges that come with applying tax relief retroactively, that is a problem for many, if not all, of the provisions.

For instance, no one is going to build a wind farm if they think, well, maybe in December we will do something retroactively. They will not get the financing or whatever. But there is an additional practical challenge for the transit benefit because the benefit already exists in permanent law for employees who drive to work.

So what this means is that, if you are an employee given the choice to drive to work, park, and get your associated costs fully covered by the commuter benefit, or alternatively use public transit and get about half the same benefit because the transit relief expired at the end of last year, what would employees choose?

Once they choose it, it is hard to get them to go back. It is also hard to make this happen retroactively the way it is a part of everybody's individual paycheck as opposed to a big provision that comes at the end of the year.

So I want to make clear that, in this particular instance, we have a discrepancy between a permanent provision in the code for drivers and a temporary provision in the code for transit riders that will drive behavior—no pun intended—and do so in a way I believe is contrary to sound public policy.

So I would like your comments on the idea of retroactivity for this, why you might disagree, if you do, on the special nature of the transit benefit, and particularly the disparity between having the parking benefit be permanent and the transit benefit be temporary.

Dr. ALTSHULER. I am one of those commuters, so I am upset.

Senator SCHUMER. All right.

Dr. ALTSHULER. I wrote in my testimony that you should look at provisions that should be structural parts of the tax code. Now I am not sure that a commuter benefit should be a structural part

of the tax code, but you might want to argue that, if you have that as a structural part of your tax code, then you should have parity.

Senator SCHUMER. Right. That is the point.

Dr. ALTSHULER. I will give you that. But, as somebody who believes in a broad base, I am not sure there should be any commuter benefits.

Senator SCHUMER. Right. I understand that is your view. But, if you are having one, you ought to have the other. Is that right?

Dr. ALTSHULER. I hate to say that because again——

Senator SCHUMER. Come on. You could. It will not hurt as much as you think. [Laughter.]

Dr. ALTSHULER. But I did try to single out structural——

Senator SCHUMER. Yes. All right.

Dr. Fichtner?

Dr. FICHTNER. Yes. Senator, I actually completely agree with you. One of the things we are looking at on tax reform with these extenders is, are you leveling the playing field? As you said, there is an unfairness right now.

Senator SCHUMER. Right.

Dr. FICHTNER. I drive to work. My employer pays for my parking spot.

Senator SCHUMER. Yes.

Dr. FICHTNER. I do not want higher taxes, but I do not think the government should be subsidizing my parking. So, whether that should be a question for permanent tax reform, maybe that comes out. The question Senator Cardin referred to earlier has to do with, supporting public transit is a much different idea than supporting driving to work. You are reducing energy costs, you are reducing traffic congestion.

So the idea of supporting public transit is a good one. So, having that retroactive, of course, changes decisions. If I do not know that you are going to make this retroactive come December, I am not going to take Metro, I am going to drive to work.

Senator SCHUMER. Right. And it is harder than some of the others where you take a deduction in April of 2013 if we do it in, say, December of 2012. You cannot really recoup the transit benefit very well.

Dr. FICHTNER. That is exactly correct. All you might be able to do is to give them a lump sum going forward.

Senator SCHUMER. Right.

Dr. FICHTNER. The behavior is——

Senator SCHUMER. That does not really work.

Dr. FICHTNER. You are exactly correct.

Senator SCHUMER. And it does not encourage the behavior you and I wish to encourage.

Dr. FICHTNER. Yes, sir.

Senator SCHUMER. Ms. Harris, this is an area where the Chamber and I agree, so——

Ms. HARRIS. This is an area where you and the Chamber agree, Senator Schumer. We would agree with you very much that retroactive tax policy has real damaging consequences. We would agree with you on your argument that you should bring into parity the treatment of commuters versus those who drive, and we are here

today urging action on all extenders immediately, including the commuter transit benefit.

Senator SCHUMER. Thank you, Mr. Chairman.

Senator HATCH. Thank you, Senator.

Senator Cantwell, you are next.

Senator CANTWELL. Thank you, Mr. Chairman.

Listening to this discussion this morning, it is almost like people woke up and said, you know what? We are not in a recession anymore. It is like, we do not have to do anything to help the economy in the short term because, if we just do comprehensive tax reform in the long run, everything will be all right. I guess I certainly support doing tax reform, and doing it as soon as possible.

But I am offended when someone thinks that the sales tax deduction, which is about equity for States like Washington and Florida and South Dakota and others, is somehow special. It is not special. It was in the tax code for decades. It got taken out inadvertently, I think, and was restored and now has been restored for more than 7 years.

Yet, every year we have to play this game about whether or not we are going to have the equity that other States have. So I could talk about the green energy tax credits and certainly support predictability there, and I would say, if anything, extenders are being held hostage to the notion that you cannot do them unless you have major tax reform. I do not believe in cutting off your nose to spite your face.

So I guess my question is, when I look at the numbers, Washingtonians, it is \$1.8 billion; Floridians, it is \$2.5 billion. Those are the itemized deductions that those taxpayers in those States have, and many other States.

So my question is, are we not really deterring manufacturing when we are not giving predictability to the taxpayer starting now, because they are going to have a lot of conversations with their accountants in the next couple of months about their last year's returns, and their accountant is going to point out to them, you know what? I do not know whether you are going to be able to itemize this year or not; it is up in the air. It is up in the air.

So, if that is the case, are you going to buy an automobile? Are you going to buy those appliances you thought you were going to buy? Are you going to make those expenditures? Are you going to sit around and wait and see whether we do what we are supposed to do, which is make these decisions?

So I guess I would like, Ms. Harris, for you to comment on what you think the impact is on manufacturing of a delay in a message when we are saying we are not going to give predictability on something that is about tax fairness for Washingtonians and for other States that choose to raise their revenue through a sales tax instead of an income tax.

Ms. HARRIS. Thank you for your question, Senator Cantwell. I think that the sales tax deduction, as I mentioned in my statement, is incredibly important. It is also included in my written testimony. It is absolutely essential that we extend this provision, because it does bring parity between States such as yours that rely on a sales tax for their revenue base as opposed to those which rely on an in-

come tax. As you noted, there are several of these States—Washington, Florida, I believe Texas is one also.

I think it is absolutely essential, and taxes are part of the cost of doing business. When businesses, as you say, sit down with their accountants and figure out what the cost of doing business is when this deduction is not in place, that may impact their decision whether to operate in your State or go to an income tax State.

Senator CANTWELL. Right. But my point is also that individuals will be having this discussion as well, and so you are deferring. People are going to think, well, I do not know whether I am going to get this deduction this year or not so maybe I will stave off this investment that I was going to make.

Ms. HARRIS. Sure. Sure. With large items, the possibility that there is an increased tax cost is absolutely a factor.

Senator CANTWELL. So now you are deferring what could be an incentive. I mean, there is no predictability. It is not the whole country, but Florida, Texas, Washington, those are some pretty big States as it relates to the tax code and having predictability.

Ms. HARRIS. I think that we should seek a tax code with predictability. I mean, I think I am in agreement with you today in the sense that we should not bite off our nose to spite our face. We should absolutely do these right now.

Fundamental tax reform—the Chamber is very supportive of that also, but we are just not there yet. Allowing things like this provision, or any of the provisions on that list, to expire and causing business to sort of have to—or individuals to have to limp along in uncertainty, is not an ideal outcome whatsoever.

Senator CANTWELL. Thank you.

Thank you, Mr. Chairman.

Senator HATCH. Senator Thune?

Senator THUNE. Thank you, Mr. Chairman.

Thank you all for your testimony. Let me just echo what every member here has already stated, and I think everybody on the panel has stated as well. But it just seems like, when you do this stuff on a short-term basis, it is the worst of both worlds, because it means that businesses are less likely to make long-term investments in the economy because they do not know what their after-tax rate of return is going to be, and it makes the budget deficit look smaller than it really is in the out-years.

So I strongly believe that a critical part of tax reform is going to involve deciding which of the tax preferences we can phase out and eliminate altogether and instead use that revenue to lower tax rates across the board. So I commend you, Mr. Chairman and Senator Baucus, for beginning that important discussion today.

But on that point I wanted to ask, if I might, Ms. Harris, in your testimony you point out the long-term nature of some of our temporary extender items.

Ms. HARRIS. Sure.

Senator THUNE. You know, for example, that the active financing exception for financial services firms has been in our tax code for 91 out of the last 102 years. As we approach the whole issue of comprehensive tax reform, do you believe that longevity should be a primary criterion for determining which provisions would stay in the reformed tax code? In other words, should a tax provision that

has been in effect longer have some sort of preference given a tax provision that was enacted more recently?

Ms. HARRIS. I think when you look at provisions that have been in the code for an extended period of time you have to presume that those provisions have basically effectuated good policies.

I think one of the panelists said it before. One of the reasons, for example, we have the active finance exception is that we have a worldwide system of tax. Ideally we do not want to double tax any international income. We should have a shift to a territorial system that causes that.

Our code is not perfect right now, so we have things like active finance that fix the fact that there is double taxation. Do I think longevity should be the only factor? Absolutely not. Do I think we need to give pause and consider some of these provisions that have been in the code for an extended period of time and look into the policy reasons behind them? Absolutely.

Senator THUNE. When we start talking about tax reform, everybody is for it until they figure out how it actually impacts them. I suspect that everybody who is impacted by some preference that we have, a deduction/exclusion in the tax code today, is going to be up here lobbying to preserve it when we get serious about tax reform.

I guess my question has to do with, with ours being the highest corporate tax rate as soon as Japan lowers theirs—we are second-highest today, but soon to be the highest corporate tax rate in the world—as a business representative on the panel, with all the businesses, corporations, pass-throughs in this country, would they benefit from a lower tax rate with fewer tax credits and deductions rather than the current system?

In other words, I assume that everybody is going to make this decision based upon how they think it is going to impact their own personal situation. But, if we can get the rates lowered significantly, is that better for everybody irrespective of whether or not they might have a dog in the fight relative to the current deductions and preferences that exist in the tax code today?

Ms. HARRIS. Sure. I think that fundamental tax reform should strive absolutely for a lower rate on a comprehensive basis, both on the corporate and individual sides. It should strive for a shift to a territorial system, more effective cost recovery, predictability, simplicity.

So, if I think you can achieve those goals in a manner—I would like to believe Congress can achieve those goals in a manner that is much less convoluted than where our code has arrived today. So, yes, I do believe that we can reform the tax code and have everyone be in a better place.

Senator THUNE. Well, I just know that, in dealing with the provisions that expired either last year or are going to expire this year, and I hear from people all the time, as I am sure many of my colleagues do, it is very hard to foresee a project being invested in if it has to be placed in service before the end of the year, when there is a good amount of lead time to get a project placed in service.

For example, the wind production tax credit is something that comes to mind. We are dealing now with a very short time line in terms of getting some of these things extended, many of which will

impact jobs and investment in our economy. People are not going to make these investments if they think that the tax incentive is going away at the end of this year, not to mention those that already expired last year. So it is really a very complicating factor.

I guess, Mr. Chairman, I would simply say that this should put even more urgency behind the effort to do fundamental tax reform. If we are not going to do fundamental tax reform, and certainly not do it on a near-term basis, then we have to be looking at how to provide some economic certainty for those out there who are depending upon policies coming out of Washington, DC. It is just incredibly frustrating, and I think it is going to make it very, very hard for our economy to really grow and expand at the rate we would like to see.

So I see my time has expired, so thank you all very much.

Senator HATCH. Thank you, Senator.

Senator Nelson, you are next.

Senator NELSON. Thank you, Mr. Chairman.

I want to echo the comments of Senator Cantwell. Our State, Florida—and by the way, today is Florida, Florida, Florida—does not have an income tax, and it raises most of its State revenue from the sales tax. That actually is an item recorded in the year 2007, 2.4 million Floridians deducted \$3.25 billion in State and local sales taxes. So it is critical to make it fair.

Now, we have to get from point A to point B, which is the successful conclusion of this and other tax extenders. So share with me—and I will start with you, Ms. Harris—if you think that this tax extenders package should be paid for.

Ms. HARRIS. I believe that these tax extenders have positive growth benefits that can be reflected in greater revenues. I do not think the benefits to revenue should be mitigated with other tax hikes on the business community.

Senator NELSON. Now, not necessarily on the business community. I am talking about paid for in general without zeroing in on the business community.

Ms. HARRIS. Obviously we are always happy to hear that there is not a target on the business community's back. I still would suggest that the positive revenue growth effects of these provisions could be damaged if you attach any sort of non-growth or pay-for provisions to them.

Senator NELSON. So you think that we ought to have the tax extenders, but not have them paid for?

Ms. HARRIS. That is correct.

Senator NELSON. All right.

Dr. Fichtner?

Dr. FICHTNER. Senator Nelson and Senator Cantwell, you both make excellent points. As I outline in my testimony, as you move forward with which tax extenders to keep and not keep as you move towards fundamental reform, one of the key issues is, are you trying to level the playing field?

As you both point out, we currently allow for a deduction for State and local taxes where States have an income tax. We do not for States like yours that just rely on sales tax. So for fairness it should be included, and I wholeheartedly agree with that.

What I would add then is, as you move past that but as you move towards fundamental reform, the question is, should the government be subsidizing State and local taxes in general? If the answer is no, then maybe we move away from those as both being itemized deductions, allow for a larger standard deduction for every American, and lower rates for all.

So I would recommend, yes, pass it now so you have stability and fairness, but, as you move forward with fundamental tax reform, think about pulling them out, broadening the base, have a higher standard deduction and lower rates for all Americans.

Dr. ALTSHULER. I agree with Dr. Fichtner. Again, I said in my testimony that you need to look at what are structural parts of the tax code. The tax reforms that I have recommended, the panels that I have worked on, have removed the State and local tax deduction.

But, if you are going to have a State and local deduction, there is a fairness issue. I just feel that what we are doing is kicking all of this down the road again, and, as I said, it is quite depressing. So I could see us just continuing doing this. We are going to have to have fundamental tax reform. We are going to have to raise more revenue from our tax code.

We cannot do it with the mess of a tax code that we have today. That will have to involve broadening the base. The only way you can do that is to get rid of special provisions, and you are going to have to get rid of ones that affect millions and millions and millions of taxpayers. The State and local tax deduction is one of those that we will have to continue. Please do not keep kicking the can down the road. Yes, these should be paid for.

Senator NELSON. And I think that a number of us, almost half of the Senate, when the Super Committee was deliberating, did a press conference—it was about half Republicans, half Democrats—and said that we wanted the Super Committee not only to do a big deal, which was \$4 trillion-plus in deficit reduction over 10 years, but that we also wanted major tax reform.

In this very room, we held a hearing on the subcommittee that I have the privilege of chairing, with a distinguished panel of economists, suggesting ways—and I will not reiterate that; it is already part of the record—in which you could diminish the tax preferences and then use that money to lower people's rates and corporate rates.

Then of course, if you eliminate enough of the \$14 trillion of tax preferences over 10 years, you could actually use that then for deficit reduction as well. But as we know, the Super Committee did not agree, and here we are, back asking a lot of the same questions and having to worry about the sales tax deduction and the R&D tax credit, and the restaurant accelerated depreciation deduction, and so forth and so on. Until we get to fundamental tax reform, Mr. Chairman, we are going to be in a heck of a mess.

Senator HATCH. Well, I agree with you.

I want to thank the three witnesses for being here. We really appreciate the testimony you have given and the answers to our questions. We are going to keep the record open for any further questions anybody on the committee would like to submit in writing. If

you folks would cooperate in getting us answers to those questions, we would be very grateful.

With that, we will recess until further notice. Thanks so much for being here.

[Whereupon, at 11:26 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Testimony of Dr. Rosanne Altshuler
Professor and Chair, Department of Economics, Rutgers University

Before the Senate Finance Committee

Hearing on Extenders and Tax Reform: Seeking Long-Term Solutions

January 31, 2012

Chairman Baucus, Ranking Member Hatch, and Members of the Committee, it is honor to appear before you today to discuss the very important topic of tax extenders and tax reform.

I am a professor in the economics department of Rutgers University. During various leaves from this position, I have served as Special Advisor to the Joint Committee on Taxation, chief economist for the President's Advisory Panel on Federal Tax Reform in 2005, and director of the Urban-Brookings Tax Policy Center. In each of these positions, I have advocated the compelling case for tax reform, evaluated the economic consequences of different tax reforms, and studied the implementation issues and transition costs associated with various reforms.

A total of 60 temporary tax provisions expired at the end of 2011.¹ Despite the large number of provisions affecting millions of taxpayers, the expiration of these provisions, which we call "extenders", was unremarkable. With some exceptions, each was originally enacted with an expiration date and every one of those dates subsequently has been extended. In most cases, these temporary provisions have been extended over and over again for just a couple of short years or less.² In fact, the semi-permanent package of tax extenders we are considering today are now referred to as "traditional tax extenders" raising serious questions about their temporary nature and making it hard to argue that they are not fixtures of our tax code. Some of the provisions, like the research and experimentation credit, have been extended so many times they have achieved a state of near immortality.

The vast majority of extenders we are considering today were originally enacted to provide specifically limited incentives for certain activities or investments. Unlike other tax provisions that provide targeted tax benefits, however, extenders have a limited shelf life. Much like the items in the meat section of the grocery store, our tax code is littered with expiration dates. As we will hear today, the past-due inventory is quite large.

I believe these extenders must be considered within the context of fundamental tax reform. In my testimony, I address both the desirability of maintaining a tax code that includes myriad unrelated temporary provisions that are routinely extended (sometimes retroactively) and the need for tax reform. I recommend that instead of arguing about which provisions should be

¹ The staff of the Joint Committee on Taxation publishes an annual report on these provisions that now totals more than 30 pages.

² For details on the current set of extenders, see "Legislative Background of Expiring Federal Tax Provisions 2011-2022," Joint Committee on Taxation, January 27, 2012 (JCX-6-12).

included in an extenders package, we should instead devote our energy to building a tax code that will allow us to face the daunting fiscal challenges ahead.

For many taxpayers who are impacted by one of these extenders the frequent ritual of being on tax code death watch only to be saved by last minute clemency --- or, in instances like this year, resurrection --- creates tremendous volatility. This volatility not only creates uncertainty and a perception that our tax code is unfair, it reinforces the view that the current legislative process is dysfunctional and our elected representatives are unwilling or unable to chose among competing priorities.

By making provisions temporary, Congress reduces the benefit of these subsidies relative to their revenue cost. Businesses, for example, are not likely to make long-term investment decisions based on subsidies likely to disappear. Teachers may not buy school supplies using their own money if they do not think they will be allowed a deduction for their expenditures. Temporary provisions by their very nature are more likely to present taxpayers with windfalls for undertaking certain investments providing Congress with little to no economic benefit. As a result, they are likely less effective than they would be if they were permanent.

There are three broad reasons why Congress has enacted so many temporary provisions. First, for better or for worse, tax policy is sometimes used as a stimulus measure in response to an economic downturn or to provide targeted disaster relief. Given their rationale, it makes sense for these provisions to be temporary.³

Second, policymakers may impose expiration dates on provisions so that they can periodically evaluate their effectiveness. In this case an expiration date can be seen as a mechanism to force policymakers to consider the cost and benefits of the special tax treatment and possible changes to increase the effectiveness of the policy. This reasoning is compelling in theory, but has been an absolute failure in practice as no real systematic review ever occurs. Instead of subjecting each provision to careful analysis of whether its benefits outweigh its costs, the extenders are traditionally considered and passed in their entirety as a package of unrelated temporary tax benefits.

Finally, temporary tax legislation may simply (but sadly) be the result of Congress playing a budget game. The Congressional Budget Office (CBO) must project the revenue baseline using current law. This means that the CBO must assume that temporary provisions expire as scheduled.⁴ If, as past history would strongly suggest, temporary provisions are never allowed to lapse, then they effectively become permanent features of the code that are not accounted for in the revenue baseline. Since almost all extenders involve tax cuts, the assumption that they will be terminated tends to makes the CBO project a healthier revenue baseline than is likely to occur.

³ The temporary nature of a provision increases its strength as stimulus but reduces its long-run impact. Consider the bonus depreciation provision in the American Recovery and Reinvestment Tax Act of 2009. Expiration raises a firm's net cost of new investment back to its previous level and removes any further incentive to invest now rather than later. In fact, because the provision primarily leads businesses to move their investment up in time and not to increase overall investment, it may lead businesses to reduce investment when the provision expires. If the economy is still in recession at that point, this could be especially undesirable.

⁴ There is an exception to this rule for temporary taxes whose revenue is deposited in trust funds. CBO considers these provisions to be permanent.

Thus, by making provisions temporary, Congress can effectively pass tax breaks that do not worsen the budget picture.

Thinking about the reasons why we have a slew of temporary provisions should help us decide what to do with the current package of extenders. Stimulus and disaster relief measures should be allowed to expire if they have had their intended effects (or have been found to be ineffective). These provisions, however, represent a small set of the current extenders.

The “traditional extenders” account for the vast majority of items on the current list and have, for the most part, been around for many years through routine extension of their expiration dates. These provisions vary widely in their intent and purpose from special depreciation rules, alternative energy incentives, and investment incentives for developers in tax-favored communities on the business side to education, commuting, charitable contribution and adoption benefits on the individual side.

Based on the three reasons given above, the traditional tax extenders should not be carried forward from year to year as temporary provisions. They are not stimulus or disaster measures. We have not subjected them to systematic review (and it is not at all clear why these special tax incentives should be subject to yearly evaluation and others that happen to be permanent parts of our tax code should not). And hiding the true cost of a provision by giving it an expiration date that is likely to be subsequently extended is not good or responsible budget policy. The traditional extenders should either be permanent features of the tax code or should permanently expire.

In deciding whether to let the traditional extenders expire, I suggest we take the following two steps. First, isolate provisions that are fundamental policies of our current tax system and make them permanent. It does not make sense for provisions that are more properly considered structural features of our tax system, like the active finance exception, to be temporary in nature. If the tax system provides deferral for active business income earned abroad of U.S. corporations in controlled foreign corporations (as it does), it should not single out certain types of active business income and subject it to current taxation. Second, admit that the remaining provisions, however well-intended, should be evaluated along with similar permanent provisions in the context of fundamental tax reform.

In practice, that review should be forthcoming as building the case for tax reform is easy. The current system is riddled with tax provisions favoring one activity over another or providing targeted tax benefits to a limited number of taxpayers. Whether permanent or temporary, these provisions create complexity, generate enormous compliance costs, breed perceptions of unfairness, create opportunities for manipulation of rules to avoid tax, and lead to an inefficient use of our economic resources. The numerous and frequent changes we have made to the tax code have made the income tax system even more difficult for taxpayers to understand, less stable, and increasingly unpredictable. The state of our current system with its many permanent and temporary special provisions reflects that we have forgotten that the fundamental purpose of our tax system is to raise revenues to fund government.

While there are many fundamental reforms that could be considered, a reform that broadens the base would not only raise revenue but would simplify the system, increase transparency, make it less distortive by both allowing for a lower rate and reducing tax-induced biases towards certain activity, and improve the fairness of the system. Broadening the base involves deciding which special tax provisions to *keep* in the code and how best to design them. It involves consolidating and simplifying duplicative provisions and eliminating conflicting provisions (for example, energy provisions that both encourage and discourage the use of certain fuels).⁵ Tax reform forces policymakers to decide whether to use the tax code to promote widely shared and valued goals such as charitable giving and, if so, how incentives can be optimally designed. On the business side, tax reform involves thinking about how to treat cost recovery for business assets and whether the tax code should be used to encourage research and development and implement energy policy. As such, a base broadening tax reform is the perfect vehicle to consider the traditional tax extenders.

Our current fiscal situation requires that we refrain from our habit of kicking the can down the road on tax reform. Instead of wasting time engaging in a debate over which temporary tax provisions we should save for another year or two and how to manage the revenue impact, we should focus on designing and building support for a reform of the current system that can enhance the growth of the U.S. economy and the well-being of Americans. A reformed tax code would allow special treatment only when it could be demonstrated that the tax code is the best vehicle for delivering the subsidy and that the subsidy is optimally designed. Only tax benefits that provide incentives to change behavior in ways that benefit the economy and society, rather than representing windfalls to targeted groups of taxpayers for activity they would be likely to undertake even without a tax subsidy, should survive.

The process is not easy, but is necessary. A tax reform that broadens the base by eliminating temporary and permanent tax provisions that distort economic activity would leave us with a system that is less costly to our economy and raises more revenue. At the same time the new system would be perceived as being fairer than the current system and would also have the benefits of being considerably less complex and easier to administer.

Thank you. I would be happy to answer any questions you may have.

⁵ As Howard Gleckman points out in an Urban-Brookings Tax Policy Center blog entry, the extenders list includes a provision that keeps the cost of fossil fuels low by continuing tax breaks for marginal oil wells along with provisions designed to encourage the use of alternative fuels (<http://taxvox.taxpolicycenter.org/2009/12/10/it's-cold-it's-sic-y-it's-tax-extender-time>).



January 31, 2012

**Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding Tax Extenders and Tax Reform
*As prepared for delivery***

Benjamin Franklin once said, "In this world, nothing can be said to be certain, except death and taxes."

But today not even our taxes are certain. There are currently 132 expiring provisions in the code. That number has more than tripled since 1998. These policies, commonly-known as "tax extenders," expire every year or every two years.

The lack of certainty about these tax incentives is bad for American families, it's bad for businesses looking to create jobs and it's bad for our economy. It leaves businesses unable to plan ahead and invest, because year-to-year incentives are ineffective.

Many construction projects, for example, take at least five years to plan, finance and build. When Congress passes an investment tax credit for only one year, there's no guarantee for a town, city or developer to move forward with a five-year project. But when Congress provides businesses with long-term incentives that cover their entire business plans, businesses can invest with confidence and our economy can grow.

Take the small wind investment tax credit as an example. In 2008, Congress provided more than eight years of uninterrupted tax policy with this credit. The planning that Jenny Bryce of Belt, Montana has been able to do thanks to the long-term nature of this tax incentive has helped her business grow.

Jenny owns Pine Ridge Products, a 15 year-old company with about 800 thousand dollars of revenue per year. Pine Ridge manufactures, services and installs small wind turbines for farmers across Montana. A turbine installed by Pine Ridge costs about \$60,000 but has the ability to take a large farm entirely off the grid when the wind is blowing.

Sixty thousand dollars is a big capital investment for a farmer or rancher. That's why Congress passed the small wind investment tax credit in 2008. It covers 30 percent of buying and installing a small wind turbine.

The long-term nature of this credit has helped create an industry that includes more than 80 small wind companies and thousands of American manufacturing jobs. For Jenny Bryce and Pine Ridge, it has led to a sustainable business. But for other industries that rely on the tax code, the stop-and-start nature of year-by-year extenders has been disastrous.

The biodiesel industry relies on a tax credit to help them compete against diesel fuel from petroleum. Originally created in 2004, the credit has been extended three times. In 2010, the credit lapsed for almost the entire year. That devastated the industry.

More than 9,000 jobs were lost and 80 facilities shut down. Production dropped by more than 40 percent. The industry is now trying to cope with another lapse in the credit. Companies are laying off workers and reducing production.

This is unacceptable. We need to do better.

For businesses to succeed, Congress must provide a stable and certain tax code. And it is not just the biodiesel industry that is feeling the effect of the lapse in tax extenders.

Each year, the number of extenders grows. Extending last year's provisions would have cost 38 billion dollars. Once in the tax code, very few provisions expire completely; they are added to the list of extenders and the cost continues to grow.

We need to address these tax extenders to provide long-term certainty. And through tax reform, we should evaluate each and every extender and determine whether it should be allowed to expire or be made permanent.

We should either address each incentive's shortcomings and fix them, or we should let the incentive expire.

This process, however, will take time – time that our recovering economy doesn't have.

Each day that businesses do not know whether tax extenders will be in place this year means less American manufacturing, less production and fewer jobs.

In the meantime, we need to pass these tax incentives to help business-owners like Jenny Bryce in Belt, Montana create jobs.

So as we work to pass tax extenders through this year, let us also continue the hard work of tax reform. Let us consider whether we should retain these provisions, or whether we should use the money to lower tax rates.

And if we should retain them, let us consider how to reform them to get the most bang-for-the-buck, while making them permanent. And let us provide the certainty that our families, businesses and our economy need.

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**INCREASING AMERICA'S COMPETITIVENESS BY LOWERING THE CORPORATE
TAX RATE AND SIMPLIFYING THE TAX CODE
JANUARY 31, 2012**

Jason J. Fichtner, PhD
Senior Research Fellow

United States Senate Committee on Finance
Hearing on "Extenders and Tax Reform: Seeking Long-Term Solutions"

Good morning, Chairman Baucus, Ranking Member Hatch, and Members of the Committee. Thank you for inviting me to testify today.

My name is Jason Fichtner, and I'm a Senior Research Fellow at the Mercatus Center at George Mason University where I research fiscal issues, including tax policy, budget policy, and Social Security. I am also on the adjunct faculty of Georgetown University, Johns Hopkins University, and Virginia Tech, where I teach courses in economics and public policy. All opinions I express today are my own and do not necessarily reflect the views of my employers. While my oral remarks are brief, I request your permission to submit my full written testimony for the record.

I'd like to begin by thanking Chairman Baucus and Senator Hatch for the leadership you provide this Committee in ensuring that important public policy issues get the attention and debate they deserve and also for ensuring that ideas and viewpoints from all sides are aired in a collegial and respectful manner. It is truly a privilege for me to be here testifying before you today.

There is no more important issue to discuss than tax reform. Committee staff requested that I focus my attention on 59 provisions that expired at the end of 2011 and are commonly referred to as "traditional extenders." While I do not separate these 59 tax provisions into "the good, the bad, and the ugly," my goal is to provide you with a general framework for evaluating any tax provision. And since 46 of these 59 tax provisions generally relate to business taxation, the majority of my testimony is devoted to corporate tax reform.

The most basic goal of tax policy is to raise enough revenue to meet the government's spending requirements with the least impact on market behavior. But the United States' tax code has long failed to meet this aim: by severely distorting market decisions and the allocation of resources, the tax code hampers job creation and impedes both potential economic growth and potential tax revenue.

To increase employment and expand their economies, most developed countries are both reducing their corporate tax rates and restructuring their corporate tax systems to make them simpler. The United States appears to be taking the opposite approach. The very fact that we are here to discuss the dozens of tax provisions that expired *last year alone* is evidence of the tax code's complex and temporary nature—two faults that increase both uncertainty and costs for American businesses. This drives competitive, profit-seeking corporations to minimize their tax exposure and defer income overseas to lower tax countries. Unless the United States reforms its corporate tax system, the country will fall further behind in global competitiveness.

While there appears to be widespread agreement on the need for tax reform, there is no consensus—either between or within parties—on specific elements of reform. To move the debate forward, policy makers need to know the goals of successful tax reform and what steps to take to achieve those goals.

WHAT ARE THE GOALS OF TAX REFORM?

Clearly, the nation's increasingly dire economic and fiscal situation has increased the motivation—and the urgency—to reform the federal revenue system, along with the federal government's other unsustainable institutions and practices. But what would an "ideal" tax code look like?

Luckily, policy makers need not fly blind when it comes to defining the principles and goals key to a successful revenue system. Academic research suggests that a successful revenue system should be:

SIMPLE. The complexity of the tax system makes it difficult and costly to comply with the tax code. Congress should make the tax code as simple and transparent as possible so as to increase compliance and reduce compliance costs.

EQUITABLE. Policies intended to benefit or penalize select individuals and groups riddle the tax code; these policies also result in immeasurable unintended consequences. Fairness is subjective, but "tax fairness" would at least reduce the number of provisions in the tax code that favor one group or economic activity over another. The government should not be in the business of picking winners and losers.

EFFICIENT. Because the tax code alters market decisions in areas such as work, saving, investment, and job creation, it impedes economic growth and reduces potential tax revenue. An efficient tax system must provide sufficient revenue to fund the government's essential services with minimal impact on taxpayer behavior.

PERMANENT AND PREDICTABLE. The negative effects of the current tax code result not just from what it does today, but also from what it may do in the future. Such uncertainty deters economic growth. An environment conducive to growth (and thus, increased revenues as a result of a larger economy) requires a tax code that provides both near and long-term predictability. Temporary tax provisions should be avoided.

Further, instead of focusing on ways to increase revenue, focus should be directed on ways to increase economic growth, saving, and investment; a larger economy will result in larger tax revenue. We don't just need more revenue—we need a better revenue system.

WHAT REFORMS ARE MOST LIKELY TO ADVANCE THESE GOALS?

There is broad consensus across academic research as to which key policies are most likely to promote solid, sustainable economic growth and revenues—and which policies are most likely to fail:

LOWER RATES. Exhaustive economic research repeatedly proves this most basic effect: the more you tax capital or labor, the less you get. It also makes clear that incentives matter. Successful reform will lower current individual and corporate tax rates.

One thing we should not do is raise tax rates. There is much research to support the negative consequences of raising tax rates on economic growth. Research by economists Christina Romer, former chair of President Obama's Council of Economic Advisers, and David Romer suggests, "A tax increase of 1 percent of GDP reduces output over the next three years by nearly three percent."¹ Further, according to research by Harvard University economist Jeffrey Miron, "Both macroeconomic and microeconomic perspectives suggest that [higher] taxes slow economic growth, thereby limiting the scope for revenue gains."² To regain

¹ Christina Romer and David Romer, "The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks," *American Economic Review*, June 2010, <http://www.econ.berkeley.edu/~dromer/papers/RomerandRomerAERJune2010.pdf>.

² Jeffrey Miron, "The Negative Consequences of Government Expenditure" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), http://mercatus.org/sites/default/files/publication/Negative-consequences-of-government-expenditure.Miron_9.14.10.pdf.

competitiveness, the US corporate tax rate should be reduced to at-or-below the 25 percent average rate of other Organisation for Economic Co-operation and Development (OECD) countries.³

For those who advocate for higher taxes on business, it is important to note two things: the first is that the United States' corporate tax rate is among the highest in the industrialized world; this increases business' flight to lower tax countries, taking their jobs, money, and tax dollars with them. Second, a tax on corporations is actually a tax on labor. A Congressional Budget Office Working Paper finds that, "[D]omestic labor bears slightly more than 70 percent of the burden of the corporate income tax."⁴

BROADEN BASE, ELIMINATE LOOPHOLES. One of the keys to successful fiscal reform is to move away from a spending system that depends upon an easily manipulated income tax system. Tax reform should lower rates, broaden the tax base, and eliminate loopholes; this will increase stability, and lead to greater economic growth, added employment, and perhaps even increased revenues.⁵

NO DOUBLE TAXATION. For economic efficiency, it is important that income be taxed once and only once. There is much concern that those who report significant earnings from capital gains or dividends pay a lower tax rate than those with ordinary income. But this fails to accurately reflect the incidence of the corporate income tax.

Currently, corporate profits are generally subject to "double taxation," whereby firm profits are taxed first at the corporate level and then again at the individual level.⁶ Stephen Entin, testifying before this Committee in September 2011, stated, "Increasing the double taxation of corporate income by raising tax rates on capital gains and dividends would dramatically reduce capital formation and wages, and would not raise the expected revenue."⁷

One of the reasons why we currently have a lower tax rate for individuals on capital gains is to account for the fact that capital gain income received by an individual was first taxed at the corporate level, up to 35 percent. Hence, if a corporation first pays the maximum statutory tax rate of 35 percent on each \$1 of profit, leaving \$0.65 of retained profit to either be distributed as a dividend or realized as capital gain, then combining the individual's 15 percent tax rate yields a combined tax rate of 44.75 percent.

REDUCE BAD INCENTIVES. Predictable tax policy is essential to long-term economic growth. Generally, temporary tax provisions should be avoided, especially when trying to correct or rectify a permanent problem. Further, allowing any provisions that favor one group or activity over another not only puts the government in the position of picking winners and losers, but also opens the Congress up to be influenced by those seeking special favors.

This Committee has already held several hearings on the Tax Reform Act of 1986 (TRA86). TRA86 was remarkable for its bipartisan passage and sweeping reforms. But because the legislation failed to fix the revenue system's large institutional problems, reforms were clawed back almost immediately. As a result, the tax code looks even worse today; in 1985 there were only 25 temporary tax provisions; in 2010 there were 141 provisions set to expire by the end of 2012.⁸

³ Jason Fichtner and Nick Tuszynski, "Corporate Tax Reform: Why the United States Needs to Restructure and Reduce Its Corporate Income Tax" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011), http://mercatus.org/sites/default/files/publication/Corporate_tax_FichtnerTuszynski_WP1142.pdf.

⁴ William Randolph, "International Burdens of the Corporate Income Tax" (Congressional Budget Office Working Paper, 2006), <http://www.cbo.gov/ftpdocs/75xx/doc7503/2006-09.pdf>.

⁵ Robert Barro and Charles Redlick, "Macroeconomic Effects from Government Purchases and Taxes" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), [http://mercatus.org/sites/default/files/publication/Macroeconomic effects from government purchases and taxes.pdf](http://mercatus.org/sites/default/files/publication/Macroeconomic%20effects%20from%20government%20purchases%20and%20taxes.pdf); and Jason Fichtner and Jacob Feldman, "Lessons from the 1986 Tax Reform Act" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2011), http://mercatus.org/sites/default/files/publication/Fichtner.86Tax.4.12.11_0.pdf.

⁶ Jason Fichtner, *Reforming the U.S. Corporate Tax System to Increase Competitiveness* (Washington, DC: Joint Economic Committee, United States Congress, 2005), www.house.gov/jcc/CorporateTaxReform.pdf.

⁷ Stephen J. Entin, president and executive director, Institute for Research on the Economics of Taxation, testimony before the United States Senate Committee on Finance, September 2011, <http://finance.senate.gov/imo/media/doc/Entin%20Testimony.pdf>.

⁸ Fichtner and Feldman, "Lessons from the 1986 Tax Reform Act."

History has shown that tax reforms seldom last when special interests have large incentives to lobby Congress for tax breaks. Keeping the tax code as simple—by taxing a broad base at the same low rate—and transparent as possible will help reduce the ability and incentives to reverse future tax reforms.⁹

The current tax code is detrimental to our economy. Our tax system severely distorts market decisions and the allocation of resources; it hampers job creation and impedes both potential economic growth and potential tax revenue. Tax expenditures also set up a system where the government discriminates among taxpayers by picking winners and losers.

Fundamental tax reform is ultimately the goal of this Committee. As you consider which tax provisions to extend or which ones should remain expired, promote provisions that level the playing field so everyone plays by the same rules and also those provisions that move toward fundamental reform over provisions that discriminate.

THE PERILS OF A HIGH CORPORATE RATE

U.S. Firms at a Disadvantage

Firms respond to high tax rates and relocate economic activity to lower tax countries. Thus, the current U.S. corporate tax structure places U.S.-headquartered corporations at a tremendous disadvantage in the global marketplace because other countries have lowered their corporate income tax rates to welcome multinational corporations. In December 2010, Japanese Prime Minister Naoto Kan said he hoped to stimulate Japan's slow economy with a 5 percent corporate tax rate cut.¹⁰ The United Kingdom is undergoing a multiyear process to lower its combined corporate tax rate to 24 percent by 2014.¹¹

Canada is attempting to lower its national corporate tax rate from 18 percent to 16.5 percent, giving it a combined rate of roughly 28 percent. Canada has good reason to do this. A recent study by Jack Mintz, head of the Public Policy School at the University of Calgary, estimated that a 3 percent reduction in Canada's national statutory rate, from 18 percent to 15 percent, would create 100,000 jobs and draw \$30 billion in additional business investment over a seven-year period.¹² An independent study by the Canadian Manufacturers and Exporters found that a similar rate cut would create 98,000 jobs over a two-year period.¹³

The corporate income tax rate plays a major role in determining where a company will invest capital.¹⁴ Thanks to communications technology, companies doing business together often do not require physical proximity. Thus, if two countries are similar in culture, infrastructure, and economic growth potential and one has a dramatically lower corporate income tax rate, an entrepreneur or an expanding firm would be financially reckless to invest in the country with the higher corporate tax rate.

U.S. firms are indeed moving away from the United States to initiate and expand business opportunities. U.S. corporations' share of worldwide profits attributable to foreign revenue has increased from 6.7 percent in

⁹ Jason Fichtner and Katelyn Christ, "Uncertainty and Taxes: A Fatal Policy Mix" (working paper, Mercatus Center at George Mason University, Arlington, VA, 2010), http://mercatus.org/sites/default/files/publication/Economic%20Impact%20of%20increases%20in%20the%20marg.%20tax%20rate.%20Fichtner.Christ.12.13.10_0.pdf.

¹⁰ Hiroko Tabuchi, "Japan Will Cut Corporate Income Tax Rate," *New York Times*, December 13, 2010, <http://www.nytimes.com/2010/12/13/business/global/14yen.html>.

¹¹ Scott A. Hodge, *Countdown to #1: 2011 Marks 20th Year That U.S. Corporate Tax Rate Is Higher than OECD Average* (Washington, DC: Tax Foundation, 2011), <http://www.taxfoundation.org/news/show/27100.html>.

¹² Duanjie Chen and Jack Mintz, "Federal-Provincial Business Tax Reforms," University of Calgary, School of Public Policy Research Papers 4, No. 1 (Calgary, AB: University of Calgary, 2011), http://www.policyschool.ucalgary.ca/sites/default/files/research/fed-prov-tax-reform-1a_0.pdf.

¹³ Paul Vieira, "Corporate Tax Cuts to Create 100,000 Jobs: Study," *National Post*, January 25, 2011, <http://www.financialpost.com/Corporate+cuts+create+jobs+study/4163689/story.html>.

¹⁴ Curtis Dubay, "Corporate Tax Reform Should Focus on Rate Reduction," WebMemo no. 3146 (Washington, DC: Heritage Foundation, 2011), <http://www.heritage.org/Research/Reports/2011/02/Corporate-Tax-Reform-Should-Focus-on-Rate-Reduction>.

1965 to 38.2 percent in 2009.¹⁵ A recent study in the journal *Tax Notes* showed that in 2004 multinational corporations shifted roughly \$50 billion away from the United States to lower tax countries.¹⁶ This investment shift not only creates losses and impedes growth for firms, it also creates losses for American workers. Companies could have utilized such profits to create more U.S. jobs.

Distorted Incentives

With a tax rate so much higher than that of other countries, U.S. corporations must turn their accounting departments into profit-maximizing centers. Companies need complex financial engineering tactics to minimize revenue losses using tax code preferences. Through various transfer-pricing arrangements, accountants can allot income and capital to different countries to minimize tax liabilities and help companies to remain competitive.

Companies can spend more time and resources using tax rules as profit centers than focusing on potential business investment. This system is inefficient: the resources used to combat the tax could be invested in intellectual or physical capital. Investment could help the company to grow, which would lead to more jobs and output and would expand the domestic economy. Instead, the high corporate income tax rate distorts firms' incentive structures and investment behaviors. It sometimes becomes more "profitable" for companies to invest in lobbyists who can expand tax preferences than to use those resources to expand business output. Public policy should provide the proper structure to encourage growth. The current corporate tax structure forces firms to misallocate resources, causing a ripple effect throughout the organization's financial structure. The higher U.S. corporate tax rate means that firms have to cut costs or raise prices elsewhere to compete with firms based in lower tax countries.

Recently, both job creation and economic growth have been key topics among economic policy advisors. Restructuring the corporate tax system would address both issues. Policy makers debate the need for the federal government to continue investing in economic growth, yet such investment can do little good when current economic policies actually inhibit growth. When other countries have lower corporate income tax rates, firms may choose overseas destinations for business. Estimates of how many domestic jobs the current corporate income tax has killed range from 200,000 to 3 million,¹⁷ but the consensus is that many employees are terminated specifically because of the high costs imposed by the current corporate tax structure. During the 2000s, major multinational corporations reduced U.S. jobs by 2.9 million while increasing overseas employment by 2.4 million.¹⁸ Not all of these jobs were cut and outsourced specifically because of the corporate tax system. But was that system a contributing factor? Absolutely. Though outsourcing is no longer a popular trend, it remains an option for almost any multinational corporation seeking to reduce costs, including costs imposed by the corporate income tax.

Burden of Tax Falls on Individuals

A tax upon a corporation is an additional tax on individuals. Many people view the taxing of corporations as if some faceless entity were paying the tax. However, corporations are made up of individual investors and workers attempting to earn money by maximizing profits. Companies are not the only ones affected by corporate tax rates either. Individuals are also affected when high tax rates force corporations to charge more for their products and services. The poorly constructed U.S. corporate tax is, thus, a form of double taxation on productive workers, consumers, and investors.

A report I authored while a staff economist on the Joint Economic Committee of the United States Congress explained, "Any tax imposed on corporations results in either a reduction to employee wages, an increase in costs passed on to consumers, a reduction in the return to capital received by shareholders, or a combination

¹⁵ Business Roundtable, "Taxing American Corporations in the Global Marketplace," March 30, 2011, <http://businessroundtable.org/studies-and-reports/taxing-american-corporations-in-the-global-marketplace/>.

¹⁶ Peter R. Merrill, "The Corporate Tax Conundrum," *Tax Notes*, October 8, 2007, http://www.pwc.com/en_US/us/washington-national-tax/assets/corporate_tax_conundrum.pdf.

¹⁷ David J. Lynch, "Does Tax Code Send U.S. Jobs Offshore?" *USA Today*, March 21, 2008, http://www.usatoday.com/story/perfi/taxes/2008-03-20-corporate-tax-offshoring_N.htm.

¹⁸ David Wessel, "Big U.S. Firms Shift Hiring Abroad," *Wall Street Journal*, April 19, 2011, <http://online.wsj.com/article/SB10001424052748704821704576270783611823972.html>.

of all three.”¹⁹ Economist Steve Horwitz similarly notes that the corporate tax has “negative effects on real human beings” in several ways:

“If corporations respond by reducing compensation or firing workers, the impact of the tax hits the employees. If they raise prices, the impact falls on the consumers who buy the product. And if they take a reduction in profits, the falling stock values lowers the value of various investment funds on which millions of Americans depend for retirement and other income.”²⁰

A working paper by the Congressional Budget Office finds workers bear “slightly more than 70 percent of the burden of the corporate income tax.”²¹ Moreover, economists Kevin Hassett and Aparna Mathur found an interesting unseen consequence of raising tax rates. For every 1 percent increase in corporate tax rates, they found a 1 percent decrease in wages.²² This fact illustrates that corporations respond to incentives and allocate resources within given constraints and shows another way that individuals ultimately bear the burden of any corporate tax.

Decreased Economic Growth and Tax Revenue

The corporate income tax also impedes the country’s economic growth. A 2008 National Bureau of Economic Research (NBER) working paper concluded that a “10 percent increase in an effective tax rate reduces the aggregate investment to GDP ratio by 2 percentage points.”²³ The NBER paper also shows that corporate tax rates are negatively correlated with economic growth. And, of course, lower economic growth leads to less job creation.

Further, a higher tax rate may actually lead to lower tax revenue. The \$50 billion that U.S. corporations shifted to lower tax countries in 2004 may have cost the U.S. government \$17.4 billion in tax revenue.²⁴ Indeed, corporate tax revenue in the United States is lower than that in other OECD countries, even as a percentage of GDP. As figure 1 shows, even as the economy has grown, corporate tax receipts as a percentage of GDP have decreased and have remained fairly constant since 1990. A study by economists Alex Brill and Kevin Hassett shows significant evidence that lowering the U.S. corporate tax rate would enhance tax revenue.²⁵

¹⁹ Jason Fichtner, *Reforming the U.S. Corporate Tax System to Increase Competitiveness* (Washington, DC: Joint Economic Committee, United States Congress, 2005), www.house.gov/jec/CorporateTaxReform.pdf.

²⁰ Steven G. Horwitz, “Corporations Are Indeed People,” *Austin Statesman*, August 13, 2011, <http://www.statesman.com/opinion/corporations-are-indeed-people-1740934.html>.

²¹ William C. Randolph, “International Burdens of the Corporate Income Tax” (working paper, Congressional Budget Office, Washington, DC, 2006), <http://www.cbo.gov/ftpdocs/75xx/doc7503/2006-09.pdf>.

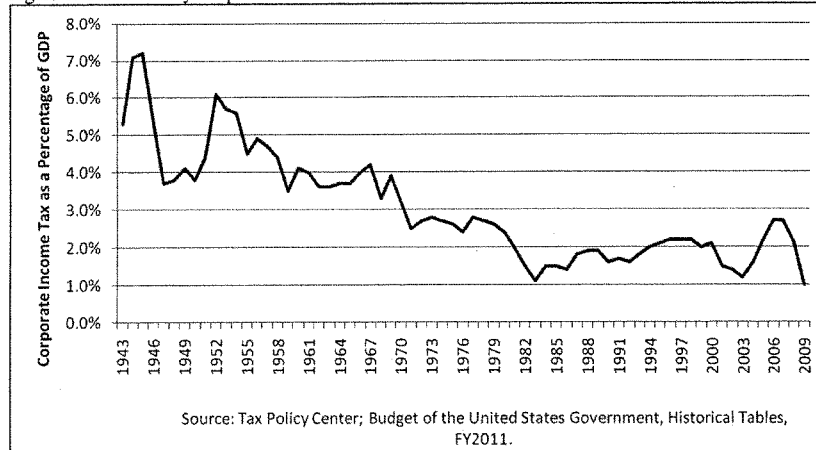
²² Kevin A. Hassett and Aparna Mathur, “Taxes and Wages” (American Enterprise Institute Working Paper no. 128, Washington, DC, June 2006), http://www.aei.org/docLib/20060706_TaxesandWages.pdf.

²³ Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho, and Andrei Shleifer, “The Effect of Corporate Taxes on Investment and Entrepreneurship” (National Bureau of Economic Research Working Paper no. 13756, Cambridge, MA, 2008), www.nber.org/papers/w13756.

²⁴ Peter Merrill, “The Corporate Tax Conundrum,” *Tax Notes*, October 8, 2007, http://www.pwc.com/en_US/us/washington-national-tax/assets/corporate_tax_conundrum.pdf; and Business Roundtable, “Global Effective Tax Rates,” April 2011, http://businessroundtable.org/uploads/studies-reports/downloads/Effective_Tax_Rate_Study.pdf.

²⁵ Alex Brill and Kevin A. Hassett, “Revenue-Maximizing Corporate Income Taxes: The Laffer Curve in OECD Countries” (American Enterprise Institute Working Paper no. 137, Washington, DC, 2007), http://www.aei.org/files/2007/07/31/20070731_Corplaffer7_31_07.pdf.

Figure 1: U.S. Statutory Corporate Income Tax as a Share of GDP



CONCLUSION

The uncompetitive U.S. corporate tax system impedes American corporations' ability to compete in the global marketplace. It also discourages potential domestic investment. If the United States is to be competitive in the future, some level of corporate tax restructuring has to occur. While other nations have been racing over the last 20 years to slash corporate tax rates, the United States has stagnated. At times the government has enacted temporary changes to tax policy, but it has ignored the underlying, fundamental problems that need permanent reform.

The United States has an infamously dense and complicated tax code that is in dire need of simplification. Temporary tax provisions only further the day of reckoning and postpone the tough choices that need to be made. Systemic problems exist not only in loopholes and tax havens, but also in the uncompetitive high corporate income tax rate and the worldwide-based tax system that encourages businesses to move jobs and investment overseas and to lobby for more loopholes. High corporate taxes lead to lower wages and investment and hinder long-term economic growth. To protect American jobs and secure future fiscal stability, the United States must slash its corporate tax rate. Absent sweeping corporate tax reforms, U.S. competitiveness will continue to languish. Inaction will create troublesome results: the foreign outsourcing of economic activity, a further loss of American jobs, the sale of U.S. companies to foreign multinational companies, a further erosion of the corporate tax base, and the continuation of harmful tax policies that are biased against saving, investment, job creation, and economic growth.

Thank you again for your time and this opportunity to testify today. I look forward to your questions.



Statement Of the U.S. Chamber Of Commerce

ON: Hearing on Extension of Certain Expired and Expiring Tax Provisions

TO: Senate Finance Committee

DATE: January 31, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

Introduction

The Chamber thanks Chairman Baucus and Ranking Member Hatch for this opportunity to provide feedback on the annual tax extender provisions. These tax provisions, which benefit a wide range of taxpayers, are important to U.S. jobs and the broader economy. The failure to extend these provisions has brought more instability and uncertainty into the economy and has created significant challenges for taxpayers planning for the future. The Chamber strongly urges this Committee and Congress to act as soon as possible to extend these vital provisions.

Extenders and Comprehensive Tax Reform

The Chamber strongly supports comprehensive, fundamental tax reform to increase simplicity, efficiency, transparency, compliance and global competitiveness. While the Chamber applauds the hearings and other efforts this Committee has undertaken on tax reform and strongly supports the continuation of these efforts, we believe that true fundamental tax reform is still a long way down the road. Thus, in the interim, we believe this Committee and Congress must take action on the annual extender provisions now.

The Need for Immediate Action on Extenders

The Chamber believes that this Committee and Congress need to act immediately to prevent the negative impact on jobs and the fragile economy that is likely to result from inaction on these annual extenders. We believe that the best way to get the economy growing fast enough to create jobs and drive the unemployment rate down is to ensure that taxes do not increase for consumers and businesses. Leaving income in the hands of businesses is the best way to spur investment and job creation. Thus, to help drive the economic recovery, these annual provisions should be extended immediately.

The Chamber believes this Committee and Congress should provide businesses with certainty and predictability in the Internal Revenue Code (the "Code")¹, which in turn improves compliance and reduces the cost of administration for both taxpayers and the government. Many of the extenders provisions have long been part of the Code, and taxpayers have come to expect they will be extended annually. The President has also called for extending all of these provisions.² Extending these provisions later and later in the legislative sessions causes greater uncertainty and bigger obstacles to business planning. Recently, extensions of these provisions have been done retroactively, which exacerbates this problem, while also undermining any incentive effects that Congress had envisioned in enacting particular provisions. In short, retroactive extensions are hardly ideal tax policy.

The Chamber appreciates that all tax policies, including these annual extender provisions, must be carefully examined in the context of fundamental tax reform. However, we must not delay these provisions while we engage in that debate.

¹ All references to the Code are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

² See Department of the Treasury, "General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals," (February 2011).

Longstanding Policies

As noted above, many of these extender provisions encompass deductions and credits that have been in the Code for many years and have been extended multiple times. Despite their expiration dates, such provisions in reality are longstanding deductions and credits that taxpayers have come to rely on when making business decisions. Nevertheless, the uncertainty of expired deductions and credits can have a material impact on a business' bottom line in certain cases, requiring certain disclosures such as in financial statements filings, which can adversely affect the business more broadly.

For example, consider the active financing exception. Generally, under the U.S. tax system, American worldwide companies are subject to tax on the *active* foreign earnings of their foreign subsidiaries only when those earnings are repatriated. The Subpart F rules operate to subject American worldwide companies to current U.S. tax on certain *passive* income earned by foreign subsidiaries. The active financing exception generally ensures that income from active foreign business operations in the financial sector is not subject to current taxation in the United States. Thus, this provision mitigates the double taxation of such income, thereby bringing the tax treatment of American worldwide financial service providers into parity with their international competitors. This provision was in the Code for 77 years and was repealed by the 1986 Act. The historical treatment was reinstated in 1997 and has been in the Code since then.³ A provision that has been in the Code for 91 of the 102 years it has existed can hardly be considered temporary.

The research and development (R&D) tax credit has been in the Code for almost 30 years and is a proven incentive for driving investment in R&D, encouraging long term capital investment, creating jobs, strengthening the economy, and spurring innovation in the United States.⁴ Since coming into office, President Obama, in each of his Greenbook explanations of his budgetary tax proposals, has proposed expanding and making permanent the R&D credit.⁵

The above examples are not, by any means, intended to be a comprehensive list of provisions that are of importance to the business community. They simply demonstrate that there

³ See Statement by the Active Financial Services Working Group, For the Record of the Hearing on Expiring Tax Provisions Before the Committee on Finance, U.S. Senate on March 16, 2005, "The Subpart F Active Financial Services Provision Should Be Made Permanent" (March 30, 2005).

⁴ See, e.g., U.S. Department of the Treasury, "Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit" (March 25, 2011) (noting that the R&D credit in its current form offers a cost-effective way to encourage research spending and supports high-wage jobs). See also Carroll, Prante, and Quek, "The R&D Credit: An effective policy for promoting research" (September 2011) (estimating the higher wage and employment impacts of the R&D credit).

⁵ See General Explanations of the Administration's Fiscal Year 2012 Revenue Proposals (February 2011), General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals (February 2010), General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals (May 2009). See also U.S. Department of the Treasury, "Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit" (March 25, 2011) (suggesting that a strengthened credit would leverage more than \$100 billion in domestic private sector research in next 10 years, support nearly 1 million U.S. research workers in higher than average wage jobs, strengthen the incentive effect of the credit "by providing certainty to taxpayers") (emphasis added).

are longstanding and sound tax policy reasons for many of the annual extender provisions and that these kinds of provisions have very real impacts on American businesses.

Recent Pro-Growth Developments

Not only are longstanding provisions based in sound policy, more recently added provisions also are reasonable and necessary policy. The related controlled foreign corporation (CFC) look-through rules are essential to mitigating double taxation. These rules were originally designed to help American worldwide companies simplify and organize their numerous subsidiaries without creating issues for those companies with the Internal Revenue Service (IRS). Under the rule, related CFCs of a common U.S. parent company can make cross-border dividend, interest, rent, or royalty payments without creating subpart F income, as long as the amounts are paid from active foreign business profits or effectively connected income of the payor. According to the legislative history,⁶ Congress believed that the provision would make American worldwide companies and American workers more competitive. The rule permits CFCs to reinvest their active foreign earnings where they are most needed without incurring the immediate additional tax that companies based in many other countries never incur.

Consider the deduction for state and local sales tax. Absent from the Code for 16 years, it was reinstated in 2004.⁷ This provision is essential for taxpayers who live in “sales tax states.” By allowing residents of those states to deduct state and local sales tax, it places them on an even footing with residents in income tax states who can deduct their state income taxes for federal purposes. This provision was in the Code for an extended period of time and then was reinstated to bring parity to those taxpayers in sales tax states.

Consider also the 15-year depreciation period for leasehold improvements, restaurant improvements and new construction, and retail improvements, which reflects the tax policy principle that costs of assets are allocated over the period in which they are used. The 15-year recovery for such improvement is predicated on the rationale that the current 39.5-year depreciation period for buildings bears little relationship to the economic life of such structures and even less to building improvements and upgrades required in successful businesses, in particular restaurants and retailers. Business property must be remodeled and updated periodically to maintain a positive consumer environment and to remain competitive, and the lifespan of such updates is far shorter than the 39.5-year depreciation building life. Similarly, the duration of leases of real property are typically for a period well short of 39.5 years, giving improvements to such property a shorter lifespan. Thus, this 15-year recovery period reduces the cost of capital expenditures and increases cash flow. In turn, this provides needed capital for American businesses – which, in turn, translates into American jobs.

The railroad track maintenance tax credit was enacted in 2004 to enable small and mid-sized railroads to modernize and enhance their own infrastructure to meet the country's growing freight needs. The Federal Highway Administration has forecast a more than 60 percent increase in freight demand across all transportation modes by 2040, yet we lack adequate capacity to meet

⁶ See Joint Committee on Taxation, “Bluebook Of Legislation Enacted By 109th Congress,” (JCS-1-07).

⁷ See Joint Committee on Taxation, “Description Of H.R. 4520, The “American Jobs Creation Act Of 2004,” (JCX-41-04) (June 10, 2004).

this demand. We cannot compete in the global economy without significant upgrades to our infrastructure, and this is an industry which pays its own way, without direct government involvement, that is expanding on its own to the benefit of the entire U.S. economy.

Global Competitiveness

As this Committee considers renewal of the annual tax extenders, it is important to consider the role these provisions play in the global competitiveness of American worldwide companies. These extenders not only help level the playing field for American worldwide companies today, they offer these companies a chance to compete as we strive to overhaul the Code in the long run to make it more in line with other countries' tax laws.

Mitigating the Burdensome High Marginal Rate

Currently, American worldwide companies face the second highest marginal tax rate among the 34 countries in the Organisation for Economic Cooperation and Development (OECD). On April 1, 2012, when Japan reduces its rate, the United States will have the highest marginal corporate tax rate in the OECD.⁸

The credits and deductions included in the annual extenders provisions help mitigate the impact of our over-burdensome marginal rate and outdated Code structure, reducing taxpayers' effective tax rates to levels that gives them a chance to compete on a level playing field with foreign competitors. Congress' failure to extend these provisions seriously hampers the ability of American worldwide companies to compete, create jobs, and drive economic growth.

Research & Development (R&D)

In 1981, the United States was one of the first countries to add an incentive for research and development to the Code. For a period in the 1980's, the United States was at the forefront of R&D incentives. However, other countries soon followed, introducing their own R&D incentives. By 2008, the United State's R&D tax incentive ranked 17th overall amongst OECD nations.⁹

Other countries have moved to incentivize R&D, through adoption of super deductions, credits, and patent and innovation boxes. These countries use these incentives to promote the relocation of R&D operations to their countries as part of "innovation-led economic development strategies."¹⁰ Thus, the United States' R&D credit must compete with the aggressive incentives marketed by other countries. The failure to, at very least, simply maintain our current credit increases the risk that the jobs, capital investment, and intangible property developed in the R&D process will move outside our borders.

⁸ See President's Council On Jobs And Competitiveness, "Road Map to Renewal" (January 2011) (commenting on U.S. marginal corporate rate and comparing to other countries).

⁹ See Information Technology and Innovation Foundation, "Create Jobs by Expanding the R&D Tax Credit," (January 26, 2010).

¹⁰ See Deloitte, "Global Survey of R&D Tax Incentives," (July 2011).

Mitigating Double Taxation

The United States is currently the only OECD nation to continue to employ a worldwide system of taxation, thus subjecting American worldwide companies to a second layer of taxation that their foreign competitors don't face. While provisions such as deferral and certain foreign tax credits mitigate some of this double taxation, other provisions, such as the active financing exception and CFC look-through rules discussed above, require annual Congressional action to make sure companies affected by those rules are not subjected to double taxation.

These annual extenders are essential pieces of the Code that give American worldwide companies a fighting chance against foreign competitors by lowering our anti-competitive marginal tax rate, providing R&D incentives to encourage research within our borders, and mitigating the potential double taxation of large segments of the American business sector.

Conclusion

The Chamber thanks the Committee for the opportunity to testify today on the extension of these vital tax provisions. The Chamber applauds this Committee's continuing work towards comprehensive fundamental tax reform. However, we believe that the extension of these annual extender provisions cannot be delayed until work on comprehensive tax reform is complete. Taxpayers need stable and predictable rules they can rely upon while that important process is completed. We strongly urge the Committee and Congress to act quickly to extend these longstanding policies and prevent unnecessary damage to the economy and job creators.

**STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF JANUARY 31, 2012
EXTENDERS AND TAX REFORM: SEEKING LONG-TERM SOLUTIONS**

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining expiring tax provisions and tax reform:

It is difficult to find many people who will argue that Congress can, or should, continue dealing with tax extenders in a business as usual manner. The explosion of temporary tax provisions in recent years is a very notable and problematic trend. The number of temporary tax provisions has grown from 42 in 1998 to 154 in 2011. Even those tax extenders that are sound tax policy lose much of their power due to their temporary character.

For example, Congress has recently allowed important temporary tax incentives such as the research and development credit to expire. Then, after business decisions have already been made, Congress has retroactively extended the tax provisions. If a provision is worthy of being in the tax code, then it generally should be made permanent. For instance, the R and D credit is an extremely worthy provision, and it should be enhanced and made permanent, as Chairman Baucus and I proposed in a bill that we introduced in September 2011.

Certainty in the Tax Code is a very important factor in allowing businesses to plan their affairs, make investments, and create jobs. And these job creators don't want bad certainty — they don't want to hear that their taxes are going up. Congress should provide this certainty by making permanent the provisions that are worthy of remaining in the law, and eliminating those that are not. Chairman Baucus and I agree, along with many of our colleagues, that the current tax code demands comprehensive reform. In the meantime, before tax reform is accomplished, Congress needs to decide what to do about the tax extender provisions that have expired. That is the subject of this hearing, and I'm interested in hearing the testimony of our witnesses.

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Extender Tax Provisions
Hearing of the Senate Finance Committee, January 31, 2012
Statement of Calvin H. Johnson, Austin, Texas

Opening Statement

Congress needs to exercise budget responsibility and give strict scrutiny to the items of this Extender list. I have gone through the list and conclude that 13 of the provisions, worth about \$18 billion over ten years, need to be left expired. They expired at the end of 2011 and good riddance. Rejoice in the news that they are dead.

For nine of the provisions, worth \$12 billion over ten years, there is a worthy cause, but the provisions need to be reworked to cut out the fat in the program and government-caused waste. The provisions need to be refocused on their worthy goal with greater efficiency.

For three of the provisions, worth \$2 billion over ten years, the government does not know enough to know whether the government is getting its money's worth for its costs. Indeed, there are \$6 billion over ten years in the provisions I did not know enough about to talk about them, and there might be junk in the group that I cannot talk about.

The Extender items, in general, are subsidies delivered through the tax system. They are exceptions to the normative rule that "taxable income" needs to describe accurately the standard of living of the taxpayer. These are almost all accounting or tax gimmicks. A subsidy delivered through tax gimmicks is an unfair subsidy because it is hidden. If the subsidy is in the form of federal spending and on the federal budget, the cost is transparent to the Democracy. Federal spending is not popular, but it is clear, and if the Democracy approves of spending, that is legitimate. Tax gimmicks are hard to understand, including for me and this Committee, and that means that they are opaque to the Democracy and not legitimated by the general understanding.

Even beyond my general skepticism about tax gimmicks as an instrument in a Democracy, I have gone through the list and made critical evaluations where appropriate and suggested improvements to the focus and efficiency where appropriate.

Congress has a lot of work to do to cut out the fat and government waste in the worthy goal programs, repeal the bad ones and study the unknowns. It would be easy, and not far from wrong, to let them all stay expired, dead in their graves. Even the good ones are in bad company. But some of the provisions are worse than others.

Congress, in passing these things in the first place, knew that a future Congress, this Congress, needed to look at these provisions with a skeptical eye. Congress, by making them temporary, knew that we could not afford to make the provisions permanent. That judgment was wise. Congress also knew then that these provisions were on the junky side, which is why they told a future Congress to look at them again before passing them. We should listen to their wisdom.

Congress, in its official measurement of the budget, treats these provisions as expired at the end of 2011, as the law in fact provided. We are now running federal deficits that are too large to be sustained. We might expect a budget crisis, that could come on very quickly, in which investors who lend to fund the federal deficit lose faith in American debt. A budget catastrophe can come on very suddenly. These extenders are additional deficits.

In this partisan Congress, it is going to be very hard to find the \$38 billion in revenue over ten years to pay for the extenders. In fact, it would be wrong to raise tax rates to pay for these. Tax rate increases do harm. It would be even worse to extend this list without pay-fors. The list does not have that much quality.

The items on this list expired on January 1 and are dead. Resurrecting items retroactively is especially problematic. The arrow of time works only forward so you cannot influence the past. The deals already done are highly likely to be those that would have been done without the tax subsidy. Giving money to a deal done without it just creates a windfall to the beneficiary and waste by the government. There was no contract with Congress for these things or commitment, only some preliminary negotiations or hopes, and the deal is not a deal until the President signs it. If Congress resurrects any of these, it needs to do so only prospectively.

I understand that many of these provisions are extraordinarily popular. Indeed the most popular provisions are those that are the worst from a good government point of view. I am reminded of the high price lawyer, who told his clients, "If you have justice on your side, why do you need me?" Government waste, whatever the platitudes, is very popular. Every government waste gives a bonanza on the other side, and your constituents and supports like the bonanza. Still Congress needs to exercise budget responsibility, *even* over wasteful provisions.

Evaluation of Specifics

The proposed Extenders are listed as follows:

A. "Keep it Dead" list. These are provisions for which the 2011 expiration should be allowed to take hold. I recommend keeping dead 13 provisions that would increase our deficit by about \$18 billion over 10 years.

B. "Re-enact only after Better Focus Cuts Down Government Waste." These provisions have a worthy goal, but the provision needs to be redone to focus its cost in a more efficient way. There is fat and government waste in these programs that needs to be cut out. I recommend fat-cutting revisions to nine proposals worth about \$12 billion over 10 years.

C. "Too little information to know," covers those provisions in which the government does not even know enough to know whether it is wasting money. These provisions should be re-enacted only after a cost-benefit study collects enough information to see if these are cost effective and well focused for optimal efficiency. I identify three proposals worth about \$2 billion over ten years. All of the \$6 billion of proposals I do not comment on would probably fall into this category. I do not know enough to know we do not know enough.

Within the categories, the items are listed, roughly, according to their size by revenue estimate over 10 years, but provisions raising the same issue are grouped together. I do not comment on all of the provisions because my expertise is limited. The analysis draws on the Senate Budget Committee, Tax Expenditure Compendium of Background Provisions (Comm. print 2008) for almost every provision, even when my analysis departs from the Compendium.

A. “KEEP IT DEAD” LIST

1. Exception under Subpart F for active financing income (\$5.2 billion over 10 years)

Description. The U.S. parent of a foreign subsidiary engaged in a banking, financing, or similar business is eligible for deferral of tax on such subsidiary’s earnings if the subsidiary is predominantly engaged in such business and conducts substantial activity with respect to such business. The subsidiary must pass an entity level income test to demonstrate that the income is active income and not passive income. The proposal extends the provision to the end of 2012.

Assessment. Do not resuscitate because Uncle Sam needs the money.

A lead story in the New York Times has suggested an illegitimate tie-in between the extension of section 954(h) and GE’s \$11 million contribution to school districts in the congressional district of the then Chairman of the House Ways and Means Committee. David Kocieniewski, “G.E.’s Strategies Let It Avoid Taxes Altogether,” *The New York Times*, Mar. 25, 2011, at A-1. GE paid no tax in 2010 on \$9 billion of economic income. It reports saving about \$2.3 billion tax for that year by reason of global activities generally, although it does not break down the savings to the various ways to avoid subpart F.

Fundamental accounting principles require that a parent and subsidiary group of corporations must report on a single consolidated basis. A wholly owned subsidiary is just a separate pocket book, but U.S. tax law treats a wholly-owned subsidiary with a certificate from a tax haven as if it were a separate entity with a mind of its own. The “kiddie tax” of IRC §1(g) taxes the unearned income of children in the household at the parent’s tax rate. Teenagers, indeed two-year-olds, can say no. A consolidated group of corporations is even more of one economic group than a household subject to the kiddie tax. A wholly-owned Bermuda or Cayman Island subsidiary cannot say no.

The treatment of foreign subsidiaries as if they were separate means that the corporations can avoid U.S. tax on income they can allocate by transfer pricing to the overseas tax haven, unless they bring it home. The multinationals abuse transfer pricing to allocate as much of their global income to foreign havens as they can. Affiliated groups have reported average returns of 24 percent in tax haven subsidiaries at the same time that they are reporting 4 percent returns on U.S. affiliates. Martin A. Sullivan, “U.S. Citizens Hide Hundreds of Billions in Cayman Accounts,” *Tax Notes*, May 24, 2004, p. 956. Whether profits are shifted by legal but aggressive accounting or by illegal means is not always clear.

Subpart F attempts to deny the benefits of tax deferral until repatriation to income that is easily moved. For businesses with factories and tangible sources of income, one needs the factory to be overseas to be economically real. Financial assets, by contrast, can be moved to a tax haven with a click of the send button, without any real activities moving overseas. It is said that Cayman Islands is a suburb of Greenwich Connecticut because the financial assets are managed by people who never leave Greenwich but sourced to Cayman’s by mere electrons. One small office building in Georgetown, Cayman Islands is the registered home of 18,857 corporations with billions of reported income, and the parking lot is quite modest.

In 1986, Congress made financial services income Subpart F income that was not deferrable because the financial services are so easily allocated to tax havens without any economic substance to back up the allocated. The proposed re-enactment would continue the repeal of the 1986 anti-abuse provision and allow financial income to be allocated to tax havens. Letting the

exception to Subpart F expire as it did on January 1 would mean the U.S. could collect tax on the financial investment income, which is good.

As the Budget Committee Compendium puts it, the tax incentive for investment abroad generally results in an allocation of investment capital that is inefficient from the point of view of both the capital exporting country (in this case the United States) and the world economy in general. Economic theory instead recommends a policy known as “capital export neutrality,” under which marginal investments face the same tax burden at home and abroad. Ending deferral of the financial income just brings the taxation of the financial profits back into the general norms, that unconsolidated returns do not reflect economic income and that the income tax in general applies to “income from whatever source derived.” (US CONST., 16th Amendment).

2. 15-year straight-line cost recovery for qualified leasehold improvements, qualified restaurant buildings and improvements, and qualified retail improvements (\$2.9 billion over 10 years)

Description. The proposal extends for one year, through 2012, the temporary 15-year cost recovery period for certain leasehold, restaurant, and retail improvements, and new restaurant buildings, which are placed in service before January 1, 2013. The extension is effective for qualified property placed in service after December 31, 2011.

Assessment. Let the dead be dead. Do not resuscitate.

The 15-year life for leasehold improvements is too short, and it warps investment into inferior uses. In theory, taxable income should identify the economic income from a property. Improvements to a building will last as long as the building lasts. Under current law nonresidential buildings have a 39-year tax life. Congress, when it thought about it, mandated a 35% tax rate for corporations and highest tax bracket individuals. A tax life of 15 years for the improvement, however, means that tax reduces the pretax return by only 22%, instead of 35%.¹ With debt financing of the leasehold, the tax rate is negative, that is, tax not only collects no revenue from the 10% profitable investment but gives 13% of the borrowed amount each year.

Congress can make a serious economic study of how long buildings and improvements last. The study, however, is likely to conclude that current lives for all buildings are too short and inconsistent with debt.

The subsidy reducing the real effective (internal rate of return reducing) tax rate to 22% will distort investment into projects that do not have enough real demand for them. A project should carry the cost of capital based upon what consumers are willing to pay for the product. When tax is a subsidy, however, investors waste capital and go into projects without sufficient real demand, relying the tax subsidy to make up the difference.

A subsidy delivered through short tax lives is also an illegitimate subsidy because it is hidden. If a subsidy is federal spending and on the federal budget, the cost is transparent to the Democracy and gets Democratic legitimacy. The short lives are tax cuts that are opaque to the Democracy and not legitimated by the general understanding.

¹ The calculations available from the author assume a 10% pretax rate of return and constant cash flow over 40 years that yield a 10% return before tax and a 7.8% return after tax.

3. Deduction for state and local general sales taxes (\$2.8 billion over 10 years if AMT is patched)

Description. The proposal extends for one year the election to take an itemized deduction for state and local general sales taxes in lieu of the itemized deduction permitted for state and local income taxes. In 2004, the “American Jobs Creation Act of 2004,” (P.L. 108-357) temporarily allowed taxpayers to deduct states in lieu of state income taxes. The sales tax deductibility option has been extended several times, most recently by P.L. 111-312, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. State and local taxes were among several deductions subject to the phase-out on itemized deductions for taxpayers whose AGI exceeds the applicable threshold amount.

Assessment. Do not resurrect. Enjoy its death.

The general function of calculation of taxable income is to determine the standard of living of the taxpayer. We calculate standard of living and apply tax brackets with different rates for different standards of living because it would do more harm to the sum of human happiness to take a dollar of tax from a taxpayer with a low, subsistence level of income than it would to take a dollar of tax from amounts that would be spent on luxuries.

Amounts lost should be deducted to calculate standard of living, but where a taxpayer gets a quid pro quo in the form of goods or government services, the expenditure should not be deducted. Under the is-it-lost theory, the big progressive taxes should be deducted because the state is stealing from Peter to pay Paul, and Peter should get a deduction for his loss. When Peter is getting some quid pro quo for the expenditure that he himself enjoys, however, Peter’s taxable income should include the expenditure, and it should not be deducted.

Sales taxes are especially likely to be an expense in which the taxpayer gets goods in return. One incurs sales tax only by voluntarily paying for some good and only because the good is worth its cost or more to the purchaser. We need to give respect to consumer sovereignty of choice and disallow the cost because of the choice. The money is not lost.

It is sometimes hard to distinguish redistributive stealing-from-Peter taxes from Peter-got-the-full benefit taxes, but sales taxes are an easy case in which Peter himself announced the tax was worth paying because he bought the goods, including the tax, voluntarily. The sales tax is part of the cost of consumption.

4. Energy shift credits

4a. Grants for specified energy property in lieu of tax credits (\$1.3 billion over ten years)

4b. Incentives for biodiesel and renewable diesel (\$1.1 billion over ten years)

Description. The grants in lieu of credits proposal extends for one year the start-of-construction deadline for the cash grant in lieu of tax credit program, established in Section 1603 of the *American Recovery and Reinvestment Act*. The biodiesel proposal extends for one year, through 2012, the \$1.00 per gallon tax credit for biodiesel, as well as the small agri-biodiesel producer credit of 10 cents per gallon. The proposal also extends through 2012 the \$1.00 per gallon tax credit for diesel fuel created from biomass.

Assessment. Allow the provisions to die quietly and replace with needed higher taxes on carbon and oil.

We need to move away from reliance on gasoline as quickly as possible to other energy sources, both because we import oil from trouble spots in the world and because fossil fuels

pollute and lead to global warming. First, the tax system can induce movement to alternative fuels best by a carbon tax on externalities caused by oil consumption.² Second, the oil industry is undertaxed. Redoing computation of oil accounting to lead to an accurate and honest description of oil profits³ would increase the price of the oil and help the necessary shift to other forms of energy.

5. Special rules for qualified small business stock (\$1.2 billion over 10 years)

Description. Generally, non-corporate taxpayers may exclude 50 percent of the gain from the sale of certain small business stock acquired at original issue and held for more than five years. For stock acquired after February 17, 2009 and on or before September 27, 2010, the exclusion is increased to 75 percent. For stock acquired after September 27, 2010 and before January 1, 2012, the exclusion is 100 percent, and the AMT preference item attributable for the sale is eliminated. Qualifying small business stock is from a C corporation whose gross assets do not exceed \$50 million (including the proceeds received from the issuance of the stock) and who meets a specific active business requirement. The amount of gain eligible for the exclusion is limited to the greater of ten times the taxpayer's basis in the stock or \$10 million of gain from stock in that corporation. The provision extends the 100 percent exclusion of the gain from the sale of qualifying small business stock that is acquired before January 1, 2013 and held for more than five years.

Assessment. Let the whole program expire and good riddance.

The general tax rate on sale or distributions from a C corporation⁴ is the capital gain rate now at 15%. Distributions after the death of the original owner are subject to zero tax. The low shareholder 15% tax rate and zero rate after death is our form of "corporate integration," that is, adjustment at the shareholder level to take account of tax paid at the corporate level.

There is no sign that 15% and zero after death is too high within the goal of corporate integration. Corporations avoid tax on their economic income because taxable income is such a terrible loophole-ridden description of the corporation's real economic income. (GE had \$9 billion of economic income in 2010 under the stock market assessment but paid tax of almost zero.) The corporate tax is shifted to officers and employees and to all suppliers of capital and not then borne in full by the shareholder-owners. Corporate tax also lowers tax by putting off shareholder tax, which offsets the detriment of corporate tax. The 15% shareholder rate is not bad accommodation with a bad corporate tax base, the deferral of shareholder tax that C corporations give, and the shifting of the corporate burden to others.

Zero tax rate on gain or distributions, as the extender would provide, is too low a rate in general to achieve integration. We need to increase shareholder taxes and lower section 11 tax, as the ease of global investment increases, because corporations can avoid tax by shifting their activities, but shareholders have to live where they live. Reducing shareholder tax is a move in the wrong direction.

² Ian Parry, *Raise \$100 Billion from a \$20 CO₂ Tax*, 123 TAX NOTES 243 (April, 2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1517474.

³ Calvin H. Johnson, *Accurate and Honest Tax Accounting for Oil and Gas*, 125 TAX NOTES 575 (2009) [<http://www.utexas.edu/law/faculty/calvinjohnson/accurate-and-honest-tax-acct-for-oil-and-gas-11-02-2009-tax-notes.pdf>].

⁴ A "C" corporation is a regular corporation subject to corporate tax of between 15% and 35% under section 11.

“Small business” is an honorific title in America, up there with Apple Pie, but it is difficult to see what there is about it that deserves a subsidy. Most small business are dry cleaners, propane shops, funeral homes, restaurants, clothes boutiques and hardware stores, doctors, lawyers and insurance salesmen. Small businesses serve their customers well when they stay in business, but are not investing massive capital. They are also inventing new quantum physics storage techniques or decoding DNA secrets with cutting edge research to give benefits to the public at large. The theory of a subsidy is to pay for benefits beyond those to customers and owners, and the primary benefit of a small business to the customers and the owners.

Any tax reduction for small business needs to be given at the individual level, not because of the way by which he makes his money, but because of his standard of living. Taxable income in general needs to describe the standard of living of the beneficiary who gets it. Tax on the near poor maximizes the pain of tax, and a tax on money that is going to be spent for luxuries minimizes the pain of tax. Whether a taxpayer makes his money in a big office building or his own shop, money is money. Money should be treated the same from whatever source derived. Anything else is unfair.

6. Look-through treatment of payments between related controlled foreign corporations under the foreign personal holding company rules (\$775 million over 10 years)

Description. The proposal allows deferral for certain payments (interest, dividends, rents and royalties) between commonly owned controlled foreign corporations (CFCs). This provision allows U.S. taxpayers to deploy capital from one CFC to another without triggering U.S. tax. The proposal extends present law to the end of 2012. The proposal is effective for tax years beginning after December 31, 2011.

Assessment. Keep it dead.

Subpart F ends deferral for passive income that can be placed into a tax haven, and this proposal creates an exception to Subpart F and allows the movement of passive income into the haven. The grand norm is that the U.S. taxes income from whatever source derived because it needs the money, and the fundamental accounting principle is that income received by a subsidiary needs to be taxed on a consolidated basis.

7. Premiums for mortgage insurance deductible as interest that is qualified residence interest (\$739 million over 10 years)

Description. Under current law, a taxpayer may itemize the cost of mortgage insurance on a qualified personal residence. The deduction is phased-out ratably by 10% for each \$1,000 by which the taxpayer’s AGI exceeds \$100,000. Thus, the deduction is unavailable for a taxpayer with an AGI in excess of \$110,000. The proposal extends this provision for an additional year, through 2012.

Assessment. It is dead and thank goodness.

Costs of a home, including the insurance premiums, are a necessary part of a normative tax base that describes the standard of living of the taxpayer. The primary beneficiary of expenditures for a house is the person who lives in the house. Houses are very selfish investments. It is unfair and an economic distortion to subsidize shelter that benefits only the resident. When you subsidize costs that benefit only the person who lives in the house, then the resident pays more than they would be willing to pay off looking only to their real desires. The

tax system induces waste in paying for what people don't really want. And the subsidies are expensive.

Perhaps there is a benefit to the neighborhood to have people own their houses instead of renting them. But the benefit does not extend beyond the neighborhood, and thus the subsidy should be paid for by the neighbors. From the perspective of the national economy, renters are also good people because they have greater mobility and can adjust quickly to new opportunities or changes in local situations. Subsidy for housing also diverts capital from more productive uses like innovative research of value to the general public.

People who specialize in housing construction like subsidies to housing. But their considerable talents would do more good for the economy if they were building things that people really wanted, judged without the tax subsidy, instead of the less desired things that have an artificially high demand because of the subsidy.

8. Credits for more efficient and alternate energy

8a. Credit for certain nonbusiness energy property (IRC §25C) (\$610 million over 10 years)

8b. Credit for energy efficient appliances (IRC §25M) (\$325 million over 10 years)

8c. Credit for construction of new energy efficient homes (\$74 million over 10 years)

Description. The section 25C credit proposal extends through 2012 the credit under Section 25C of the Code for energy-efficient improvements to existing homes, reinstating the credit as it existed before passage of the American Recovery and Reinvestment Act. Standards for property eligible under 25C are updated to reflect improvements in energy efficiency. The section 25M proposal extends through 2012 and modifies standards for the Section 45M credit for US-based manufacture of energy-efficient clothes washers, dishwashers and refrigerators. The construction of energy efficient homes proposal extends for one year, through 2012, the credit for the construction of energy-efficient new homes that achieve a 30% or 50% reduction in heating and cooling energy consumption relative to a comparable dwelling constructed per the standards of the 2003 International Energy Conservation Code (including supplements).

Assessment. Keep dead.

Keeping a house warm imposes costs on others that the customer does not pay for. For example, electricity generated by coal plants, puts carbon into the atmosphere which increases global warming. It would be more efficient and necessary in the pending budget catastrophe to reduce carbon emissions by imposing a tax on carbon. People will then avoid the new carbon tax by insulating their house or paying for non-carbon energy sources. In the end, keeping the house warm is a very selfish investment, and gives little or no benefit to anyone outside of that house. Costs that benefit only the person who pays for them should not be subsidized because that causes an increase in cost expenditures not justified by the real willingness of that person to pay for them.

Energy efficiency is not a tax issue, and the government tax writing committees do not know enough from their tax expertise to know how to design. The IRS knows nothing about this stuff and should not be the administration to administer them. These credits have no business being in the Tax Code.

9. Geographically targeted programs:**Empowerment zone tax incentives** (\$253 million over 10 years)**Accelerated depreciation for business property on Indian reservation** (\$90 million over 10 years)**Tax incentives for investment in the District of Columbia** (\$76 million over 10 years)

Description. The Empowerment Zone proposal extends for one year the designation of certain economically depressed census tracts as Empowerment Zones. Businesses and individual residents within Empowerment Zones are eligible for special tax incentives. The Indian reservation proposal extends for one year the placed-in-service date for the special depreciation recovery period for qualified Indian reservation property. In general, qualified Indian reservation property is property used predominantly in the active conduct of a trade or business within an Indian reservation, which is not used outside the reservation on a regular basis and was not acquired from a related person. The DC proposal extends for one year the designation of certain economically depressed census tracts within the District of Columbia as the District of Columbia Enterprise Zone. Businesses and individual residents within this enterprise zone are eligible for special tax incentives. The proposal also extends for one year the \$5,000 first-time homebuyer credit for the District of Columbia.

Assessment. The goal is worthy but the programs are government waste. Let die.

According to the Senate Budget Committee Compendium of Tax Expenditures, government-sponsored studies by the Government Accountability Office (GAO) and the Department of Housing and Urban Development (HUD) have failed to link Empowerment Zone and EC designation with improvement in community outcomes. Academic studies have found modest, if any, effects and call into question the cost-effectiveness of these programs.

The programs have flunked the best available cost-benefit analysis.

10. Deduction of inventory in excess of cost**Enhanced charitable deduction for corporate contributions of computer equipment for educational purposes** (\$240 million over 10 years)**Enhanced charitable deduction for contributions of food inventory** (\$138 million over 10 years)**Enhanced charitable deduction for contributions of book inventories to public schools** (\$60 million over 10 years)

Description. All three proposals allow the donor to deduct the value of inventory given for charitable purposes. The separate proposals extend for one year deductions in excess of cost for (1) computer equipment and software to elementary, secondary, and post-secondary schools (2) food inventory and (3) book inventory to public schools (kindergarten through grade 12).

Assessment. These proposals arise from an accounting fallacy that needs to be corrected, and the provisions all need to die.

These three provisions arise from an accounting mistake or from the cynical taking advantage of an accounting mistake. All allow a combination of exclusion and deduction, which is a double accounting, not unlike counting dollar expenses twice. The double deduction shelters unrelated income from other sources that he has retained the donor. The treatment is not a description of money the donor has lost in favor of the charity by the donation. A deduction of basis of the property alone would accomplish that.

One can confidently attribute these provisions to accounting misconceptions because one could not otherwise explain their pattern. The schools are worthy beneficiaries, but why is a double deduction from taxable income the right pattern? Why does the benefit to the donor depend upon undoing tax, by twice? This feels like an accounting gimmick giving a steal subsidy because the people will not understand it. Stealth subsidies are not legitimate in a Democracy.

Because the accounting mistake of deducting untaxed appreciation is so common, it is worth explaining with patience. Assume a cash-method lawyer properly bills two clients for \$40,000 each but collects from only one. There can be no deduction for the \$40,000 excluded amount that the lawyer did not receive, no matter how offensive the client has been by not paying. The taxpayer has a standard of living of \$40,000 from her practice from the bill she collected. One can reach that result only by allowing no deduction for the \$40,000 nonpayment. If we go beyond excluding the nonreceipt and also give the lawyer a \$40,000 loss deduction for the unpaid bill, then the lawyer has cash and consumption of \$40,000 from the client who paid, but no net income. It is an accounting mistake to allow both an exclusion of the unpaid bill and a deduction for it. Current law fixes the problem by allowing a deduction for only basis, and a cash-method lawyer has no basis in unreceived client bills. But it is a very common fallacy, an accounting mistake, that the lawyer should get a deduction when the client does not pay.

Similarly, a taxpayer cannot take a deduction for services given to charity. If a taxpayer gives \$40,000 worth of work to charity, the full and complete accounting remedy is to not tax the taxpayer on salaries he does not have. If we both exclude the \$40,000 worth of charitable work and allow a deduction for \$40,000, the taxpayer will have \$40,000 worth of cash in hand that can be consumed for selfish and greedy purposes, and the accounting error of deduction of amounts that are already excluded would exempt the greedy consumption from tax. This is not a valuation issue but a priority accounting-logic issue that says that double counting should not be allowed. She has the \$40,000 worth of cash salary from noncharitable clients and we must tax it, notwithstanding her charitable work. Current law cures the problem by providing that the value of services is not deductible no matter how truly proved up and how valuable the services are.

Giving blood follows the same principle: we do not tax blood you give to charity, but that is sufficient remedy and there is no deduction of the blood either. Allowing a deduction for blood donation would not be to allow a deduction for losses but rather a deduction for money the donor has kept and consumed.

As a matter of logic, the same results should apply if a taxpayer gives \$40,000 worth of untaxed appreciation to charity. If I make inventory with a cost of \$20,000 that appreciates in value to \$60,000 because of my work when I give it to charity, the right deduction to describe my retained and consumable cash is \$20,000 and not the value of \$60,000. If I have \$60,000 of total income, of which \$20,000 put into the inventory, then I have \$40,000 left after the donation. Allowing a deduction of \$60,000 would shelter out the remaining consumable cash that has not been put in the inventory but which I retain.

It is fairly common even for sophisticated tax people to make the accounting mistake. But once the misperception is corrected, it is difficult to see why the mistake is justified.

The proposals under review create separate problems because the deduction of value is not of value based on an arm's length purchase price by real people, but upon an assessment of value. Taxpayers cheat on valuation. They tend to give the old food, the unsaleable books and the last generation computers to the schools and deduct the list price of the inventory as if that were the value. Old food and old books and old computer inventory do generate valuation disputes

because there is no arm's length bargain to validate the asserted value. But it is tragic that the valuation disputes are unnecessary because cost and not value is the proper deduction.

The issue here is not the level of incentive given to a charity but the opaqueness of the gimmick. Transparent subsidies given on budget are fair disclosure to the democracy. But the shelter for amounts retained by the donor are opaque and unfair because they have insufficient disclosure. The democracy can give incentives as budgeted government spending because it understands the costs as real money. Section 170(e)(3), (e)(4) and (e)(5) of the Code do not have fair disclosure of the costs. They are opaque undisclosed tax gimmicks. They are unfair and they need to be stopped.

11. Suspension of 100 percent-of-net-income limitation on percentage depletion for oil and gas from marginal wells (\$125 million over 10 years)

Description. The proposal extends through 2012 the suspension on the taxable income limit for purposes of depleting a marginal oil or gas well.

Assessment. Stay dead.

The percentage depletion allowance is a deduction of imaginary costs. Oil production recovers most of its costs by expensing of intangible drilling cost and pool of capital doctrine (which pays for services out of production and without any basis). The percentage depletion continues to be allowed even when all costs have been recovered.

The percentage depletion allowance arose out of a misperception in the early income tax of what "capital" was that needed to be allowed to compute income. The old conception was that "capital" was the starting value or discovery value of the oil and not its lower "basis." Senator David Reed of Pennsylvania was the floor manager of the 1925 act that created percentage depletion, and he argued that if he discovered a gold mine, basing depletion on cost "would not allow me an adequate return on my 'real capital.'"⁵ "Real capital" meant to Reed the extraordinary value of the gold mine when found, not the invested costs in the gold mine. We now use the term "basis" rather than "capital" to describe what needs to be subtracted to compute economic income, which is cost. That corrects the old error.

Public policy needs to increase the tax on the oil and gas industry. We need to be investing in alternative energy sources, both for national security concerns and because of the damage that oil does to the environment. Errors like the percentage depletion increase our national security concerns because they induce a faster use of our domestic reserves; if security concerns are paramount, we should be prohibiting the pumping of domestic oil to save it for the future when an international crisis blocks access to foreign oil. The oil from marginal wells should stay in the ground. A higher tax on oil will raise the price of oil and induce consumers to conserve oil and investors to invest in the alternative sources of energy. The old "capital" mistake, giving percentage depletion exclusions for imaginary costs, needs to be corrected as quickly as possible.

12. Basis adjustment to stock of S corporations making charitable contributions of property (\$82 million over 10 years)

⁵ Calvin H. Johnson, *Accurate and Honest Tax Accounting for Oil and Gas*, 125 TAX NOTES 575 (Nov. 2, 2009) [<http://www.utexas.edu/law/faculty/calvinjohnson/accurate-and-honest-tax-acct-for-oil-and-gas-11-02-2009-tax-notes.pdf>].

Description. The proposal extends for one year the provision allowing S corporation shareholders to take into account their pro rata share of charitable deductions even if such deductions would exceed such shareholder's adjusted basis in the S corporation.

Assessment. Keep dead. Pound on it a bit to make sure.

A deduction in excess of basis is always a tax shelter, exempting from tax money the taxpayer has retained and used for his own purpose. The charitable deduction of basis is appropriate to describe the diminution in the donor's standard of living because of amounts given to others. It is unfair, however, to exempt from tax amounts in excess of basis because that represents amounts the taxpayer has kept because that ain't charity. While adjustment to describe standard of living is appropriate within an income tax, a subsidy for amounts not lost is illegitimate. The subsidy delivered as a deduction depends upon tax bracket with the higher subsidy going to the richer taxpayer and the lesser or no subsidy given to worthy donations from out of lower tax brackets. The mirror image of the progressive tax system is never the appropriate pattern for a subsidy that is trying to accomplish something.

Extending the erroneous subsidy to gifts by an S corporation adds damage. A corporation is an artificial entity organized for profit. Taking shareholder money, by a mere majority vote of the directors, and diverting it to a charity of the officer's choice is a breach of duty to the minority shareholders. But even when the donation has full shareholder consent, facilitating a tax loophole is never a good idea.

This is an unfair subsidy because it is sneaky. When the government makes a cash grant by government spending, the budget process makes the cash grant known and generally understood by the electorate. Democratic legitimacy does not attach, however, to sneaky tricks delivered through the tax system because the Democracy does not understand what is going on. This one is UNFAIR.

13. Seven-year recovery period for motorsports entertainment complexes (\$29 million over 10 years)

Description. The proposal extends for one year the special seven-year cost recovery period for property used for land improvement and support facilities at motorsports entertainment complexes.

Assessment. Keep dead. Kick to make sure.

Improvements to land to prepare for buildings and make a race track or race course have indefinite value and, like the costs of stock or money in the bank, the costs are not generally depreciable under the tax law. Allowing a seven-year write-off for the improvements to land is a sneaky, unfair accounting trick to reduce tax inappropriately. Using 10% as the appropriate interest rate for risky investment, a seven-year life for an indefinite life asset turns a 35% nominal tax rate in to a 13% tax rate. Tax with the seven-year life will reduce the 10% pretax return only to 8.7%, whereas the tax rate that Congress voted with on was a tax rate of 35% when it deliberated about tax rate in enacting section 11. The seven-year write-off reduces the real tax to about a third of the statutory rate or 13%.

Nonresidential buildings are treated as lasting for 39 years, which is a generous treatment. If you assume a 40-year building and the same 10% pretax return, then the seven-year write-off reduces the tax from 35% statutory rate to a real (internal rate of return reduction) rate of 14% or less than half of the statutory rate.

The lower rates to recreational motorsports complexes do harm to the private economy. Recreational complexes that could not carry their cost of capital in absence of tax should not be built. The demand of people coming through the gate is not high enough to carry the real costs. But the tax subsidies through the seven-year write-off mean that we waste money on recreational projects for which there is insufficient real demand. That is inefficient, distorting economics, and it is unfair.

B. RE-ENACT ONLY AFTER BETTER FOCUS CUTS DOWN GOVERNMENT WASTE

The following provisions have a worthy goal, but the provisions need to be altered to cut out the fat and the government waste.

1. Tax credit for research and experimentation expenses (\$7.7 billion over 10 years)

Description. The proposal extends for one year, through 2012, the research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenses for a taxable year exceed its base amount for that year and provides an alternative simplified credit of 14 percent.

Assessment. Let the provision expire and replace it. Define research strictly and after the fact to refocus the benefit on costs that give benefits to society at large beyond customers. This can be done with the most bang for the buck by giving the National Science Foundation grant money and by giving NSF money to pay multi-million-dollar awards after the fact to the research over the last decade with the greatest social benefit. If the NSF will set up a tournament to win a \$500,000,000 prize, many people will be induced to try for it. Indeed the NSF could set up 14 of these prizes for a decade and still save money over the cost of this credit.

Increasing the research and experimentation that would give benefits to the general public is a worthy goal, but the waste and the fat need to be trimmed out. The for-profit market will not pay for research unless the developers can charge their customers for it. The really big breakthroughs so influence the country as a whole that they are reflected in benefits far beyond any product the innovator can make or sell. Without government subsidy to research, we would not have had penicillin, lasers or internet. Venture capital funds are looking now for "killer apps," but without the government-paid-for research that created the internet, these killer apps would have no value. But no one knew before penicillin, lasers or internet were created how extraordinary they would be and no one knew how to charge customers to justify the costs of development. Government subsidy for penicillin, lasers and internet was wise expenditure.

The current subsidies, however, waste money because the cost is spent for costs in which the customer is the only beneficiary, or for costs where the benefits beyond the customer are very modest. "Research" is a nice sounding word, but the current definition of research to include all "innovation" wastes money because it includes costs that need to be fully justified by customer demand or should not be undertaken at all. Subsidizing those costs wastes both government money and private money because they give incentive to products that are not worth their costs.

For example, the R&D credit is given to computer games with dubious or even pernicious general social impact. The NY Times had a page one, above-the-fold article on how Dead Zone 2 was a major beneficiary of tax benefits, including expensing, exclusions with respect to domestic production, and the 20% R&D credit. In Dead Zone 2, the aliens look like baby seals, they bleed and squeal when blasted, unless you play on mute. David Kocienevski, [Rich Tax](#)

Breaks Bolster Makers Of Video Games, NY Times, September 11, 2011. Onion spoof interviewed a Mother who asked “Does the subsidy mean that computer games are good for you? Oh, it doesn’t does it?” No, they are not. Video Games, *Onion*, September 13, 2011, <http://www.theonion.com/articles/us-funding-video-games,21364/>. The tax subsidies turn a 10% pretax return into a 21% post tax return, on one set of reasonable assumptions. Calvin Johnson, *Capitalize Costs of Software Development*, 124 TAX NOTES 603 (2009). <http://www.utexas.edu/law/faculty/calvinjohnson/CapitalizeCostsOfSoftwareDevelopment.pdf>]. Whatever we say in speeches, games like Grand Theft Auto IV (teaching gamers how to work for violent drug lords) must represent our highest values because they are among the most heavily subsidized activities in America. Congress needs to get control of this stuff.

Subsidies for the computer games and other cases where customers get the benefit cause waste. Quite disgusting games that would not be produced if they had to rely on their real demand by gamers become rational to develop with the tax subsidies. We thus waste costs on cases where the real (nontax) demand would not justify them. The fact that real demand does justify the costs is a terrible reason to subsidize an activity if the society at large does not value in excess of what it paid for.

The way to get the biggest bang for the buck is for National Science Foundation to fund fundamental research. The NSF should also set up a winner tournament with a \$500 million prize for the innovation with the largest social benefit. Tournaments take advantage of behavior economics to get the most investment from the private sector with the least government cost.

A second best solution is to define research and experimentation strictly to focus on cases in which the primary beneficiary is the general public. The costs should need to qualify as basic or fundamental research or experimentation. Development, meaning the investment for a marketable product, should be excluded. The costs should pass the patent standard – that is, they are surprise breakthrough discoveries beyond what a well trained computer scientist could be expected to develop from the state of the art. Normal development not qualifying as extraordinary unanticipated breakthroughs should not qualify. At the very least, computer games and recreational apps should be excluded.

Given the difficulties of identifying research that will benefit the general public beyond the customers, the credit should be cut to 2% of basis. Costs deducted already get zero tax, and zero tax is well enough subsidy to deliver through the tax system.

2. Above-the-line deduction for qualified tuition related expenses (\$2 billion over 10 years)

Description. The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) created an above-the-line tax deduction for qualified higher education expenses. The maximum deduction was \$4,000 for taxpayers with AGI of \$65,000 or less (\$130,000 for joint returns) or \$2,000 for taxpayers with AGI of \$80,000 or less (\$160,000 for joint returns). The proposal extends the deduction to the end of 2012.

Assessment. The goal is worthy, but the program needs to be refocused to cut down the government waste.

The costs of going to higher education is a wonderful investment that will give its high returns over the full lifetime of working. The accurate description of an investment is to capitalize it and then allow a depreciation-like deduction over the useful life of the investment, as the investment shrinks in value as the time remaining shrinks. Education costs have a value over a

full 50-year working life of the student. If we assume the long-term 3% discount rate, the present value of a capital investment write-off over 50 years is 51% of the amount paid. A rule of thumb description would be to allow an immediate deduction of half the cost and be done with it.

A deduction of more than 51% is a government subsidy, not an accurate description of the taxpayer's standard of living, and the format of the subsidy needs to be refined. The deduction is worthless to a student who concentrates on studies and so has less than \$14,000 of income, because they don't have enough taxable income to use it. It is worth as much as $15\% * \$4000$ or \$600 to taxpayers at the top of the allowed range. Roughly 51% is needed to describe the investment in present value terms, so the benefit is about \$300 more than needed to describe income accurately. The cut offs are an imperfect remedy for the upside down effect that comes from using the tax system, not to calculate standard of living, but to deliver subsidy. The subsidy is not very much, but too much of it goes to taxpayers who would go into higher education anyway, and delivering to those who would do it anyway is government waste.

The subsidy will also get an annual review of whether we can afford it, only if it is put on the federal spending budget. The federal budget is the primary tool by which the government thinks about comparisons of what to spend money on. Off budget means a less intelligent assessment. An on-budget government spending program would of course not deliver its subsidy with more going to higher bracket taxpayers than to those making too little as a graduate student to pay tax. An on-budget government would be transparent to the democracy and fair. The tax deduction subsidy has a weird pattern and is unfair.

3. Expansion of adoption credit and adoption assistance programs (\$762 million over 10 years)

Description. The proposal extends for one year the expansion of the adoption credit and adoption assistance programs. The maximum credit is increased to \$13,170 per eligible child (a \$1,000 increase). This increase applies to both non-special needs adoptions and special needs adoptions. Also, the adoption credit is made refundable. The new dollar limit and phase-out of the adoption credit are adjusted for inflation in taxable years beginning after December 31, 2010. For the adoption assistance program, the maximum exclusion is increased to \$13,170 per eligible child (a \$1,000 increase). The new dollar limit and income limitations of the employer-provided adoption assistance exclusion are adjusted for inflation in taxable years beginning after December 31, 2010.

Assessment. The goal is worthy, but the program needs to be refocused to reduce governmental waste.

The benefit from a program includes only the extra children adopted by reason of the governmental cost. Thus, you need to focus all of the federal cost on the marginal cases, where a family would adopt if it can get the federal subsidy, but cannot afford to adopt or would not adopt without it. Daddy Warbucks is going to adopt Orphan Annie (or not) (in the third Act), for reasons independent of the Federal Government paying for his costs of adopting her. Thus money given to Daddy Warbucks is a waste of federal money.

Once upon a time, a county program gave a \$10 bounty for a rat carcass because the rats were eating too much grain. They paid out \$18 million under the program for 1.8 million carcasses and felt pretty good about it. But then they found that last year, without the bounty, the farmers' usual reasons for hating rats meant 1,799,997 rats were killed, so the program only

added 3 more rats. Hold up a carcass because that county had a \$6 million rat. The moral of the story is that you cannot count as a benefit of the program the children who would be adopted anyway; their cost is categorized as government waste.

A means test taking away both credit and exclusion above some level of income is not a perfect way to focus the cost on where it makes a difference, but it is good enough and would improve the efficiency and the cost benefit ratio of this program.

4. Tax-free distributions from individual retirement plan for charitable purposes (\$556 million over 10 years)

Description. The proposal extends for one year the provision that permits tax-free distributions to charity from an Individual Retirement Account (IRA) of up to \$100,000 per taxpayer, per taxable year. The distributions from IRAs directly to the charity allows the taxpayer to avoid the 50% of AGY limitation on charitable deductions to public charities and 30% of AGY limitation on contributions to private foundations. The proposal is estimated to cost \$556 million over ten years.

Assessment. Re-enact only after including the distributions within the 50% and 30% of AGY limitations.

IRAs generally reduce the sum of national savings. Individual retirement saving is dominated by target savers who save less when they can meet their retire goals by setting aside less from current consumption. Other savers fund their IRAs by borrowing, collecting an inappropriate interest deduction, or by diverting fixed savings from some other vehicle. These contribute nothing to national savings. The government deficit, which is the symmetrical opposite of savings, gets larger by the tax cost to it of the IRAs.⁶

Whatever one thinks about the 50% and 30% of AGY limitations on charitable deductions, stop treating IRAs as a privileged case.

5. Deduction for certain expenses of elementary and secondary school teachers (\$206 million over 10 years).

Description. The proposal extends for one year the \$250 above-the-line tax deduction for teachers and other school professionals for expenses paid or incurred for books, supplies (other than non-athletic supplies for courses of instruction in health or physical education), computer equipment (including related software and service), other equipment, and supplementary materials used by the educator in the classroom.

Assessment. A worthy goal, but keeping track and auditing these expenses is more than the system can bear or the benefit is worth. Just pay teachers \$37.50 each.

There is a 2% of AGY floor on employee expenses that makes a lot of sense. Small items should not be part of the tax system, unless you are willing to put an IRS agent in the classroom counting the supplies used in the classroom, and taking away the deduction for the books and supplies that get home. There is also a standard deduction, now at \$11,900 for married couples, that (gloriously!) means that two-thirds of taxpayers do not have to keep track of their records for

⁶ Calvin H. Johnson, *Repeal Roth Retirement Plans To Increase National Savings*, 128 TAX NOTES 773 (August 16, 2010), [<http://www.utexas.edu/law/faculty/calvinjohnson/repeal-roth.pdf>].

itemized deductions, and can often file a tax return that is about the size of a post card. The small stuff has to be cleaned out of the recordkeeping and the annual tax return.

Small business expenses are distinguishable and not subject to the 2% haircut or lost if you take the standard deduction because a business keeps serious books for nontax reasons, and an employee usually does not. If the employer pays for the supplies, as indeed the local school board should, then administrative efficiency goes the other way, and we should not sweat the small stuff or burden the tax return with them if some small supplies turn up at home.

It would make more sense to pay every full time primary or secondary teacher with a \$37.50 federal check (which is 15% of \$250). Don't bother trying to keep track of how they use it at that level, because that imposes a burdensome year round recordkeeping requirement and the \$37.50 benefit is not worth the record keeping. Tell them this is prepayment for the love and supplies they will give to their students. The current above the line deduction is too small for the IRS to audit so that cheaters get ahead and honest taxpayers get overburdened with record-keeping. Let these worthy people have a \$37.50 federal check and be done with it.

6. Parity for exclusion from income for employer-provided mass transit and parking benefits (\$158 million over 10 years).

Description. The proposal extends through 2012 the increase in the monthly exclusion for employer-provided transit and vanpool benefits to that of the exclusion for employer-provided parking benefits.

Assessment. Allow to expire. And repeal exemption for parking as well.

Commuting is treated as a cost of choice of where you live under long standing tax rule. One incurs a long and expensive commute because housing is cheaper the further out you go. Housing costs and commuting costs are trade-offs for the same fundamental need for shelter, and all of the costs of shelter are consumption and part of the appropriate tax base. They should not be deducted in calculating standard of living.

Employees who pay for their own commuting are not allowed a deduction for their costs. Employees who can convince their employer to switch compensation from cash to the employer's paying for commuting, however, get an exclusion that is equivalent to a deduction and avoid tax on the costs. That is unfair! The fact that the employer provides for the cost does nothing to make the costs anything other than a cost of housing, because employers are always looking for ways to pay their employees with money that will not be taxed to them. Both employer provided and employee provided costs of commuting should be subject to employee tax.

Since exclusion or deduction of commuting is a violation of the fundamental purpose of "taxable income," that is, the computation of standard of living, the deduction is a subsidy, not connected with tax, although it is delivered through the tax system. Every subsidy delivered through a deduction is unfair because the effective value of the transit benefits deduction rises with the marginal tax rate of a recipient. The negation of the bracket system is never the right pattern of distribution when you are trying to accomplish something.

The exclusion of parking costs is even worse. Massive amounts of downtown space are moved from their most productive use over to support for the automobile. Urban areas where space is so valuable get misused, warped by tax. Parking should always be treated as a personal cost, part of the package of where to live, and neither excluded nor deducted.

Employers who are in a position to pay compensation in the form of tax exempt fringe benefits like parking and transit get an unfair advantage over employers who do not have access to the fringes. They can pay employees less taxable cash, and they get a competitive advantage. For optimal efficiency, the tax system should create a level playing field among employers in the competition for good employees.

7. Special rules for contributions of capital gain real property made for conservation purposes (\$117 million over 10 years)

Description. The proposal extends for one year the increased contribution limits and carry-forward period for contributions of appreciated real property (including partial interests in real property) for conservation purposes.

Assessment. Repeal the deduction for conservation easements in full to get rid of fraud and government waste. There is no real market for conservation easements, and the figures are made up. Conservation easements will also harm our descendants.

Conservation easements are a bad accounting, a double deduction that shelters money the donor gets to keep and party with. For strict accounting that describes a taxpayer's standard of living, unrealized appreciation should not be deducted. To describe the taxpayer's standard of living, the charitable deduction needs to be limited to the taxpayer's basis in the property because deductions in excess of basis shelter money the taxpayer has kept and consumed. Assume a taxpayer (TP) buys rural timber property for \$100,000 that grows in value to \$1 million because the high cost of timber is so high. TP gives a perpetual easement to a conversation fund saying that the property will remain forever undeveloped. TP claims the value of the land is now \$400,000 and deducts \$600,000.

The \$600,000 deduction is a double deduction that shelters \$600,000 of money that TP can party with. If TP had given the whole property to charity, then it would be appropriate to deduct the \$100,000 basis of the property to reflect the fact that TP no longer has it. We should take out of the tax base the \$100,000 the taxpayer has presumably already paid tax on. But the unrealized appreciation of \$900,000 has not previously been taxed, and it is a double counting to both exclude and deduct the \$900,000. The double counting means the TP has \$600,000 of shelter deduction that exempts from tax unrelated cash the taxpayer has in hand. The purpose of the charitable deduction is to reflect taxpayer's standard of living for amount given away, and the only the basis of property should be deducted to reflect the amount given away. This is not charity, but greed – a deduction for kept and consumed amounts. (See also the deductions for food, computers and book inventories above, for a similar explanation.)

It is sometimes said that the TP must be given the privilege of capital gain on appreciated property because the TP could always sell the property. But there is no market for conservation easements. TP could not sell. Capital gain for \$600,000 on an imputed sale and ordinary income for the \$600,000 on the gift yields a tax windfall of the difference (35%-20%) for a fictitious sale that could not be replicated in the real world. The right deduction is no deduction for the capital gain amount in conservation easements, not the combination of capital gain and ordinary deduction.

The same absence of a market means that conservation easements are like the subprime liars' mortgages—the value is made up. Far better to require TP to sell to the charity with cash the charity has raised from some unrelated donor, because then and only then will we get arm's length purchases that validate the value. That would end the fraud and the bad accounting.

Conservation easements also will do more harm than good to the future of our country. Suppose that the purchasers of Manhattan had slapped on a conservation easement requiring the land remain dedicated to corn and foxes. That would have destroyed about \$164 billion in present value terms because, with the current development that was actually allowed, so many people want to live or work in Manhattan. The conservation easement would have stopped all that. If the original Chicagoans had slapped a no-development easement around Fort Dearborn, we never would have had our Chicago. We need to let the future decide on how best to use its land: they will know better than we do what is the highest and best use of their United States, once it is no longer our land.

8. Reduction in S corporation recognition period for built-in gains tax (\$189 million over 10 years)

Description. If a taxable corporation converts into an S corporation, the conversion is not a taxable event. However, following such a conversion, an S corporation must hold its assets for a certain period in order to avoid a tax on any built-in gains that existed at the time of the conversion. The American Recovery and Reinvestment Act reduced that period from 10 years to 7 years. The proposal extends the reduced holding period for sales occurring in 2012.

Assessment. Stay dead.

The normal rule is that becoming a pass through entity requires the immediate recognition of corporate gain. When a corporate entity converts to a partnership, which is the other form of pass through that competes with the S Corporation, there is an immediate gain recognized to the corporation and to the shareholders. Recognition of gain by the corporation when it becomes a partnership was required by the Tax Reform Act of 1986, which followed the recommendation of the prestigious private American Law Institute. The reason for the recommendation was to stop what was then called the “golden triangle:” Corporate purchasers were getting a step up in basis for business assets including inventory and short life depreciable assets, while the corporate seller was avoiding any tax on the sale. The various forms of the golden triangle did require the shareholders to pay tax on gain from the value of the sale, but with shareholders who turned over their assets or heirs of recent decedents there was not much shareholder gain. Current law is symmetrical. If the buyer gets a higher basis, the selling corporation must recognize gain.

Consistency would require an S election to constitute a constructive sale on which the corporation recognition of its built-in gain is recognized. Both partnerships and S corporations are pass through entities and no viable distinction can be drawn from their tax status. The 1986 compromised with consistency, however, and instead added a taint, requiring corporate recognition of gain if the corporate assets were sold within ten years after the election. The proposed resurrected provision would reduce the taint period to seven years. Sales after seven years of the election would have no corporate level tax.

Shareholders who buy shares at a discount because the corporation has appreciated assets including inventory and intangibles that buyer and seller expect to produce tax will get a windfall when they avoid the tax within the corporation whose shares they have just purchased. The ten-year taint was part of the 1986 deal and it seems we should keep to the deal.

There is, on the other hand, now almost no commitment to preserving the corporate tax.

9. Expensing of “brownfields” environmental remediation costs (\$184 million over 10 years)

Description. The proposal extends for one year the provision that allows for the expensing of costs associated with cleaning up hazardous “brownfield” sites.

Assessment. First best result would be to let the provision remain in place among the dead. But a viable alternative, with some extra administrative burden, is to allow some expensing to get basis down to value. To prevent windfalls, the alternative would disallow deductions that would reduce the adjusted basis of the land to an amount lower than its value. All cleanups would be treated as capital investments to land. The taxpayer should never be allowed to deduct a cost he has not lost because that understates his economic income and standard of living. But he would deduct the basis to reduce adjusted basis to value.

As a matter of theory, the calculation of economic income requires that the taxpayer have a basis in an investment equal to the remaining value. We use internal rate of return as the universal yardstick of economic income. To identify internal rate of return adjusted basis needs to be kept equal to the bank account that is just like this investment. That bank account balance is the value of the investment. If the taxpayer’s basis is higher than its value, reflection of income would allow a deduction to get basis down to value.

The expensing or more than necessary to calculate income will create a windfall to buyers who buy well located land at a discount knowing that they will need to invest some cleanup costs to allow the land to be used to its full potential. Cleaning up the toxic waste on brownfield is a capital investment that makes the land valuable. Many of the brownfield sites are close to metropolitan centers and will be valuable properties under a building foundation because of their location if the toxic damage to the land can be repaired. The ability to deduct an investment means, as a matter of economics, that the internal rate of return from the investment is taxed at zero rate. When debt and expensed investments are combined, the tax is less than zero, the taxpayer shelters unrelated income from tax, and taxpayers go into investments that would not be undertaken in a nontax world.

While calculation of economic income requires that basis be deducted to get down to value, the administrability of the tax system requires that a taxpayer sell the property in order to have a bargained exchange that will validate the value. We ordinarily require an arm’s length sale of property in order for the tax system to recognize its reduced value. The administrative value of the sale is so we can ascertain lower value needs to be applied to brownfields.

C. TOO LITTLE INFORMATION TO KNOW

1a. Work opportunity tax credit (\$971 million over 10 years)

1b. New markets tax credit (\$857 million over 10 years)

Description. Under current law, businesses are allowed to claim a work opportunity tax credit equal to 40 percent of the first \$6,000 of wages paid to new hires of one of nine targeted groups. These groups include members of families receiving benefits under the Temporary Assistance to Needy Families (TANF) program, qualified veterans, designated community residents, and others. The WOTC program is currently set to expire December 31, 2011. The proposal extends this provision through December 31, 2012 and would be effective for employees hired after date of enactment.

Under the New Markets Tax Credit (NMTC) program, the federal government provides investors with either five cents or six cents of federal tax credits (depending on the amount of time that has passed since the original investment was made) for investments in low income

communities. The proposal extends for one year the new markets tax credit, permitting a maximum annual amount of qualified equity investments of \$3.5 billion each year.

Assessment. These programs are not tax related, and knowledge of tax is of no help. The government has too little information to determine whether the benefits justify the costs.

Cutting the credit in half to 20% for the work opportunity credit and to 2-1/2 to 3% for the New Markets Tax Credit, however, would save money and allow a controlled experiment as to what the impact of the credit is.

2. Definition of gross estate for RIC stock owned by nonresident not a citizen of the U.S.
($\$8$ million over 10 years)

Description. Although stock issued by a domestic corporation generally is treated as property within the United States, stock of a RIC that was owned by a nonresident non-citizen is not deemed property within the United States in the proportion that, at the end of the quarter of the RIC's taxable year immediately before a decedent's date of death, the assets held by the RIC are debt obligations, deposits, or other property that would be treated as situated outside the United States if held directly by the estate (the "estate tax look-through rule for RIC stock"). The proposal permits the look-through rule for RIC stock to apply to estates of decedents dying before January 1, 2013.

Assessment. The government does not have enough information to determine whether it is getting its money's worth from its cost.

COMMUNICATIONS

ACTIVE FINANCING | *Working Group*

Statement for the Hearing Record
United States Senate Committee on Finance
Extenders and Tax Reform: Seeking Long-Term Solutions
Hearing Date: January 31, 2012

The Active Financing Working Group
900 7th Street, NW, Suite 750
Washington, D.C. 20001

Statement of the Active Financing Working Group

The Active Financing Working Group applauds the Senate Committee on Finance for holding its hearing on the critically important topic of extending expired tax provisions.

It is essential that the active financing rules be reinstated retrospectively, to the beginning of 2012, and extended forward.

The active financing rules, which have broad bipartisan support, are necessary to maintain the competitiveness of the U.S.-based financial services industry and of manufacturing companies that rely on financial services arms to provide financing for large-ticket manufactured products.

With the active financing rules, the global active business income of U.S. financial services firms is given the same treatment as is provided for the active business income of other, non-financial U.S. companies doing business outside the U.S.

The active financing rules provide that U.S. financial services companies will be taxed by the U.S. on active business income earned by their foreign subsidiaries only when the income is repatriated to the United States. As a result, that income is taxed on a current basis at the same local country rate (e.g., the current UK rate is 26%) paid by non-U.S. competitors serving *customers* in that country. Absent this rule, U.S. subsidiaries serving customers in foreign markets would be subject to immediate tax at the 35% U.S. rate, which would place them at a decisive competitive disadvantage.

The active financing rules have already expired. U.S. businesses urgently need the rules to be reauthorized. The rules are critical to the ability of U.S. financial services firms to win foreign business, compete in foreign jurisdictions to serve local customers, and to be global market leaders. If U.S. firms are disadvantaged in global markets, foreign firms will become dominant. It is in the interest of the United States to have U.S.-owned companies among global financial services industry leaders.



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The active financing rules do not come at the expense of U.S. jobs. The provision of financial services is inherently a local business. To make loans, sell insurance, provide credit, or lease machinery, the business has to be where the customers are located. U.S. financial services companies cannot serve foreign markets without having an active foreign presence.

To the contrary, the active financial services rule supports U.S. jobs. Tens of thousands of jobs at U.S. headquarters and in U.S. service centers are directly attributable to supporting the business of serving global customers outside the United States. Further, U.S. manufacturers rely on the active financial services rule to promote their export of products made by American workers; the rule allows them to offer competitive financing through their foreign affiliates.

The Active Financing Working Group notes that the testimony of Dr. Roseanne Atshuler, Professor and Chair, Department of Economics, Rutgers University, correctly identifies the active financing rules as one of the "fundamental policies of our current tax system" and calls for the rules to be made permanent. In her words, "It does not make sense for provisions that are more properly considered structural features of our tax system, like that active finance exception, to be temporary in nature." Likewise, the testimony of the U.S. Chamber of Commerce recognized the active financing rules as longstanding policy that should be extended without further delay.

In contrast, the written testimony of Professor Calvin Johnson with respect to the active financing rules demonstrates a profound lack of understanding of the statute, its historical context, and its relationship to broader tax policy both in the U.S. and in other countries. Professor Johnson asserts that allowing the active financing rules to expire would be consistent with "general norms". The opposite is true. If the active financing rules are allowed to remain expired, the financial services industry will be the only sector of the U.S. economy in which companies engaged in active business in foreign markets are subject to current U.S. tax (at rates that are among the highest in the world). Throughout our history, the U.S. tax treatment of active foreign financial services income has generally mirrored the treatment of active foreign income of non-financial companies. That is, from 1913 until 1986, and again from 1997 through 2011, such income has not been subject to current U.S. income tax. In addition, this long-standing treatment of active foreign financial services income is consistent with international norms.

Further, Professor Johnson states that financial assets are unlike factories or other tangible sources of income because, "financial assets, by contrast, can be moved to a tax haven with a click of the send button, without any real activities moving overseas." Professor Johnson betrays a fundamental lack of familiarity with the active financing rules. Not even a casual reader of the statute could credibly make such an assertion. Contrary to Professor Johnson's testimony, the active financing rules include numerous anti-abuse provisions. Qualification under the active financing rules is available only for income derived by a foreign subsidiary from the active conduct of a banking, financing or similar business and only if "substantially all of the activities in connection with which are conducted directly by [the subsidiary] in its home

country.” As the legislative history to the statute elaborates, these activities, which include product development, solicitation, underwriting and collections, are required to be conducted by local employees of the subsidiary in the subsidiary’s home country. Further, deferral is unavailable, without exception, for transactions with U.S. customers. Indeed, as a result of these and other requirements, the active financing rules are, beyond a doubt, the most rigorous in all of Subpart F. Professor Johnson’s “click of the send button” characterization, while glib, cannot withstand even a cursory reading of the statute.

In sum, the Active Financing Working Group urges Congress to extend the active financing rules immediately. Their continuation is critical to the competitiveness of American financial services firms and the tens of thousands of U.S. jobs that are dependent on that competitiveness.

ADVANTAGE PERSONNEL, INC.

11224 Boardwalk Drive, Suite E1-1 • Baton Rouge, LA 70816
Phone: (225) 273-8900 • Fax: (225) 273-8909
www.advantage-inc.com

February 2, 2012

Senate Committee on Finance
Attention: Editorial and Document Section
Room SD-219
Dirksen Senate Office Building
Washington, DC 20510-6200

STATEMENT FOR THE RECORD OF
LARRY FREEMAN, OWNER
ADVANTAGE PERSONNEL
11224 BOARDWALK, SUITE E1-1
BATON ROUGE, LA 70816

FOR THE HEARING ON

“EXTENDERS AND TAX REFORM:
SEEKING LONG-TERM SOLUTIONS”

BEFORE

THE U.S. SENATE
COMMITTEE ON FINANCE

HELD: TUESDAY, JANUARY 31, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance:

Thank you for the opportunity to submit this statement for the record on behalf of Advantage Personnel.

As Congress and this Committee undertake the tax reform effort, we wanted to bring to your attention a tax policy that is important to our company. The Work Opportunity Tax Credit (“WOTC”). This provision provides a benefit to the economy and should be continued as permanent aspects of the Internal Revenue Code (“tax code”). This expired provision is essential to our nation’s economic and financial recovery.

Work Opportunity Tax Credit (WOTC)

WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC: targeted employee groups include veterans who either are food stamp recipients or are unemployed and suffering a service-connected disability,

“We Work For You!”

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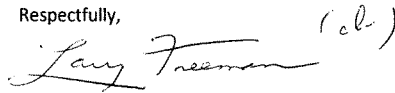
former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients; the most difficult cases are being employed in the private sector and 7 out of 10 welfare recipients are using WOTC to find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance. Further, WOTC works. In 2011, more than 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

Allowing this provision to expire at this time in our nation with unemployment rates as they are is a significant setback for job creation, and the provision should be extended. In the longer term, Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Thank you for the opportunity to submit this statement. We encourage the extension of the WOTC program to encourage economic growth and job creation.

Respectfully,



Larry Freeman, Owner

LF/cb

STATEMENT OF ALLIANTGROUP**EXTENDERS AND TAX REFORM: SEEKING LONG-TERM SOLUTIONS****BEFORE****UNITED STATES SENATE COMMITTEE ON FINANCE****ON****JANUARY 31, 2012*****EXTENDING THE RESEARCH AND DEVELOPMENT TAX CREDIT –
AND SMALL AND MEDIUM BUSINESSES***

alliantgroup welcomes the opportunity to submit comments for the record for the January 31, 2012, Senate Finance Committee hearing to consider extenders and tax reform. Specifically, we wish to focus our comments on the Research and Development (R&D) tax credit.

alliantgroup is the national leader in working with small and medium businesses and their accountants – assisting them in qualifying for the Research and Development (R&D) tax credit. We are proud to have worked with thousands of companies across the country in the last 10 years to ensure that they benefit from this important incentive provided by Congress – resulting in the creation of thousands of jobs. Our comments are based on our unmatched experience working with small and medium businesses seeking to benefit from the R&D tax credit.

We would like to start by focusing on an unappreciated problem of the extenders merry-go-round is that it makes it difficult to make much-needed improvements and changes to the R&D tax credit. Senators are all too familiar that in the drive to get the extenders train out the door before the end of the year the call is always for a “clean” extenders – i.e. no changes to the current law.

The push for a clean extenders bill makes it hard to enact reforms to an extenders provision – even reforms for which there is wide agreement. The reason is that any efforts at reform of an extenders provision “opens up” the extenders bill to other provisions – provisions that are more controversial or problematic. The end result is that to get the extenders bill out of the station all proposed changes are dropped and we keep on keep on with current law – to the detriment of the economy and jobs.

For extenders, nowhere is the case for reform stronger than the R&D Credit. The need for improvements and expansion of the R&D Credit was made clear in the recent Committee hearing last year on the R&D Credit and brought home by the legislation by Chairman Senator Baucus and the Ranking Member Senator Hatch that would expand and enhance the credit.

We encourage the Committee to not only make a priority the expansion of the R&D credit as proposed by Senators Baucus and Hatch but also three additional reforms to the R&D tax credit that will particularly help small and medium businesses.

REMOVE AMT BAR FOR SMALL AND MEDIUM BUSINESSES

Of first importance is removing the top barrier for small and medium businesses taking the R&D credit – that the credit cannot be used to reduce the business owners' alternative minimum tax (AMT). This means, that a business owner of a pass-thru entity that is subject to the AMT cannot use the R&D credit to reduce her taxes. alliantgroup has found in reviewing tens of thousands of tax returns that 8 out of 10 businesses that would otherwise qualify for the R&D credit will receive little to no benefit because the credit cannot be used to reduce AMT. Given that the vast majority of small and medium businesses are organized as pass-thru entities, the potential benefit of the R&D tax credit to encourage innovation and create jobs is greatly diminished.

The Senate Finance Committee made the right policy call in allowing the R&D tax credit to be taken against AMT in enacting the Small Business Jobs Act of 2010 last year. We have seen first-hand that this simple change in the law has translated into providing significant benefit to thousands of small and medium businesses and helped create a small city worth of jobs. The only drawback is that this legislation was good for only one year – 2010. alliantgroup encourages the Committee to make this common sense change permanent for the R&D tax credit or alternatively to extend this provision going forward. We especially commend Senators Snowe and Landrieu for proposing to extend this provision in recent legislation – as part of a broader bill to continue all the provisions in the 2010 Small Business Jobs Act.

ALLOW ASC ON AMENDED RETURNS

The second change to the R&D tax credit we encourage the Committee to consider is allowing companies to take the Alternative Simplified Credit (ASC) on an amended return. Currently, businesses can elect to take only the traditional R&D tax credit on an amended return not the ASC.

While there is no statutory bar to allowing companies to take the ASC on an amended return, the Treasury Department has through regulations – recently reaffirmed – prevented companies from taking the ASC on an amended return.

The GAO in its report to Congress on the R&D tax credit recommended that companies be allowed to take the ASC on amended returns and the Committee heard testimony from its witnesses during the recent hearing on the R&D tax credit that the ASC should be allowed to be taken on amended returns.

alliantgroup sees first-hand the negative impact of this regulation. We are aware of thousands of companies that are performing activities that qualify for the R&D tax credit but are being

prevented by this regulation from benefitting fully from this important tax incentive – and at times are discouraged from even taking the ASC on their current return.

Therefore, because of this regulation, thousands of our nation’s most innovative small and medium businesses are not receiving the assistance intended by Congress through the R&D tax credit.

While the regulation bars all companies regardless of size from electing ASC on an amended return, we find in practice this limitation falls especially heavily on small and medium business. Small and medium business owners do not have the benefit of sophisticated in-house tax departments and aren’t aware of the R&D tax credit or don’t know they are eligible for this tax incentive.

The current regulation effectively places small and medium businesses at a disadvantage to larger business. Further, the regulation is denying the tax incentive intended by Congress and supported by the administration to encourage innovation and new technology – creating new jobs and strengthening our economy.

CREATE A LIMITED REFUNDABLE CREDIT

We encourage the Committee to give consideration to a limited and capped R&D tax credit that is refundable. Recent studies have highlighted that a significant part of jobs growth as well as innovation comes from new companies – from startups. However, these new companies are mostly unable to take advantage of the R&D tax credit – due to the fact that they are not making a profit.

Several states – including New York, Minnesota, Arizona, Iowa and Louisiana – have put in place a refundable R&D tax credit. These state credits are typically capped overall or limited in terms of amounts a company can receive. However, even with these parameters, alliantgroup has seen a refundable credit provide much needed cash for startups – helping keep doors open and create new jobs.

The Committee should consider the refundable credits of these states and we also encourage the committee to consider as an alternative the proposal of Senator Coons, included in his legislation the Job Creation Through Innovation Act, which would realize the same policy goal by allowing startups to sell their R&D credits.

RESPONSE TO COMMITTEE WITNESSES

We agree with the general comments from Dr. Altshuler that the Committee should consider the R&D tax credit as a “traditional extender.” alliantgroup would encourage that a new and improved R&D tax credit should be a permanent part of the tax code.

The Committee also received written testimony that proposed that the R&D credit either be eliminated and replaced with grants from the National Science Foundation or limited only to activities that benefit the “general public.”

Such a proposal fails to appreciate the difference of basic research supported by the government through grants in contrast to the R&D Tax Credit which is designed to encourage and reward businesses that apply science to improvements and innovation. Basic research is that research in the university or laboratory setting as compared to applied research which is research often done on the manufacturing floor and the day-to-day work of a company seeking to solve a specific commercial question.

It is the application of scientific principles to the job at hand – to a set problem or issue – that results in the new new thing or the improved thing and a stronger economy. In the real world it is in the applied research that innovation, efficiencies and new and improved products are realized – not the “eureka” moment in a lab. Recognizing this reality, the R&D tax incentive is targeted for companies engaged in the design and development of new or improved products, processes, technologies and software.

Grants for basic research will do little to encourage and stimulate applied research. For Congress to remove the tax incentives for businesses to engage in applied research and instead pour more money into funding basic research is to promote jobs for academics and sacrifice economic growth and manufacturing jobs. The Congress was right to create the R&D credit to encourage applied research to support industry and manufacturing jobs in this country. The drive of economic growth and new jobs and businesses is ultimately from applied research.

The Committee should also bear in mind that the credit’s success has been due to the fact that it is for applied research conducted by a wide range of industries and activities. At its core the credit is seeking to support those companies engaged in innovation and the application of science and engineering principles in response to the demands of the market. To start to have government agencies single out for reward what they believe are industry “winners” is to go down a path that will fundamentally weaken the goals of the R&D tax credit and harm the prospects of long-term manufacturing in this country. One of the successes of the R&D tax credit is that in practice it is the market that largely decides who shall receive the tax benefits.

As the Committee reviews extenders, alliantgroup encourages the Committee to focus its efforts on ways to improve and expand the R&D tax credit – as was made clear in much of the testimony from its recent hearing on the credit.

On behalf of the thousands of small and medium manufacturing businesses we work with across the nation – thank you for consideration of this submission.

United States Senate Finance Committee

Statement for the Record: January 31, 2012 Hearing

Extenders and Tax Reform: Seeking Long-Term Solutions

Mr. Chairman Baucus, Mr. Ranking Member Hatch, and members of the Committee:

I am Conrad Teitell, volunteer legal counsel for the American Council on Gift Annuities (ACGA), and submit this statement for the record on its behalf.

Let's win this one for the giver. Make permanent now the expired law that allows generous individuals 70½ or older to contribute up to \$100,000 annually from their IRAs directly to public charities. Although transfers from IRAs to charities from the expired law saved taxes for some givers, those charitable individuals would have been far better off financially by not making gifts.

Actually, the real winners are the Americans who are served by our nation's charities.

The federal government is also a winner. Americans making gifts to charity provide funds to meet needs that in many cases would otherwise be a function of government.

The American Council on Gift Annuities (ACGA) (formerly the Committee on Gift Annuities) was formed in 1927, is an IRC §501(c)(3) organization described in IRC §170(b)(1)(A)(vi). ACGA's officers, board of directors and its legal counsel are all unpaid volunteers. **ACGA is sponsored by over 1,000 social welfare charities, health organizations, environmental organizations, colleges, universities, religious organizations and other charities.** The Mission of ACGA is to "actively promote responsible philanthropy through actuarially sound charitable gift annuity rate recommendations, quality training opportunities and the advocacy of appropriate consumer protection." Contact information: The American Council on Gift Annuities, 1260 Winchester Parkway, SE, Suite 205, Smyrna, GA 30080-6546, Phone: (770) 874-3355, Fax: (770) 433-2907, email: acga@acga-web.org.

Statement prepared by: Conrad Teitell, volunteer counsel to American Council on Gift Annuities, (Chairman, National Charitable Planning Group, Cummings & Lockwood, Six Landmark Square, Stamford, CT 06901. Phone: (203) 351-4164; Fax: (203) 708-3840; e-mail: cteitell@cl-law.com).

We ask Congress to now permanently extend and expand the expired Charitable IRA.

Question. Why are we asking Congress to act on the Charitable IRA now even though it may not act on all the other expired provisions until the very end of this year — or even next year?

“Others” is the answer. Over 100 years ago, General William Booth, the founder of The Salvation Army, was asked what one word describes the work of the Army. He replied, “Others.”

The Charitable IRA benefits others. There can be bipartisan agreement on this. The other expired provisions, no matter how worthy, benefit businesses and some classes of individual taxpayers.

The remainder of this statement describes the expired Charitable IRA and a proposed expansion to include transfers for life-income arrangements.

Background — the off-again-on-again-off-again law that allowed tax-free IRA rollovers for direct (outright) transfers to specified categories of charitable organizations. The law, enacted in 2006, expired a few times, but was extended (sometimes retroactively). It expired again on December 31, 2011. The Charitable IRA is an important source of support for America’s charities. Being off-again-on-again-off-again is confusing and reduces the number of new donors and repeat annual donors. The law should be made permanent.

The expired 2011 law in a nutshell. An individual age 70½ or older can make outright (direct) charitable gifts from an IRA — including required minimum distributions — of up to \$100,000 to public charities (other than donor-advised funds and supporting organizations) and not have to report the IRA distributions as taxable income on his or her federal income tax return. Most private foundations are not eligible donees, but private operating and pass-through (conduit) foundations are. The tax-free rollover is for outright gifts only, not life-income gifts. A charitable deduction is not allowable for the amount transferred to charity from an IRA, but the donor is not taxable on the amount transferred — up to \$100,000. Not being taxable on income that would otherwise be taxable is the equivalent of a charitable deduction.

The IRA/charitable rollover is unique in that it gives tax incentives to the two-thirds of taxpayers who don’t itemize but take the standard deduction. Although no charitable deduction is allowable for IRA/charitable rollovers, the rollovers aren’t taxable. No tax on otherwise taxable income is the equivalent of a charitable deduction for the two-thirds of taxpayers who take the standard deduction.

Mr. Chairman Baucus, at the October 18, 2011 hearing, Tax Reform Options — Incentives for Charitable Giving, you stated: “Most Americans aren’t able to receive

tax benefits from the charitable deductions since they don't itemize. Less than one-third of taxpayers itemized their deductions last year."

Making the expired Charitable IRA permanent would continue to provide charitable tax incentives for nonitemizers.

The Charitable IRA should be expanded to include life-income charitable gifts — gifts that pay income to the donor for life, with a remainder to a qualified charity. This would be at no revenue loss to the government because annual payments to the donor would be fully taxable at ordinary income tax rates.

The Senate now has before it a bipartisan bill co-sponsored by three Senate Finance Committee members that would make the IRA/charitable rollover permanent and expand it to include life-income charitable gifts.

The Public Good IRA Rollover Act of 2011 was introduced by Senator Charles Schumer (D-NY) and Senator Olympia Snowe (R-ME) on March 10, 2011 with co-sponsors: Sherrod Brown (D-OH), Richard Burr (R-NC), Kirsten Gillibrand (D-NY), Tim Johnson (D-SD), John Kerry (D-MA), Patrick Leahy (D-VT), Carl Levin (D-MI), Mark Pryor (D-AR).

The Public Good IRA Rollover Act has been introduced in every Congress over a number of years. The original co-sponsors were Senator Byron Dorgan (D-ND) and Senator Olympia Snowe (R-ME).

The Public Good IRA Rollover Act — in a nutshell. It would allow tax-free IRA rollovers for both outright and life-income gifts and with no annual ceiling. And it includes rollovers to *all* public charities and *all* private foundations.

If it is deemed that the absence of annual ceilings on the amount that can be rolled over outright annually would make this bill too costly at this time and if there are concerns about including donor advised funds, supporting organizations and private foundations as qualified donees, we ask the Senate Finance Committee to report out ACGA's proposed All-American Charitable IRA Rollover.

The All-American Charitable IRA Rollover Act would:

(draft language is at the end of this statement)

- Make permanent the expired law (the provision that was in effect for years 2006 through 2011) that allowed individuals age 70½ or older to make direct (outright) gifts from an IRA of up to \$100,000 per year to public charities (other than donor advised funds and supporting organizations) and to private operating and passthrough (conduit) foundations without

having to report the IRA distributions as taxable income on their federal income tax returns.

- **Expand current law to authorize tax-free IRA rollovers for gifts that benefit charities and provide taxable retirement income for the donors.** The qualified charities would be the same donees authorized under the expired law for direct rollovers. There would be a \$500,000 annual ceiling for life-income rollovers and donors must be age 59½ or older.
- The types of life-income plans assure that the annual taxable payments will be equal to (or greater than) what an individual would receive under the required minimum distribution rules had he or she kept the funds in the IRA instead of rolling them over for a life-income plan. The life income paid from the rollover cannot be assigned.
- Under the authorized life-income plans, the IRA owner will be taxable on income received at ordinary income tax rates. Because the payouts are 5% or more, there will be more income paid with the charitable plans than under the normal payouts of the minimum required distribution rules. The higher payout amounts will produce greater tax revenue for the Treasury.

The expired outright (direct) IRA/charitable rollover has resulted in millions of dollars of charitable gifts that would not otherwise have been made. It helps the Americans served by our nation's charities — provides for housing assistance, feeding the hungry, education, medical services and thousands of other services that American citizens need. The life-income rollover would greatly increase those gifts.

Why would IRA owners not just give outright to charity (a direct gift) from an IRA as provided under the expired law? Many IRA owners want to make charitable gifts, but also need retirement income. The life-income IRA rollover is an excellent way for donors of average resources to combine a charitable gift with retirement income. Many charities have donors who are "standing by" and wish to make life-income charitable gifts from their IRAs.

This is an All-American Charitable IRA Rollover. It allows all Americans with IRAs — not just those with large stock portfolios — who meet the minimum age requirements, to benefit charities. And since it encourages non-itemizers (over 65% of taxpayers) as well as itemizers, it is truly All-American.

Senate Finance Committee member Snowe was the original co-sponsor of the Public Good IRA Rollover Act. On November 14, 2007, the Senate Finance Committee held a hearing titled: "Federal Estate Tax — Uncertainty in Planning Under the Current Law." I was one of the four invited witnesses.

Among the written questions asked of me by Committee members after the hearing, was this question from Senator Snowe and my response:

Senator Snowe

Mr. Teitell, thank you so much for your reference in your written testimony to the Public Good IRA Rollover Act of 2007 (S. 819) that I introduced with Senator Byron Dorgan earlier this year. I agree with you that it is a critical incentive for both donors and charities.

Mr. Teitell, focusing on the planned-giving component of this legislation through which an individual could donate to a charity and receive life income that is taxable, could you please comment on how this provision would promote charitable donations while simultaneously reducing individuals' present-law estate tax liabilities and addressing Congress' concern that individuals do not outlive their retirement savings?

Conrad Teitell

Senator Snowe, many individuals would like to give part or all of their IRAs outright to charity, but they need the retirement income from their IRAs. Allowing them to roll over their IRAs at age 59½ or older to a life-income plan that would pay the individual (and a spouse, if desired) income for life (through a charitable gift annuity, charitable remainder unitrust or annuity trust, pooled income fund gift) would enable them to provide retirement income for life and make a charitable commitment. The charities could plan on receiving the gift after the life interest terminates.

A life-income rollover is truly an All-American IRA/Charitable Rollover. It would encourage philanthropy by all Americans—not just those who can afford to part with their assets now and not just those who itemize their deductions on their tax returns.

The ability to roll over an IRA to charity directly—or for a life-income plan—gives charitable tax incentives to the approximately two-thirds of taxpayers who take the standard deduction. Not being taxed on income that would otherwise be taxed (withdrawal from an IRA) is the equivalent of a charitable deduction.

The IRA assets rolled over for a life-income plan would not be included in the taxpayer's estate at death. However, the vast majority of the rollover gifts would come from individuals who have no estate tax concerns.

The life-income rollover shouldn't cost the government anything because the payments received from the life-income plans would be fully taxable—just as if the payments were received from the original IRA custodian or administrator. The big difference is that the nation's charities and the people they serve will be greatly benefitted.

Rolling over an IRA for a charity's life-income plan is not giving away the assets in the plan. The individual continues to receive income for life—just as if she or he had kept the IRA assets with the current custodian or administrator.

Senator Snowe, as you know the IRA/charitable rollover law that allowed tax-free rollovers for direct (outright) rollovers to charity for 2006 and 2007 wasn't in an extenders' bill at the end of 2007. When the Senate this year (soon, I hope) considers extending the just-expired IRA/charitable rollover provision, I hope that it will add the life-income component of the Public Good IRA Rollover Act of 2007 (S. 819).

As volunteer legal counsel to the American Council on Gift Annuities (an organization of over 1200 charities receiving support through life-income plans), I convey ACGA's thanks for your being an initial co-sponsor of S. 819 with Senator Byron Dorgan—not only in this Congress, but also several years ago in an earlier Congress.

The bill that you and Senator Dorgan initiated now has wide bipartisan co-sponsorship in both the Senate and the House—including many members of the Finance and Ways and Means Committees.

To sum up: The IRA/charitable life-income rollover is not a revenue drainer and it doesn't decrease retirement savings—just puts an IRA in a different container. I hope that Congress agrees that passage should be a no-brainer.

To sum up. Decreased support from federal, state and local governments and increased burdens on charities make this the time to enact a permanent Charitable IRA and expand it to include life-income charitable gifts. Charities need the funds to do their vital work now.

Please act now.

There is a tide in the affairs of men
Which taken at the flood, leads to fortune,
Omitted, all the voyage of their life
Is bound in shallows and in miseries.
On such a full sea are we now afloat,
And we must take the current where it serves,
Or lose our ventures.

— *Shakespeare's Julius Caesar*

All-American Charitable IRA Rollover Act of 2012 — Draft Bill

To amend the Internal Revenue Code of 1986 to expand tax-free distributions from individual retirement accounts to include rollovers for charitable life-income plans for charitable purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "All-American Charitable IRA Rollover Act of 2012."

SEC. 2. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS FOR CHARITABLE PURPOSES.

(a) In General -- Paragraph (8) of section 408(d) of the Internal Revenue Code of 1986 (relating to tax treatment of distributions) is amended to read as follows:

(8) DISTRIBUTIONS FOR CHARITABLE PURPOSES

(A) IN GENERAL

For purposes of this paragraph, so much of the aggregate amount of qualified charitable distributions with respect to a taxpayer made during any taxable year --

(i) which is made directly by the trustee to an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and does not exceed \$100,000, shall not be includable in gross income of such taxpayer for such taxable year, or

(ii) which is made directly by the trustee to a qualified split-interest entity for the benefit of an organization described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and does not exceed \$500,000, shall not be includable in gross income of such taxpayer for such taxable year.

(B) QUALIFIED CHARITABLE DISTRIBUTION

For purposes of this paragraph, the term "qualified charitable distribution" means any distribution from an individual retirement plan (other than a plan described in subsection (k) or (p)) -

(i) which is made directly by the trustee to an organization described in section

170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 70½, or

(ii) which is made directly by the trustee to a qualified split-interest entity for the benefit of one or more organizations described in section 170(b)(1)(A) (other than any organization described in section 509(a)(3) or any fund or account described in section 4966(d)(2)), and which is made on or after the date that the individual for whose benefit the plan is maintained has attained age 59½.

A distribution shall be treated as a qualified charitable distribution only to the extent that the distribution would be includable in gross income without regard to subparagraph (A).

(C) CONTRIBUTIONS MUST BE OTHERWISE DEDUCTIBLE

For purposes of this paragraph -

(i) a distribution to an organization described in subparagraph (B)(i) shall be treated as a qualified charitable distribution only if a deduction for the entire distribution would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph), or

(ii) a distribution to a split-interest entity described in subparagraph (B)(ii) shall be treated as a qualified charitable distribution only if a deduction for the entire value of the interest in the distribution for the benefit of an organization described in subparagraph (B)(ii) would be allowable under section 170 (determined without regard to subsection (b) thereof and this paragraph).

(D) APPLICATION OF SECTION 72

Notwithstanding section 72, in determining the extent to which a distribution is a qualified charitable distribution, the entire amount of the distribution shall be treated as includable in gross income without regard to subparagraph (A) to the extent that such amount does not exceed the aggregate amount which would have been so includable if all amounts in all individual retirement plans of the individual were distributed during such taxable year and all such plans were treated as one contract for purposes of determining under section 72 the aggregate amount which would have been so includable. Proper adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.

(E) SPLIT-INTEREST ENTITY DEFINED

For purposes of this paragraph, the term "split-interest entity" shall include -

(i) a charitable remainder annuity trust as defined in section 664(d)(1) which must be funded exclusively by a qualified charitable distribution, or

(ii) a charitable remainder unitrust as defined in section 664(d)(2) which must be funded exclusively by one or more qualified charitable distributions, or

(iii) a charitable gift annuity as defined in section 501(m)(5) which must be funded exclusively by a qualified charitable distribution, and shall commence fixed payments of 5% or greater not later than one year from date of funding.

(iv) No person may hold an income interest in a charitable remainder annuity trust, a charitable remainder unitrust or a charitable gift annuity funded by a qualified charitable distribution other than one or both of the following: the individual for whose benefit the individual retirement plan is maintained and the spouse of such individual. Income interests in split-interest entities funded by qualified charitable distributions shall not be assignable.

(F) SPLIT-INTEREST ENTITY DISTRIBUTIONS

For purposes of this paragraph -

(i) notwithstanding section 664(b), distributions made from a trust described in subparagraph (E)(i) or subparagraph (E)(ii) shall be treated as ordinary income in the hands of the beneficiary to whom is paid the annuity described in section 664(d)(1)(A) or the payment described in section 664(d)(2)(A), and

(ii) qualified charitable distributions made for the purpose of funding a charitable gift annuity shall not be treated as an investment in the contract under section 72(c).

(G) DETERMINING DEDUCTION UNDER SECTION 170

Qualified charitable distributions shall not be taken into account in determining the deduction under section 170.

American Staffing Association

277 South Washington Street, Suite 200 • Alexandria, VA 22314-3675



703.253.2020

703.253.2053 fax

asa@americanstaffing.net

americanstaffing.net

Feb. 11, 2012

The Honorable Max Baucus
Chairman, Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Orrin Hatch
Ranking Member, Senate Finance Committee
219 Dirksen Senate Office Building
219 Dirksen Senate Office Building

Dear Chairman Baucus and Ranking Member Hatch:

On behalf of the American Staffing Association (ASA), I wanted to thank you for the Senate Finance Committee's recent hearing that examined the tax extenders package that expired in 2011. ASA strongly supports the Work Opportunity Tax Credit (WOTC), an important tool to help job creators, like our members, hire and train their workforce.

The American Staffing Association represents the U.S. staffing industry. ASA members provide a wide range of employment and work force services and solutions, including temporary and contract staffing, recruiting and permanent placement, outplacement and outsourcing, training, and human resource consulting. Staffing firms employ approximately 2.8 million temporary and contract workers every day and 10 million workers annually, and many of them benefit from WOTC.

Temporary and contract staffing firms play a vital role in the U.S. economy by providing employment flexibility for employees and businesses. Staffing firms recruit, screen, select, and employ their own employees and assign them to support or supplement the work force of their clients in various work situations such as employee absences, skill shortages, seasonal workloads, and special assignments or projects. Employees work in virtually every job category, including industrial labor, office support, health care, engineering, information technology, and various professional and managerial positions.

WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Once in the workforce, workers in the target group gain experience and on-the-job training, allowing them to subsequently "climb the ladder" to higher-skilled and higher-paying jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance.

Further, WOTC works. In 2011, more than 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments.

Extending WOTC represents common sense public policy that will help companies provide jobs. We appreciate the Senate Finance Committee's efforts to address the expired tax extenders package,

and we hope the Senate will take up and pass a package that that includes an extension of WOTC as soon as possible.

Sincerely,

A handwritten signature in cursive script that reads "Toby Malara". The signature is written in black ink and includes a long horizontal flourish at the end.

Toby Malara, Esq.
Government Affairs Counsel



AMERICAN UNIVERSITY
WASHINGTON, D.C.

KOGOD TAX CENTER

**Statement for the record of
Mr. David J. Kautter
Managing Director of Kogod Tax Center
American University Kogod School of Business
Washington, District of Columbia**

**Committee on Finance
United States Senate**

**Hearing on
Extending 2011 Tax Provisions Important to Small Businesses
February 1, 2012**

Chairman Baucus, Ranking Member Hatch and Members of the Committee, thank you for the opportunity to submit written comments on the need to extend five 2011 tax provisions important to small businesses.

I have been a tax professional for over 35 years. For most of that time, I advised clients on tax matters as a partner with a Big Four accounting firm. I also served as tax counsel to former Senate Finance Committee member John Danforth (R – MO), and I have remained closely involved in the tax policy process over the entire course of my career, including the period leading to enactment of the historic Tax Reform Act of 1986.

I am writing to you today to encourage your support to extend five tax provisions that expired last year that we believe are of great importance to not only the nation's small businesses, but also the nation's overall economy. These five tax provisions are: 100 percent bonus depreciation, Section 179 equipment expensing (with a limit of \$500,000 and a \$2 million phase-out threshold along with the expanded definition of Section 179 property), the research and development (R&D) credit, 15-year straight-line cost recovery for qualified leasehold improvements, and Section 1202 rules for qualified small business stock.

KOGOD SCHOOL OF BUSINESS

4400 MASSACHUSETTS AVENUE, NW WASHINGTON DC 20016-8044 202-885-6505 FAX: 202-885-1390

kogod.american.edu

These provisions directly affect small businesses and indirectly the overall US economy. As demonstrated over many years through testimony presented to the Senate Finance Committee and other Committees, small businesses are “first-tier” generators of jobs and vital links in the economic supply chain. Small businesses represent 98% of all businesses in the US¹, account for nearly three-quarters of new net jobs in the US², and account for approximately 45% of the total payroll of the private sector³.

Tax Provisions Impacting Small Businesses and Job Growth

Growth of small businesses would go a long way to address our current problem of high unemployment, notably among many groups where the unemployment rate is much higher than the average published rate of unemployment. As discussed in more detail below, tax provisions that provide incentives for small business to acquire equipment, modernize facilities and conduct research and development will not only stimulate small-business hiring but will also encourage hiring in the companies that manufacture the equipment and the construction firms that modernize these facilities.

The 100 percent bonus depreciation provision and the Section 179 expensing provision permit faster tax write offs of equipment compared to the “normal” depreciation rules that extend the deduction over the useful life of the asset. Extending into 2012 the 100 percent bonus depreciation and Section 179 expensing provisions would immediately reduce the out-of-pocket cost of acquiring assets. In many circumstances these tax incentives will tip the scales in favor of a small business’s decision to expand and, if so, by how much.

¹ See *The Role of Small Business in Economic Development of the United States: From the End of the Korean War 1953) to the Present* page 6

² See *The Role of Small Business in Economic Development of the United States: From the End of the Korean War 1953) to the Present* page 6

³ See *The Role of Small Business in Economic Development of the United States: From the End of the Korean War 1953) to the Present* page 6

Encouraging small businesses to increase their acquisition of equipment will directly translate into new jobs. Additionally, at a time when there is continuing pressure to simplify tax compliance, the ability under section 179 to immediately expense the cost of equipment acquisitions will reduce both the complexity and cost of tax compliance. For most small businesses it will eliminate the need both to apply the complex tax depreciation rules and to maintain records to track the adjusted basis of the asset

Additionally, 15-year straight-line cost recovery for qualified leasehold improvements, restaurant buildings and improvements, and retail improvements is equally important to many small businesses. Similar to 100 percent bonus depreciation and Section 179 expensing, the 15-year straight line cost recovery methods for qualified leasehold improvements allows small businesses to reduce the after tax cost of making improvements. This will stimulate the economy by encouraging these improvements.

Without the extension of this provision, in most cases these improvements would only be deductible "straight line" over 39 years. The shorter 15-year life also more accurately reflects the reality of leasehold improvements. It is relatively rare that a commercial tenant remains in one building for 39 years. Additionally, the 15 year rule reflects the reality that even if, for example, a restaurant remains in a building for more than 15 years, it is highly likely they will redo/replace/modernize substantial portions of the leasehold improvements long before the end of 39 years.

It is well recognized that investment in research and development (R&D) is a significant driver of technological progress and economic growth. Extending and preserving the R&D credit is important to continue innovation and growth, beginning with start-ups, continuing with small businesses and on to mid- to large-size businesses. R&D requires substantial capital outlay with the payback from that outlay typically stretched over many years.

Like the equipment expensing provisions discussed above, businesses can better afford research and development if they receive a tax benefit in the year the expenditure occurs. Without this incentive, there is concern that U.S. and foreign companies will locate more of their increasingly mobile R&D to countries offering more generous tax incentives.

In 1993, Congress took action and believed that targeted relief for investors who risk their funds in small businesses should be encouraged. Today, this message resonates to the well being of our economy more than ever⁴. The Creating Small Business Jobs Act of 2010 and the Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 both supported the increase of the applicable percentage of gain excluded from net income from the sale or exchange of qualified small business stock from 50% to 100%. Importantly, the 2010 statute also excluded the gain from being classified as a tax preference item for purposes of the alternative minimum tax. Providing relief for investors who risk their funds in small businesses is important when it comes to providing jobs and supporting small businesses. As the economy continues to struggle, small businesses typically have difficulty attracting equity financing which hinders innovation and growth and thereby threatening the viability of the business. Encouraging investments in small businesses will correlate with job growth and a stronger economy.

Conclusion

At a time when our economy is struggling to add new jobs, it is important to take proven steps to move the economy forward. The provisions discussed above need to be extended to assure the continued growth of small businesses and, as a natural result of that growth, the hiring of workers.

⁴ *Pub. L. No 103-66, Section 13113(a), Omnibus Budget Act of 1993 (1993)*

Background on the Kogod Tax Center

The Kogod Tax Center is a tax research institute located at American University's Kogod School of Business. The Center promotes balanced, nonpartisan research on tax law, the challenges of tax compliance and planning, and the implications of tax reform.

Our efforts focus principally on tax issues affecting small businesses, entrepreneurs, and middle-income taxpayers. We develop and analyze potential solutions to selected tax-related problems faced by these three sectors of the economy promote public dialogue to inform taxpayers, policymakers, academics, the press, and tax practitioners about critical tax issues.

We appreciate your taking our concerns on behalf of small businesses into account. Please do not hesitate to contact me if you have any questions.



Statement for the Record

Of

**Linda Asher, Office Administrator
Bucket Truck Service, LLC
2005 Merrick Road #321
Merrick, NY 11566**

For The Hearing On

**“Extenders and Tax Reform:
Seeking Long-Term Solutions”**

Before

**The U.S. Senate
Committee on Finance**

Held: Tuesday, January 31, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of **Bucket Truck Service, LLC**.

As Congress and this Committee undertake the tax reform effort, we wanted to bring to your attention a tax policy that is important to our company. The Work Opportunity Tax Credit ("WOTC"), this provision provides a benefit to the economy and should be continued as permanent aspects of the Internal Revenue Code ("tax code"). This expired provision is essential to our nation's economic and financial recovery.

Work Opportunity Tax Credit (WOTC)

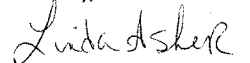
WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC-targeted employee groups include veterans who either are food stamp recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients; the most difficult cases are being employed in the private sector and 7 out of 10 welfare recipients are using WOTC to find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependant on public assistance. Further, WOTC works. In 2011, more that 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

Allowing this provision to expire at this time in our nation with unemployment rates as they are is a significant setback for job creation and the provision should be extended. In the longer term, Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Thank you for the opportunity to submit this statement. We encourage the extension of the WOTC program to encourage economic growth and job creation.

Sincerely,



Linda Asher
Office Administrator



Statement for the Record

of

Building Owners and Managers Association (BOMA) International

For The Hearing On

“Extenders and Tax Reform: Seeking Long-Term Solutions”

Before

**The U.S. Senate
Committee on Finance**

Tuesday, January 31, 2012

**Building Owners and Managers Association (BOMA) International
1101 15th Street, NW, Suite 800
Washington, DC 20005
(202) 408-2662**

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of the Building Owners and Managers Association (BOMA) International.

BOMA International is an international federation of more than 100 local associations and affiliated organizations. BOMA's 17,000-plus members own or manage more than 9 billion square feet of commercial properties in North America and throughout the world. Additionally, commercial real estate is a key economic driver and employer contributing over \$118 billion to the overall U.S. economy, supporting more than one million jobs and generating over \$37 billion in new taxable personal earnings.

BOMA International applauds and supports the leadership efforts of the Committee on overall tax reform and feels proper reform is needed in order to provide certainty, simplicity, and fairness, while encouraging economic growth and job creation to the economy.

In the meantime, BOMA International strongly urges a prompt and seamless extension of the 15-year timeline for the depreciation of leasehold improvements. On January 1, 2012, this provision, along with a number of other meritorious tax policies, commonly referred to as the "extenders package," was allowed to lapse. Until there is an opportunity to address tax policy in a long-term and comprehensive manner, extension of these tax provisions is essential to continuing the critical tax relief and access to capital that is necessary to our nation's economic and job recovery.

Before its expiration on January 1, building owners were allowed to depreciate leasehold improvements over 15 years. This provision, enacted on a temporary basis for the past seven years, also allowed for the same depreciation for restaurant improvements, new restaurant construction and retail improvements. Leasehold improvements, also known as tenant improvements, include changes to walls, floors, ceilings, lighting, and plumbing to meet the needs of a new or existing tenant. In the commercial real estate marketplace, such reconfigurations are commonplace as new tenants move in or existing tenants revamp their space to keep up with changing needs and technology.

Once the 15-year depreciation schedule lapsed, building owners returned to depreciating leasehold improvements on a 39-year schedule. To require these improvements to be depreciated at a rate of 1/39th per year until the improvement goes "out of service" runs counter to both common sense and the reality of the marketplace. With the average lease running from five to ten years, such reconfigurations are commonplace, and requiring a 39-year depreciation schedule is simply a hidden and inequitable tax that is passed along to the small businesses that lease space from commercial real estate property owners.

Furthermore, a reduced timeline for leasehold improvements spurs activity in other parts of the economy. An increase can be seen in the output and employment of construction companies, building material suppliers and construction-related services as well as industries that supply goods and services to the construction industry, many of which are small businesses themselves. However, while we support the 15-year depreciation period, BOMA International believes this timeline should be made permanent. The temporary nature of the 15-year depreciation schedule

adds to economic uncertainty and only serves to hamper investment which would otherwise increase economic activity at a time when the economic recovery is still taking hold. By making this provision permanent, as part of comprehensive and long-term tax reform, Congress would provide building owners and tenants with predictability, simplicity, and fairness necessary to more effectively assist in the growth of the U.S. economy.

BOMA International greatly appreciates the opportunity to comment on this meaningful tax policy and would urge Congress to take on the crucial task of overall tax reform sooner rather than later. Additionally, in the interim, tax certainty is necessary to encourage economic growth and job creation. Therefore we request the immediate passage of the “extenders package” and ask that Congress ultimately make permanent the 15-year depreciation for leasehold improvements.



Statement of the Business Council for Sustainable Energy

United States Senate

Committee on Finance

Hearing on Extenders and Tax Reform: Seeking Long-Term Solutions

January 31, 2012

As Congress contemplates federal spending decisions and tax policy, the Business Council for Sustainable Energy underscores the critical role that clean energy tax incentives play in helping our nation achieve vital economic and energy security objectives. The Council urges Congress to continue its long-standing support for a broad array of clean energy tax incentives to spur investment, create jobs and diversify our nation's energy portfolio to power the U.S. economy.

The Business Council for Sustainable Energy is a coalition of companies and trade associations from the energy efficiency, natural gas and renewable energy sectors, and also includes independent electric power producers, investor-owned utilities, public power and commercial end-users. Founded in 1992, the Council advocates for policies that expand the use of commercially-available clean energy technologies, products and services. The coalition's diverse business membership is united around the revitalization of the economy and the creation of a secure and reliable energy future for America.

Tax incentives can be effective, efficient tools to encourage private sector investment and reduce costs for energy users. Clean energy incentives have spurred technological innovation, enhanced the viability and deployment of a variety of clean energy options, and reduced costs for consumers and industry.

Continued support for clean energy incentives is in the best interest of American taxpayers and supports a well-reasoned national energy strategy that improves our economic conditions at home and strengthens America's competitiveness in the global marketplace. Examples of the ways in which American businesses and consumers use existing provisions of the tax code and other incentives to expand businesses and save money include:

- The Production Tax Credit (PTC) and the Investment Tax Credit (ITC) have been effective tools to keep electricity rates low and encourage development of a wide range of proven clean energy projects, which must play a central role in America's long-term electric energy supply.

- The Section 1603 Treasury Program infuses critical monies into clean energy projects by bypassing a tax equity market paralyzed by the recent economic downturn while creating jobs and building a more competitive U.S. clean energy industry.
- Clean Renewable Energy Bonding Authority (CREB) to ensure comparable tax incentives to customers of public power providers and rural electric cooperatives to employ innovative energy infrastructure investments.
- Tax incentives that lower the cost and risk of exploration and drilling for natural gas to enable the industry to explore new areas for domestic production, which provides consumers and businesses with affordable, secure and clean energy sources.

The 48C competitive tax credit for advanced energy manufacturing was a critical start in helping to increase domestic clean energy manufacturing.

Tax incentives have successfully stimulated the energy efficiency market for items such as high-efficiency appliances, combined heat and power (CHP), improvements to residential and commercial building envelopes, including insulation and windows, as well as new technologies such as fuel cells.

The Council strongly urges Congress to continue the federal commitment to clean energy tax incentives. We look forward to constructively working with you as you consider spending and tax policy proposals this fall.



Statement of Business Roundtable for the Record
Senate Finance Committee
Hearing on Extenders and Tax Reform: Seeking Long-Term Solutions
January 31, 2012

The Honorable John M. Engler
President, Business Roundtable

Business Roundtable welcomes this hearing on the vital importance of tax reform -- and your examination of the extension of expiring business provisions in this context -- with the goal of improving the international competitiveness of the U.S. economy and to promote job growth for American workers. Business Roundtable strongly supports the extension of business tax provisions that expired at the end of 2011 and further urges that Congress move forward at the same time on corporate tax reform to provide a modernized, competitive tax system that is permanent in its design in order to eliminate unnecessary uncertainty for America's job creators.

Business Roundtable (BRT), the association of chief executive officers of leading U.S. companies, represents member companies with over \$6 trillion in annual revenues and more than 14 million employees. BRT member companies comprise nearly a third of the total value of the U.S. stock market and invest more than \$150 billion annually in research and development -- nearly half of all private U.S. R&D spending. Our companies pay \$163 billion in dividends to shareholders and generate an estimated \$420 billion in sales for small and medium-sized businesses annually.

Business Roundtable commends Chairman Baucus and Ranking Member Hatch for their focus on tax reform to address significant weaknesses of the current tax system, which has not been thoroughly examined in over 25 years. Over this time period the rest of the world has modernized their tax systems and today we find the U.S. tax system a significant obstacle to the competitiveness of U.S. companies and their American workers.

Business Roundtable CEOs are firmly dedicated to business tax reform that results in a modernized and simplified tax code to increase the competitiveness of the United States as a location for investment and employment by both U.S.-based and foreign-based companies. Our policies should strive not only to make us competitive with other world economies, but to make the United States the best place in the world to launch a career, headquarter a business, hire employees and conduct business operations. Tax reform is absolutely essential to economic growth and job creation to be competitive in world markets today. A competitive corporate tax rate comparable to the OECD average and a competitive territorial tax system similar to the rest of the world are essential components of corporate tax reform.

Major structural features of our tax code have harmed U.S. competitiveness. While extension of expiring provisions is no substitute for the urgent need for competitive tax reform, failure

to extend these provisions before Congress can complete work on tax reform will only further diminish America's competitive position and result in significant deleterious effects on business expansion and job growth. Congress should immediately and seamlessly extend the expired business tax provisions from last year, including the research credit and important international provisions -- specifically, active financing income and "look through" rules -- and provide an extension of temporary 100 percent bonus depreciation to promote the economic recovery and increase private sector employment.

Tax Reform

Reform of the U.S. corporate tax system and its treatment of international income are of significant importance to the growth of the U.S. economy. U.S.-headquartered companies with operations both in the United States and abroad directly employ 23 million American workers and they create over 40 million additional American jobs through their supply chain and the spending by their suppliers and employees. The ability of American companies to be competitive in both domestic and foreign markets is essential to improving economic growth in the United States, reducing high rates of U.S. unemployment, and providing for rising American living standards.

The U.S. corporate income tax system today is an outlier relative to the tax systems of our trading partners at a time when capital is more mobile and the world's economies are more interconnected than at any time in history.

The combined U.S. federal and state statutory corporate tax rate will become the highest rate in the OECD when Japan's rate reductions take effect in April 2012. A competitive corporate tax rate is an essential element of meaningful corporate tax reform.

The United States is also the only G-8 country that taxes the worldwide income of its corporations. Within the OECD, 26 of the 34 countries use territorial systems for the taxation of foreign earnings, whereby little or no additional home country tax is imposed on active trade or business profits earned abroad when those earnings are remitted home. Japan and the United Kingdom adopted territorial tax systems in 2009 to promote the competitiveness of their locally headquartered multinationals and boost their economies. The U.S. worldwide system of taxation significantly magnifies the damage done by the high U.S. corporate tax, and significantly impairs American businesses competing in world markets.

Since the time of the last major reform of the U.S. corporate tax system in 1986, the world's economies have become increasingly integrated. The importance of cross-border trade and investment has grown significantly, with worldwide cross-border investment rising six-times faster than world output since the 1980s. Today, the U.S. corporate tax system hinders the ability of U.S. companies to grow and compete in the world economy with the consequence of less investment in the United States and a more slowly growing economy with fewer job opportunities for American workers. The ability of American companies to compete and invest abroad is vital for opening foreign markets to U.S.-produced goods and expanding the scope of investments in R&D and other activities in the United States.

As Congress undertakes tax reform, critical decisions will be made that will affect the ability of the U.S. economy to grow, create jobs, and allow American workers and the companies that employ them to be competitive in the world economy. A thorough evaluation of the tax code will be necessary to determine which policies should be changed and which temporary policies should be made permanent. In making these determinations, it is critical that Congress focus on the importance of economic growth and the significant gains that can be achieved through a more efficient and competitive tax system.

Business Roundtable fully supports your vigorous pursuit of corporate tax reform.

Tax Extenders

Much longstanding business tax policy exists in the tax code today in the form of temporary provisions. The Joint Committee on Taxation identifies 101 tax provisions as either having expired in 2011 (60 provisions) or expiring in 2012 (41 provisions). By comparison, in 1999 the comparable count was just 12 provisions. The enactment of provisions on a temporary basis rather than permanent results in diminished incentive effects and contributes to unnecessary business uncertainty. Any business that treated its customers in the way the government runs the tax code -- not telling its customers the prices charged to them until after they had made their purchases -- would find its customers leaving to a more reliable competitor.

While the best solution to fixing our corporate tax system is permanent reform, we cannot afford to let important existing business provisions expire before a permanent tax code is in place. Extension of these provisions should not be controversial. The Administration has also called for the extension of the expiring business provisions in its FY2012 Budget and in other recent proposals.

Business Roundtable strongly supports the seamless extension of business tax provisions that expired at the end of 2011 and especially notes the importance of extending the research credit, the active financing provisions, and "look through" rules as structural provisions of the tax code. The policy goals of these three provisions should also be supported in a permanent, reformed tax system in order to drive innovation and international competitiveness. In addition, the temporary 100 percent expensing (100 percent "bonus depreciation") provision enacted in 2010 to speed economic recovery should be extended to solidify the recovery and job growth in 2012.

Research Credit. The research credit is an example of a structural tax provision enacted on a temporary basis. The research credit was implemented in order to increase research activity by American businesses. It has been extended on 14 separate occasions since its initial enactment in 1981. The credit has frequently been extended retroactively, most recently in December 2010 as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which extended the credit retroactively to the beginning of 2010 and prospectively through the end of 2011. In the 31 years since its original enactment, it has been in place for all but one year when the credit expired and was not retroactively extended (July 1, 1995-June 30, 1996).

As noted by the Treasury Department, the research credit provides a strong incentive for businesses to expand their research efforts. Because scientific advancements through research are a form of a "public good," the benefits of which are not fully received by the company undertaking the research, businesses under invest in R&D activities relative to the economy-wide benefits of this spending.

The research credit directly supports employment. Approximately 70 percent of research costs that qualify for the credit are labor costs. Companies receiving the credit employ one million domestic researchers. The research credit supports innovation in manufacturing, with nearly 70 percent of research credits claimed by manufacturing companies.

Active Financing Income. A basic principle of the U.S. tax system is that active foreign business earnings of subsidiaries of U.S. companies are not taxed in the United States until such earnings are remitted back to the U.S. parent. This basic principle of deferral has also been the law for active financial services income for nearly the entire history of the tax code, until changed in 1986. Since 1997, the principle of deferral for active financial services income has been a temporary provision of the tax code, and has been extended numerous times. The current temporary provision expired at the end of 2011.

U.S. financial service companies -- including banking, securities, and insurance companies -- compete in foreign markets around the world with other financial institutions to provide financial services locally to foreign customers. Commercial clients of these financial service companies look to a financial institution that can meet their needs worldwide -- not just in the United States. The ability of U.S. financial service companies to be competitive in foreign markets increases the jobs they provide in the United States. In addition, U.S. financial service companies providing their services to foreign customers can help boost exports of U.S. goods by assisting in the financing of these goods to foreign customers.

In the absence of the active financing temporary provision U.S. financial service companies would face a significant tax disadvantage relative to their foreign-headquartered competitors. Failure to extend this provision would harm the competitiveness of U.S. companies and reduce U.S. jobs.

"Look-through" rule. A temporary provision of the tax code allows U.S. companies to redeploy income between a foreign subsidiary earning active business income and a related foreign subsidiary in another country through the payment of dividends, interest, rents, or royalties without being subject to current U.S. taxation on the payment. The look through rule "looks through" to the underlying source of income to determine whether such income is active foreign business income eligible for deferral or passive income that would be subject to current U.S. taxation.

The look through rule was first effective in 2006 and has been extended twice since its original enactment. The look through rule expired at the end of 2011.

The look through rule permits income to be redeployed among related foreign subsidiaries in an efficient manner. Because the cost of financing through internal funds is generally lower than use of external funds, a firm will generally first wish to utilize internal funds before tapping external sources of finance. The look through rule allows a multinational company to redeploy internal funds between foreign subsidiaries without creating a tax barrier to such transfers.

The look through rule helps maintain the competitiveness of U.S. companies operating in foreign markets. In the absence of the look through rule, foreign operations might require greater use of external funds or greater reliance on funds drawn directly from the U.S. parent. Most of our foreign competitors operate under territorial tax systems that facilitate the redeployment of foreign earnings. Strong and internationally competitive U.S. companies increase U.S. employment and the strength and vitality of the U.S. economy.

100 Percent Expensing (100 percent "bonus depreciation"). Temporary partial expensing at a 30 percent rate for equipment and machinery was first enacted to boost economic recovery in 2002 and 2003 for investments made on or after September 11, 2001 and before January 1, 2005. The provision was later enhanced to provide 50 percent partial expensing and expired at the end of 2004. In 2008, partial expensing was enacted at a 50 percent rate as part of the Economic Stimulus Act of 2008 and was later extended through 2010.

The 100 percent expensing provision was enacted in December 2010 to provide 100 percent expensing for investments made after September 8, 2010, and on or before December 31, 2011. The December 2010 law provided that after the expiration of 100 percent expensing, 50 percent expensing continues through December 31, 2012.

Studies reviewed by the Treasury Department support expensing as an effective investment stimulus. In view of the significant ongoing worldwide economic uncertainty, Business Roundtable supports continuation of 100 percent expensing for 2012.

Conclusion

Business Roundtable appreciates the past and ongoing work of this Committee in its focus on tax reform to improve the competitiveness of the U.S. economy and increase jobs and wages of American workers. However, before this important work is completed, it is necessary to provide the seamless extension of the business tax provisions that expired at the end of 2011. As shown in this testimony, important structural features of our tax code are currently carried out through these temporary provisions. Their expiration before a new permanent tax code is in place would diminish the competitiveness of American businesses and place at risk millions of U.S. jobs that depend on the ability of U.S. companies to compete in markets around the world.

On behalf of Business Roundtable, I look forward to working closely with this Committee on the immediate extension of these tax provisions and toward the overriding objective of tax reform.

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Testimony of

Douglas Kridler

President and CEO of the Columbus Foundation

on behalf of

The Council on Foundations

on

S. 557, the “Public Good IRA Rollover Act of 2011”

United States Senate Finance Committee

Hearing on

**“Extenders and Tax Reform: Seeking Long-Term
Solutions”**

January 31, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Finance Committee, thank you for this opportunity to present testimony in support of S. 557, "The Public Good IRA Rollover Act of 2011".

My name is Doug Kridler, and since 2002 I have served as president and chief executive officer of the Columbus Foundation, a community foundation serving the central Ohio region. During 2010, the Foundation awarded more than \$100 million in grants to more than 2,000 charitable organizations in such fields as education, health, social services, community development, urban affairs, and the arts. Since its founding in 1943, the Columbus Foundation has grown to become the tenth largest community foundation in the United States. The assets of the Foundation and our affiliates totaled \$1.06 billion as of December 31, 2010. These assets are held in nearly 2,000 funds, 29 supporting organizations, and one state-wide affiliate.

I am testifying today on behalf of the Council on Foundations, of which the Columbus Foundation is a member. The Council on Foundations represents over 2,000 grantmaking foundations and corporations with assets of over \$300 billion. As the voice of philanthropy, the Council works to create an environment in which the movement can grow and thrive, and to promote policies that enable the philanthropic sector to work most effectively.

The Columbus Foundation, and other community foundations in every region of the country, provide critical assistance to the communities we serve. We are engaged in every aspect of the lives of the cities, towns, and rural areas in which we are located, and often we are the first place our neighbors turn when in need of help. That is particularly true in times, such as now,

when so many individuals and organizations in our communities face increased need amidst diminished resources. We at the Columbus Foundation have responded to those increased needs by stepping up our own efforts. We are fully committed to continuing to do everything we can to provide essential support to the central Ohio region, and I know other community foundations are fully committed to their communities as well.

Also, community foundations are the means through which many of our neighbors choose to give back to their communities, through both volunteer service and financial support. Community foundations rely on many individual donors, most of whom contribute modest sums saved over a lifetime of work. The support of individual donors, no matter how small, is essential to our mission. We believe that applicable law should acknowledge the value of their contributions, and remove any unnecessary impediments to giving from whatever assets a prospective donor may have.

My testimony addresses a recently expired provision of the tax code that has proven to be a very important tool for donors who wish to make a positive difference in their community, but who may not have substantial assets beyond those typically saved by a family over the course of a lifetime, such as a retirement account. Until its expiration at the end of 2011, Internal Revenue Code section 408(d)(8) provided such donors the opportunity to make tax-free distributions from their individual retirement plans for charitable purposes. S. 557, “The Public Good IRA Rollover Act of 2011”, introduced by Senator Schumer, Senator Burr, Senator Bingaman, Senator Kerry, Senator Snowe, and others, would make that key provision permanent, as well as implement important revisions needed to make the provision even more effective.

By way of background, prior to 2006, taxpayers wishing to transfer Individual Retirement Account (“IRA”) assets to charity first had to recognize the amount as income, make a transfer, and then claim a charitable contribution deduction for the amount gifted. This often resulted in tax liability, even though the donor ultimately transferred the entire IRA distribution to charity. The Pension Protection Act of 2006 (“PPA”) partially solved this problem by allowing individuals to transfer amounts from their IRA accounts directly to charity without first having to recognize the distribution as income. However, that provision was limited in several respects: it was effective only for a few years; it was limited to taxpayers age 70 ½ or older; the amount of gifts was capped at \$100,000; and donors were specifically not permitted to make charitable rollovers to donor-advised funds, supporting organizations, and private foundations.

The “Public Good IRA Rollover Act of 2011” would extend permanently the provision authorizing charitable rollovers of IRAs, and make it more effective by eliminating the \$100,000 cap on rollovers, allowing donors to make rollovers beginning at age 59 ½, and permitting rollovers to donor-advised funds, supporting organizations, and private foundations.

Enactment of the “Public Good IRA Rollover Act of 2011” will be a crucial step forward in ensuring that philanthropic organizations have the means and flexibility to address dramatically growing needs. Making the recently expired law regarding IRA rollovers permanent will provide donors the greater certainty needed for prudent charitable gift planning, and will ensure future donors have the ability to use this efficient means of giving. Making the charitable IRA rollover available for gifts to donor-advised funds, supporting organizations, and private foundations will enable additional donors, particularly among middle-income Americans, to

utilize charitable rollovers for the benefit of organizations that are particularly well-suited to delivering philanthropic resources quickly and effectively to communities in need.

The charitable IRA rollover has proven popular with donors, resulting in increased giving from IRA accounts. By expanding the charitable rollover to all philanthropic tools, including donor-advised funds, supporting organizations, and private foundations, charitable giving would increase even more. In particular, community foundations, which make as much as two-thirds of their grants from donor-advised funds, would be able to attract new sources of support from within their communities. These new gifts are particularly important for small community foundations—those with less than \$5 million in assets—which are particularly dependent on donor-advised funds to provide the charitable resources their communities need.

Studies by the Council on Foundations found that, in 2007, donor-advised funds accounted for over one-third of all community foundation assets and 62% of their total grantmaking. In addition, according to a recent study by the National Philanthropic Trust, the payout rate from donor-advised funds was 17.1% in 2010. Nor was that high payout rate an exception: donor-advised funds have paid out more than 16% of assets annually for at least four years, over three times the minimum required for private foundations by federal law. Donor-advised funds also have experienced tremendous growth. Donors contributed \$7.77 billion to donor-advised funds in 2010, an increase of 25.5% compared with 2009.

The Council also has found that donor-advised funds are a particularly effective tool for middle-income Americans to engage in philanthropy. With most community foundations accepting a donor-advised fund in the range of \$5,000 to \$15,000, donor-advised funds are a

philanthropic vehicle that can go to work immediately, a particularly valuable trait given current demands. Because donor-advised funds are so critical to the work of community foundations and to the philanthropic sector generally, it is very important that foundations and donor-advised funds be able to put assets from IRA rollovers to work for their communities.

Donor-advised funds, supporting organizations, and private foundations, along with public charities, all play critical roles in meeting the needs of the communities they serve. Yet, when enacting section 408(d)(8), Congress identified no basis for limiting charitable IRA rollovers to certain philanthropic vehicles. Moreover, to the extent that such concerns existed, they were fully addressed by reforms relating to supporting organizations and donor-advised funds also enacted as part of the PPA.

In sum, the “Public Good Rollover Act of 2011” will provide philanthropies with the tools needed to fulfill their missions, and to help meet the growing needs of their communities. I respectfully urge the Committee to move quickly to enact this important legislation.

Thank you again for this opportunity to present testimony.

Statement for the Record
Of
The Depreciation Fairness Coalition

For The Hearing On
**“Extenders and Tax Reform:
Seeking Long-Term Solutions”**

Before
The U.S. Senate
Committee on Finance

Tuesday, January 31, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of the Depreciation Fairness Coalition.

The Depreciation Fairness Coalition is comprised of a broad range of industries, including retail, restaurants, construction, real estate, and small business. The issue that brings us together is the shared interest in the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements.

We applaud the Committee's leadership on tax reform. Currently, the tax law presents taxpayers with a great deal of complexity and unpredictability. In this regard, the Depreciation Fairness Coalition welcomes tax reform as an opportunity to address these issues. Done properly, a comprehensive and nuanced review of the tax system could result in certainty, simplicity, and fairness, while encouraging economic growth and job creation.

However, in the interim, we strongly urge the immediate and seamless extension of a 15-year depreciation schedule. On December 31, 2011, the 15-year depreciation schedule and a number of other meritorious tax policies were allowed to lapse. Until there is an opportunity to address tax policy in a long-term and comprehensive manner, extension of these tax provisions is essential to continuing the critical tax relief and access to capital that is necessary to our nation's economic and job recovery.

Under Current Law, the 15-Year Depreciation Schedule is Temporary and Must be Extended Regularly

Before its expiration on December 31, 2011, the Internal Revenue Code ("Code") contained a temporary provision under which leasehold improvements, restaurant improvements, new restaurant construction, and retail improvements can be depreciated over 15 years rather than a 39-year recovery period that otherwise applies to nonresidential real property.

By way of background, Congress permanently provided for the 15-year depreciation schedule for retail motor fuels outlet stores in the Small Business Job Protection Act of 1996. In recognition of their shorter expected lives, Congress subsequently expanded property subject to the 15-year depreciation schedule to include leasehold improvements (American Jobs Creation Act of 2004), restaurant improvements (American Jobs Creation Act of 2004) and new construction (Emergency Economic Stabilization Act of 2008), and retail improvements (Emergency Economic Stabilization Act of 2008).

However, the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements is temporary and must be extended annually. The piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity. Moreover, in some cases, the provision has been allowed to lapse. This situation occurred recently, when the provision expired at the end of 2009. The provision was later retroactively extended for 2010 and prospectively extended for 2011 by the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, enacted in December

2010. The provision expired again at the end of 2011. The temporary nature of the current-law 15-year depreciation schedule has made it extremely difficult for businesses to plan for the capital expenditures necessary to expand and improve their businesses.

The 15-Year Depreciation Schedule is a Reflection of Economic Reality and Should be Made Permanent as Part of Tax Reform

Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements as part of comprehensive and long-term tax reform would provide taxpayers with predictability, simplicity, and fairness.

The 15-year depreciation schedule for leasehold improvements, restaurant improvements, new restaurant construction, and retail improvements reflects the tax policy principle that costs of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time.

With more than 130 million Americans patronizing restaurants each day, such building structures experience a daily human assault. These businesses must constantly make changes to keep up with the structural and cosmetic wear and tear caused by customers and employees. The heavy use accelerates deterioration of a building's entrance, lobbies, flooring, restrooms, and interior walls. For restaurants, National Restaurant Association research shows that most restaurants remodel and update their building structures every six to eight years. As a result, 15 years is a much more accurate depreciation timeframe than is 39 years.

Until Comprehensive Tax Reform, the 15-Year Depreciation Schedule Should be Extended to Provide Businesses with Certainty

Our nation's businesses are looking forward, planning capital expenditures to improve and expand their businesses. For example, according to the National Restaurant Association April 2011 Tracking Survey, 53 percent of restaurant operators plan to make a capital expenditure for equipment, expansion, or remodeling in the next six months – the highest level in 41 months. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making decisions right now. Consequently, until there is comprehensive tax reform, the 15-year depreciation schedule should be extended.

Moreover, the 15-year recovery period is an important driver of economic activity, fueling investment and job growth at a time when the recovery is still attempting to take hold. The 15-year recovery period reduces the cost of capital expenditures and increases cash flow. This provides needed capital for American businesses – which, in turn, translates into American jobs.

As demonstrated in Figure 1 below, the annual tax savings and corresponding additional cash flow realized by restaurateurs from a 15-year, rather than a 39-year, depreciation schedule are considerable. For example, a restaurateur's annual tax liability would increase by nearly \$10,000 if the recovery period for a \$1 million investment were increased from 15 years to 39 years. In an industry with median profit margins of three to five percent, every penny counts. A more

accurate recovery period frees resources to expand business either through new hires or further capital expenditures.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-Year Schedules
\$100,000	\$2,532	\$608	\$6,667	\$1,600	\$992
\$250,000	\$6,329	\$1,519	\$16,667	\$4,000	\$2,481
\$500,000	\$12,658	\$3,038	\$33,333	\$8,000	\$4,962
\$700,000	\$17,722	\$4,253	\$46,667	\$11,200	\$6,947
\$1,000,000	\$25,316	\$6,076	\$66,667	\$16,000	\$9,924
\$1,500,000	\$37,975	\$9,114	\$100,000	\$24,000	\$14,886
\$2,000,000	\$50,633	\$12,152	\$133,333	\$32,000	\$19,848

Expenditure Scenarios

Rebuild Costs:

Quickservice - \$700,000

Fullservice - \$1,500,000

Renovation Costs:

Quickservice - \$250,000

Fullservice - \$500,000

Note: Figures are based on a 24% effective marginal tax rate

Additionally, when restaurants invest in construction and renovations, the impact spreads throughout the economy. Before the economic downturn, the restaurant industry spent more than \$10 billion in 2007 on construction of restaurant buildings. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional \$2.39 in spending in the rest of the economy and every \$1 million spent in the construction industry creates more than 28 jobs in the overall economy. This means that restaurant industry construction spending created nearly 400,000 jobs in 2008 and 2009, at a time when the overall economy was contracting (see Figure 2 below).

Figure 2.

Restaurant Spending on New Construction

Year	Billions (\$)	Jobs Created In Overall Economy
2004	5.2	145,000
2005	7.4	208,000
2006	6.6	185,000
2007	10.4	292,000
2008	7.6	214,000
2009	6.2	174,000

Source: U.S. Census Bureau and National Restaurant Association

Conclusion

We greatly appreciate the opportunity to submit this statement on behalf of the Depreciation Fairness Coalition. Tax reform presents an opportunity to provide taxpayers with predictability and fairness; however, in the interim, certainty is necessary to encourage economic growth and job creation. As Congress considers the important issue of tax reform, we are happy to be a resource for Congress and the Committee and urge you to make permanent the 15-year depreciation for leasehold improvements, restaurant improvements and new construction, and retail improvements.



Statement for the Record

By

**Jim Larson, Program Development Director
Food Donation Connection**

For the Hearing on

**Extenders and Tax Reform:
Seeking Long-Term Solutions**

Before

The U.S. Senate Committee on Finance

Tuesday, January 31, 2012

PO Box 22787 Knoxville, Tennessee 37933

865-777-2398 www.foodtodonate.com



Memorandum

To: Senate Committee on Finance

From: Food Donation Connection

Date: January 31, 2012

Subject: Tax Extenders and Enhanced Charitable Deduction for Food Inventory Contribution

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of Food Donation Connection (FDC). We appreciate your leadership on tax code reform.

It is no secret that the current economic climate has intensified the needs of aid agencies that feed the nation's hungry. One method that has proven successful in helping to meet this need is the redirection of surplus wholesome food produced by restaurants and food service companies to these hunger relief organizations. In 1976, the U.S. Congress encouraged such donations when it enacted Section 170 of the Internal Revenue Code, allowing C-corporations to earn an enhanced tax deduction for donating surplus property, including food. The intent of this law was to provide an incentive to restaurants and food service companies to take the steps necessary to save and donate surplus food to non-profit IRC 501(c)(3) organizations.

Since 1992, FDC has assisted companies nationwide in establishing programs to donate their surplus food to local hunger relief agencies. FDC's vision is to "let nothing be wasted," and the company has coordinated the donation of over 230 million pounds of wholesome prepared food to help people in need. We currently partner with companies like Yum! Brands (Pizza Hut, KFC, and Taco Bell), Darden Restaurants (Red Lobster, Olive Garden, LongHorn, Seasons 52, Bahama Breeze, Capital Grille), The Cheesecake Factory, Chipotle Mexican Grill, and Starbucks Coffee Company to coordinate donations from over 13,000 restaurants to over 7,900 non-profit agencies nationwide.

Katrina Emergency Tax Relief Act, Tax Extenders and Permanent Tax Law

When Hurricane Katrina devastated the Gulf Coast in late August, 2005, Congress passed KETRA to make it possible for *all* business entities (non-C corporations like S corporations, Partnerships, and Sole Proprietorships) to take the enhanced tax deduction allowed by Section 170(e)(3). The current law has been extended on three occasions through the Pension Protection Act of 2006, the Emergency Economic Stabilization Act of 2008, and the Tax Relief and Job Creation Act of 2010. While these measures have helped to meet the needs of the hungry, the bi-annual, retroactive tax extender approach makes it difficult for potential food donors to accomplish adequate tax planning.

The uncertainty of incentive longevity and lapses in the expansion of the deduction provision increase the difficulty of convincing new non-C corporation business owners to donate. Many things compete for the attention of business managers, and as an unfortunate result,

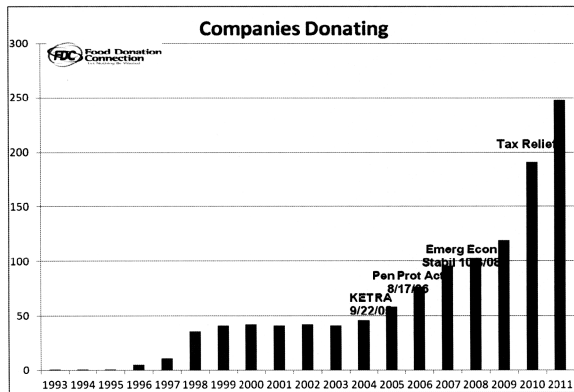
wholesome food continues to be thrown away at many restaurants. What is needed is a permanent expansion of Section 170(e)(3) to all food industry businesses. FDC supports the "Good Samaritan Hunger Relief Tax Legislation," House Bill 3729 and Senate Bill 166, which would provide a permanent tax law to allow for greater long term tax planning by food donors. For example, the language included in the Good Sam Hunger Relief Tax Extension, S.166/H.R. 3729, provides a simplified calculation of the deduction for all business taxpayers and codifies an important tax court ruling regarding valuation determinations for food donations. FDC is working with Feeding America (formerly America's Second Harvest), the National Restaurant Association, and food donors to build awareness and encourage passage of these important bills. Specifically, this legislation, when combined, will do five things:

- Permanent the food donation tax provision for non-C corps,
- Codify fair market value,
- Include the benefit for cash accounting (for farmers and ranchers),
- Increase the charitable contribution cap to 15%,
- Include a 5-year carry forward provision for non-C corps.

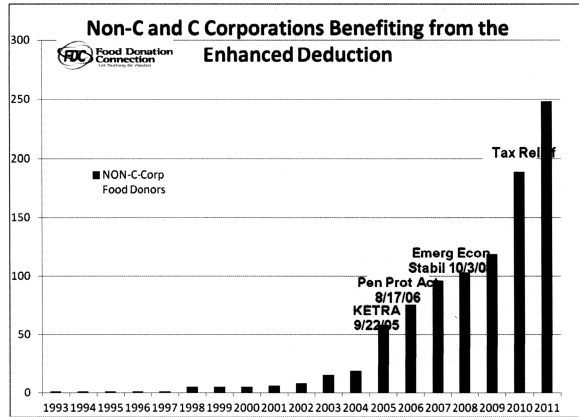
Tax Law Impact

FDC is uniquely positioned to examine the impact of expanding Section 170(e)(3) to all business taxpayers in the restaurant industry. We have found that donating prepared food in a local community is an attractive option for businesses and it has an immediate impact on the lives of the less fortunate. However, without a permanent incentive for donating, many non-C corporations will likely cease donating food.

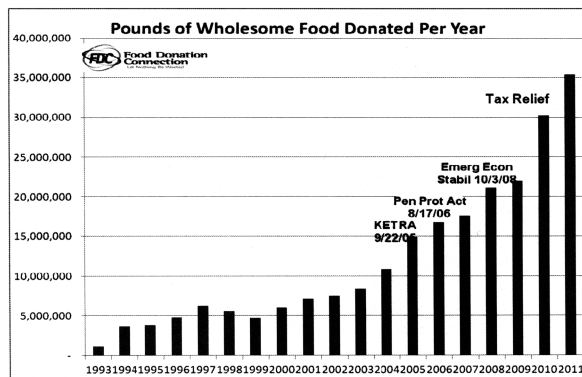
The following charts illustrate the impact of expanding Section 170(e)(3).



The first chart, **Companies Donating**, shows the increase in the number of companies donating surplus food from 1993 to 2011. (Please note that the sale of Pizza Hut corporate stores to franchise companies is responsible for the increase in the number of total companies donating in 1998 and 1999).



The second chart, *Non-C and C Corporations Donating*, illustrates the sale of the Pizza Hut stores to non-C corporation franchisees in the late 1990's. The franchisees continued to donate for a few years, but the amount of food donated declined as the non-C corporation companies were ineligible for Section 170(e)(3) deductions.



The third chart, *Pounds Donated*, graphically illustrates this drop in donations, resulting in a lack of significant gains between 1998 and 2004.

All three charts illustrate the growth in donations from companies involved in FDC's Harvest Program as a result of the expansion of Section 170(e)(3) in 2005 after KETRA and subsequent extensions.

An example of the trend for non-C corporations to stop donating can be seen in the experience of the long-donating C-corporation, Pizza Hut, Inc. Pizza Hut was the industry pioneer in launching wholesome surplus food donations in its company restaurants in 1992. However, Pizza Hut, Inc. over the past several years has divested itself of many of its restaurants by selling them to franchisees. Yum! Brands is now over 90% franchised, and these franchisees are

typically non-C corporations. As a result, the franchisees are once again not eligible for the enhanced tax deduction because the law expired December 31, 2011.

History

The fundamental features of S.166/H.R.3729 have been previously examined and agreed upon in bipartisan bills designed to expand the capacity of individuals and organizations to serve those in need - the CARE Act, S. 476, and The Charitable Giving Act, HR 7.

"In the 108th Congress, the CARE Act, S.476, passed the Senate by a vote of 95-5. The House of Representatives passed companion legislation, the Charitable Giving Act, H.R. 7 by a vote of 408-13. Tragically for those in need, the bill was chosen as the first bill to not be allowed to go to conference after passage by both chambers and thus prevented from becoming law in the last Congress."

Senator Rick Santorum, Chairman of the Subcommittee on Social Security and Family Policy Senate Finance Committee, September 13, 2005.

In closing, please consider the following, typical comment from a recipient hunger relief agency, concerning the impact of prepared food donations. Stephanie Paine, Director of Food Service for the San Diego Rescue Mission in San Diego writes:

..The donations of pizza from Pizza Hut and chicken wings, rice, mashed potatoes, corn on the cob and macaroni & cheese from KFC have increased the nutritional value of the food we had available and the men, women and children that receive these meals have been so grateful to have more variety in the weekly menus. We collect enough of the Pizza Hut and KFC items to serve three meals a week! And we serve 500 people at each meal. That is 1500 free meals that would otherwise be thrown away if these restaurants didn't donate to our organization...

As you consider the best ways to address tax reform and help end hunger throughout the United States of America, please remember that food donation programs provide free, prepared food to non-profit organizations in local communities, resulting in an immediate impact on the lives of the less fortunate. Surplus food donations re-direct wholesome food – otherwise destined for a landfill – to the stomachs of the hungry. Passage of House Bill 3729 and Senate Bill 166 would fulfill the original intent of the Section 170(e)(3)(C) legislation by allowing non-C corporations to take advantage of a charitable deduction for their contributions of food inventory to the needy. Surely this is part of a win-win solution to the troubling problem of hunger in our nation.

Sincerely,

Jim Larson
 Program Development Director
 Food Donation Connection
 PO Box 22787, Knoxville, TN 37933
 865-777-2593
Jim.Larson@FoodToDonate.com



Extenders and Tax Reform: Seeking Long-Term Solutions

February 8, 2012

HK Payroll Services Co.

2345 J.F.K. Road, P.O. Box 3310

Dubuque, IA 52004-3310

Dear Senate Committee on Finance:

We at Honkamp, Krueger & Co., P.C. are writing to urge you to include the remaining Work Opportunity Tax Credit (WOTC) categories that expired at the end of last year in the payroll tax cut bill. These tax provisions, which benefit a wide range of taxpayers, including associations, businesses, and individuals, are extremely important to U.S. jobs and the broader economy.

While the VOW to Hire Heroes Act extended the veterans categories through 2012, the categories for people living in distressed communities, at-risk youth, disabled workers, etc. expired at the end of last year, injecting more instability and uncertainty into the economy and further weakening confidence in the employment marketplace. Additionally, not including these provisions in the bill will result in a crushing tax increase to employers who have incorporated WOTC's public-private sector partnership into their hiring practices.

Moreover, the extension of the expired WOTC categories should not be delayed until policymakers complete work on comprehensive tax reform. Even though Congress has begun to consider tax reform proposals, a wide-ranging group of taxpayers is making decisions right now related to current law, which will have an immediate impact on the economy. Employers are still giving forms to new hires and state employment offices are still collecting WOTC information. While we are hopeful that the tax reform debate results in policy that is fair, efficient, and encourages economic growth, it is critical that the current tax system provide certainty in the interim. Additional uncertainty is not a recipe for improving confidence in this economy.

The recent passing of the VOW to Hire Heroes Act demonstrates that the effectiveness of WOTC is still recognized on both sides of the aisle, even after fifteen years in operation. If the rest of the WOTC program is discontinued, it should be done in an orderly way that allows employers to anticipate the change, after Congress has given due consideration to the issues.

Please consider the following testimonials from our Tax Credits department on how these credits benefit our clients:

Multiple clients have expressed concern over the expiration of the WOTC program. This program is a huge help to them. - Kris H.

In the course of conducting business for Honkamp Krueger we make courtesy calls to our clients. These calls help to address our clients' concerns regarding WOTC. During several calls, I experienced clients expressing concern about the renewal of WOTC. This credit has helped many small businesses who employ qualified employees keep their businesses operational. To lose that tax credit could be devastating to some of our clients. - Diane B.

The work opportunity tax credit program is a good thing for small companies to have to keep their business successful and profitable; it encourages businesses to hire more people, helping to get them off unemployment. – Amanda G.

The WOTC program is very important for our economy. These valuable tax credits help our businesses to stay profitable and therefore keep people working which keeps our unemployment numbers low. Also, these tax credits are an incentive for companies to hire individuals that fall into the many target groups and keep them employed. – Linda S.

I have heard frequently over the years from our WOTC clients that these credits are necessary for their company to survive and expand, that these tax credits allow the company to add additional employees. By not renewing this great tax credit program would in essence be a tax increase to our clients, something they cannot afford at this time to their company in this economy. – Judd D.

Working for the Tax Credit department at Honkamp Krueger, I have seen many of our clients flourish because of WOTC. I think it's important to extend WOTC because it helps all sizes of business whether small or large! – Kallie W.

The WOTC credits our clients receive are essential to the success of their business and their ability to create more jobs. Not only does this benefit them, but the economy as well. – Sharon K.

I know that many of our clients, especially our clients with smaller companies, have greatly benefited from this program. As you may know, many businesses have struggled in this hard economic time.

Therefore, the help that businesses receive from this program has helped them out tremendously. This program does not only help businesses but the people working for them by allowing more companies to hire more employees. With more businesses that are able to hire and more people working, the better the economy has a chance at recovery. - Erin M.

This program has proven to be a great bridge for employees who are trying to get off government assistance and the employers who can help them with this goal. Many of our clients have been able to

offer additional benefits, wages, and other workforce improvements due to the savings WOTC has provided them. One client has been able to improve their business model with the help of this program. As a result, they are now scheduling annual companywide meetings for their 22 locations to strategize effective business practices for their nearly 12,000 annual employees. – Mike N.

The program is very helpful to our clients. These credits allow the employer to provide more jobs and extend benefits to their employees. - Christine M.

As a Tax Credit Consultant, I work with hundreds of businesses every year who take advantage of this program. These businesses have higher retention rates, can pay a higher salary to their workers, and impact their economies through this program. These tax provisions also directly impact the unemployment rates in their communities. Removing this program would have a significant negative impact on businesses. Businesses who have taken advantage of the WOTC program count on the tax benefits on their fiscal year returns. Pulling these impactful benefits from their businesses will have a negative result on both employment and the economic climate of their local communities. The VOW act being passed recently shows the impact of WOTC. However, target groups are being left out if we are not able to continue the WOTC program. SSI income recipients, disabled and underprivileged employees and employees who come from disadvantaged areas are all left out if the WOTC program is not continued. Some of these target groups are the most widely used of all of the WOTC program. This makes not only the business counting on these credits at-risk, but any of the employees that fall into the target groups will have a more difficult time finding work. - Mike J.

Many of our clients are able to use the tax provisions to finance their company growth, internal and external. As you are well aware, a growing business is one of the fastest ways to a growing, recovering economy. – Emily S.

The feedback I receive from clients on why the WOTC is so important is a two-fold opportunity. First, it is a very low risk alternative to increase bottom line performance in today's struggling economy. Second, clients can direct their hiring towards target groups who might not otherwise be thought of for employment. The return can be equally beneficial to both mom and pop companies and large corporations who choose to employ low to middle class applicants while at the same time boosting our blue collar work force. – Shane B.

We urge you to include the remaining WOTC categories in the payroll tax cut bill, preventing tax increases on businesses, farmers, workers, and entire communities at this stage in the recovery.

Sincerely,

The Tax Credit Department at HKP
Affiliated with Honkamp Krueger & Co., P.C., a Top 100 CPA and business consulting firm



"Extenders and Tax Reform: Seeking Long-term Solutions"

Senate Committee on Finance
January 31, 2012

Statement for the Record

Independent Sector
1602 L Street NW, Suite 900
Washington, DC 20036



INDEPENDENT SECTOR
A vital voice for us all

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January 31, 2012

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
SD-219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
SD-219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Hatch:

I write on behalf of Independent Sector, which represents nearly 600 public charities, private foundations and corporate giving programs. In anticipation of the Committee's hearing to examine long-term solutions for the group of tax incentives known collectively as "extenders," I strongly urge you to support the passage of a package of expired tax provisions that encourage charitable giving as soon as possible.

Our member organizations and the millions of people we serve rely on the charitable gifts made possible by a number of provisions in the extenders package. In particular, it is urgent that Congress restore the IRA charitable rollover provision, the deduction for contributions of capital gain real property made for conservation purposes, and the enhanced deductions for corporate contributions of food, book, and computer inventories.

Since their enactment, these important incentives have contributed to the nonprofit community's efforts to improve lives and create thriving communities. Nonprofit organizations have benefited from contributions spurred by these incentives to build cancer centers, develop counseling programs for at-risk youth, provide housing for homeless families, conserve wilderness areas, and offer art therapy for people with developmental disabilities.

We have seen in the past that waiting until the end of the tax year to restore these provisions results in tremendous uncertainty for donors, undermining their incentive effects. This is particularly true for the IRA charitable rollover, where the ambiguity of re-enactment makes it extremely difficult for donors and financial advisors to plan their IRA distributions and related charitable giving strategies, impeding the transfer of gifts that support much-needed services.

At a time when America's nonprofits are struggling to meet increasing demand for services in the face of diminishing revenues, further declines in giving will severely limit the support we are able to provide individuals and families in communities in Montana, Utah, and throughout the nation. We urge you to act now to reinstate these critical giving incentives to help ensure that our nation's nonprofits have the resources they need to meet the needs of individuals, families and communities across the country.

Sincerely,

A handwritten signature in black ink that reads "Diana Aviv". The signature is written in a cursive, slightly slanted style.

President and CEO
Independent Sector



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

**Statement of the Investment Company Institute
Hearing on "Extenders and Tax Reform: Seeking Long-Term Solutions"
Committee on Finance
United States Senate**

January 31, 2012

The Investment Company Institute ("ICI")¹ appreciates the opportunity to describe for the Committee the reasons why temporary tax provisions impacting the competitiveness of U.S. regulated investment companies ("RICs") should be made permanent. These provisions reflect sound policy judgments made by this Committee and the Congress on fundamental structuring issues impacting the ability of RICs, more commonly known as mutual funds, to compete with foreign funds for foreign investors.

The ICI applauds the Committee for examining carefully all expiring provisions and seeking to make permanent those that achieve important long-term objectives such as spurring economic growth and job creation and enhancing the competitiveness of U.S. businesses in the global marketplace. The provisions discussed below achieve these objectives by exempting foreign investors in a RIC from U.S. tax on certain amounts that would be exempt if received directly by these investors.

The ongoing temporary nature of these provisions (enacted in 2004 and extended twice), however, limit their usefulness. Making permanent these provisions would enhance substantially the attractiveness of RICs to foreign investors. Making this change expeditiously would be particularly beneficial because withholding must be imposed on all distributions made after these provisions expire (which already has happened, as discussed below, for shareholders of many RICs).

¹ The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$12.5 trillion and serve over 90 million shareholders.

Background

RICs in the Global Marketplace

Individuals around the globe are becoming increasingly attracted to funds to meet their diverse investment needs. Worldwide mutual fund assets totaled \$23.13 trillion as of September 30, 2011.² The U.S. industry's share of worldwide fund assets has declined. As of September 30, 2011, less than half of the worldwide mutual fund assets (\$11 trillion) were in RICs.

RICs offer numerous advantages that should be attractive to foreign investors. In addition to the expertise provided by the industry's portfolio managers and analysts, particularly with respect to the U.S. capital markets, the U.S. securities laws provide strong investor protections. Foreign investors' holdings of RICs, however, are negligible.

The Internal Revenue Code ("Code") creates certain competitive difficulties for RICs seeking to compete with foreign funds for foreign investors. These difficulties arise because RICs are corporations that distribute their income annually as dividends. While income and capital gains are not subject to U.S. withholding tax under section 1441³ when paid to a individual investor who is neither a citizen nor resident of the U.S. (a non-resident alien), dividends are subject to this withholding tax. Thus, absent a Code provision providing that the tax character of this income "flows through" to its investors, RIC shareholders are subject to withholding on certain amounts that would be exempt from withholding tax if received directly by foreign investors.

The Code does provide flow-through treatment for the long-term capital gains realized on RIC portfolio transactions. Specifically, the Code treats distributions of long-term capital gains as a "capital gain dividend;" this flow-through provision exempts a non-resident alien investor from U.S. withholding tax on a RIC's long-term capital gains.

No comparable flow-through solution is provided for interest and short-term capital gains. The flow-through treatment for these types of income, as discussed below, is provided only by the expiring provisions.

Section 871(k)

Section 871(k) was added by the American Jobs Creation Act of 2004⁴ to exempt foreign investors in an electing RIC from U.S. withholding tax on "interest-related dividends" and "short-term

² http://www.ici.org/research/stats/worldwide/ww_09_11.

³ All references to section, unless indicated otherwise, are to Code sections.

⁴ Pub. L. No. 108-357.

capital gain dividends.” Interest-related dividends are amounts attributable to an electing RIC’s U.S.-source interest income; short-term capital gain dividends are amounts attributable to an electing RIC’s short-term capital gains. Section 871(k) permits electing RICs to “flow through” to their foreign shareholders the character of this income.

Prior to section 871(k)’s enactment, foreign investors in RICs were subject to U.S. withholding tax on amounts attributable to RICs’ interest income and short-term capital gains because these amounts were treated under the Code as ordinary dividends.⁵ Conversely, foreign investors are not subject to U.S. withholding tax on interest and short-term capital gains if the investments instead are made directly in the underlying securities or through foreign funds. Because of this disparate treatment, the Congress enacted section 871(k) to level the playing field and encourage foreign investment in RICs.

As originally enacted, however, section 871(k) was effective for only three years, beginning with a RIC’s first taxable year beginning on or after January 1, 2005. This section was extended twice, for two years each time, in 2008 and 2010. Thus, section 871(k) currently is set to expire for dividends with respect to tax years of RICs beginning after December 31, 2011.

Section 2105(d)

Section 2105(d) also was enacted by the American Jobs Creation Act of 2004. This provision effectively provides foreign investors in a RIC that has elected section 871(k)’s application with the same estate tax treatment they would receive if they held directly the portfolio securities held by the RIC.

A non-resident alien generally can invest in U.S. debt obligations without any concern that these assets would be treated as property within the U.S., and therefore part of the individual’s gross estate subject to U.S. estate tax, should the person die while holding these assets. Prior to section 2105(d)’s enactment, however, if the same investment were made indirectly through a RIC (such as a U.S. Government bond fund), the RIC shares would be treated as property within the U.S. and subject to the U.S. estate tax.

Under section 2105(d), RIC shares owned by a non-resident alien are not treated as property within the U.S. in the same proportion that the RIC’s assets would be treated as situated outside the U.S. if held directly by the investor. This proportional determination is made at the end of the RIC’s last quarter before the investor’s death.

Section 2105(d) thus provides an estate tax “look-through” rule for RIC shares that corresponds to the interest-related dividend flow-through exception of section 871(k). If section

⁵ The regular withholding rules continue to apply if a RIC does not elect flow-through treatment under section 871(k).

871(k) had been enacted without the corresponding enactment of section 2105(d), the interest-related dividend provision of section 871(k) would not have encouraged RIC investments by any non-resident alien investor with estate tax liability concerns. Section 2105(d), therefore, is an important element of any fundamental structuring initiative to make RICs more competitive in the international marketplace.

As originally enacted, however, section 2105(d) was effective only for individuals dying during the three-year period beginning January 1, 2005 and ending on December 31, 2007. This section, like section 871(k), was extended twice, for two years each time. Section 2105(d) in all cases has expired; only individuals who died between January 1, 2005 and December 31, 2011 were covered.

Reasons These Provisions Should be Made Permanent

Section 871(k) and section 2105(d) are important for RICs seeking to compete with foreign funds for foreign investors. The additional investment in RICs, rather than in foreign funds, benefits U.S. money managers (who hire U.S. workers and pay U.S. taxes) and the U.S. capital markets.

These provisions, as discussed above, provide foreign investors in RICs with the same U.S. tax treatment they would receive if they invested directly in a RIC's underlying portfolio securities. In some respects, it should be noted, even these rules do not go far enough to level the playing field. For example, the estate of a foreign investor in a foreign fund will not incur any U.S. estate tax on the fund shares – even if the fund holds only U.S. equities – whereas a foreign investor in a RIC holding the same securities would be treated as having property situated in the U.S. for estate tax purposes.

The temporary nature of section 871(k) and section 2105(d), however, has limited their utilization by RICs and their attractiveness to foreign investors. Many RICs, for example, have been sufficiently unsure of the provisions' long-term viability to incur the significant programming costs for the possibility of only temporary benefits. The sporadic manner in which these provisions have been extended has done little to convince RICs that the benefits will be long-lasting.

Uncertainty also has impacted investment decisions by foreign investors. Many such investors have been unwilling to make long-term investments in RICs without a long-term assurance that the flow-through benefits would be available. Some foreign investors who nevertheless have invested in RICs have redeemed their shares before receiving a distribution that would have been subject to U.S. withholding tax only because section 871(k)'s application had not been extended before it expired. A separate problem arises for those foreign investors who remain in the RIC after section 871(k)'s application has expired. Specifically, these investors can be forced to file U.S. tax returns to recover taxes, on amounts attributable to interest and/or short-term capital gains, that were collected by the RIC on distributions made during the period after section 871(k) expired and before it was retroactively reinstated.

Unlike most other expiring provisions, which generally need not be resolved until taxpayers are preparing to file tax returns, the flow-through provisions involve withholding taxes and should be addressed before they expire.

Proposal

The Internal Revenue Code should be amended to make permanent the flow-through/look-through treatment of sections 871(k) and 2015(d). Specifically, sections 871(k)(1)(C)(v) and 871(k)(2)(C)(v) – which contain the “termination” date for the flow-through of interest-related dividends and short-term capital gain dividends – as well as section 2105(d)(3) – which contains the “termination” date for the estate tax “look through” rule – should be stricken from the Code. These changes will enhance the international competitiveness of the U.S. fund industry, thus encouraging foreign investment in RICs and in the U.S. capital markets.

**Testimony of William C. Daroff
Vice President for Public Policy &
Director of the Washington Office
The Jewish Federations of North America**

**United States Senate Committee on Finance
Extenders and Tax Reform: Seeking Long-Term Solutions**

Summary: The Jewish Federations of North America urges the Senate Finance Committee to make permanent and expand the current incentive in the tax code that permits tax-free rollover of individual retirement account to charities (“IRA Charitable Rollover”). As one of the nation’s largest philanthropic networks, we know first hand that targeted tax incentives such as the IRA Charitable Rollover result in increased contributions that translate into more funds that can be spent for the overall social good. We strongly believe that if the IRA Charitable Rollover was made permanent and expanded, as discussed below, it would result in even larger amounts flowing into the nonprofit sector, which would be especially beneficial as the Nation’s charities seek to fill the void left by decreasing government funding and increased demands for social services during this time of economic distress. If the IRA Charitable Rollover was expanded to include provisions contained in the “Public Good IRA Rollover Act of 2011,” the amount of charitable distributions flowing from individual retirement accounts would expand greatly, at little, or no additional revenue cost to the government.

Background: The Jewish Federations of North America (herein referred to as “JFNA”) is the national organization that represents and serves 157 Jewish Federations, their affiliated Jewish community foundations and 300 independent Jewish communities in more than 800 cities and towns across North America. In their communities, the Jewish Federations and Network volunteers (collectively, the “JFNA System”) are the umbrella Jewish fundraising organizations and the central planning and coordinating bodies for an extensive network of Jewish health, education and social services agencies. Thus, the JFNA System represents over one thousand affiliated agencies and serves several million individuals throughout the country.

JFNA conducts an annual fundraising campaign that collectively raises nearly \$1 billion system-wide each year from over 400,000 donors. In addition, the endowment departments of Federations or their affiliated Jewish community foundations raise in excess of another \$1 billion each year through charitable vehicles including donor-advised funds supporting organizations, (together referred to a “participatory funds”), which support one or more specified public charities or programs through an active grant-making program, as well as maintaining charitable income plans. The combined endowment assets of the JFNA system is in excess of \$14 billion and annual endowment

grants from the participatory funds and other endowment assets is approximately \$1.5 billion, split between Jewish organizations and those of the general charitable sector. The IRA Charitable Rollover is another relatively recent incentive added to the income tax code that has materially increasing giving to Federations throughout the country.

IRA Charitable Rollover: A qualified tax-free distribution from individual retirement accounts provision defined in Code section 408(d)(8) was added to the federal tax law by the Pension Protection Act of 2006. Unfortunately, the provision contained an expiration date of December 31, 2007, and, as such, has joined the growing list of so-called “tax extender” items that must be regularly renewed by Congress. The current version of the IRA charitable rollover, *which expires on December 31, 2011*, permits individuals age 70-½ to make tax-free charitable gifts of up to \$100,000 directly from their individual retirement account to eligible charities. Amounts rolled over are not taken into income by the IRA owner and are not eligible for a charitable contribution deduction. However, such rollovers qualify as an annual required minimum distribution from the owner’s IRA.

It is important to note that the IRA Charitable Rollover is one of the few provisions in the tax code that provides an incentive to give to charity to those taxpayers who do not itemize their deductions. As noted above, amounts that qualify for the IRA Charitable Rollover do not qualify for a charitable contribution deduction. Such amounts, however, do not have to be taken into income, which can be equivalent to a charitable contribution deduction for the more than two-thirds of all taxpayers who do not claim itemized deductions. As Senate Finance Chairman Baucus noted at the October 18, 2011 hearing on Nonprofits and Charitable Giving, “it is our duty to make sure the tax code encourages charitable donations in the most efficient way possible.” The IRA Charitable Rollover meets this test and should be made permanent.

Charitable gifts to JFNA received from the IRA Charitable Rollover: The existing IRA Charitable Rollover has been an overwhelming success for the charitable sector in general, and the JFNA system in particular. The IRA Charitable Rollover helps charities provide needed social services at a time when there is both an increased demand and fewer resources available from government sources. In a relatively short period of time, Jewish Federations have received **more than \$30 million** in contributions from IRA charitable rollovers, through targeted campaigns, such as one to attract rollover gifts from grandparents to help fund Jewish day schools. The resulting charitable rollover gifts have enabled Jewish Federations to accelerate capital campaigns to finance new construction projects, expand existing social services programs, among other worthwhile projects. In addition, many donors have taken advantage of the IRA Charitable Rollover provision to fund an endowment for their annual Federation campaign gift. Each year since the provision has been enacted and renewed, several large Jewish Federations have received rollover contributions in excess of \$1 million.

First JFNA Recommendation: Make the IRA Charitable Rollover permanent. We recommend that, at a minimum, the IRA Charitable Rollover be made a permanent part of the Federal tax code. We advance several arguments in favor of making the provision permanent:

1. The current law that allows the IRA Charitable Rollover to expire and be reenacted adds needless confusion to taxpayers, their financial advisors, and the charities that can benefit from such transfers.
2. Because multiple parties are involved in any qualified charitable distribution under Code section 408(d)(8) (the IRA owner, brokerage firms and others that maintain or act as trustees of such accounts, and public charities that qualify to receive direct distributions), the need for permanence is magnified.
3. The interaction of the qualified charitable distributions and the required minimum distribution requirements make it essential that taxpayers know the law with certainty. Potential confusion over the interaction of these two provisions can be exacerbated when Congress fails to extend the IRA Charitable Rollover provision before expiration and does so retroactively, as was the case in 2010, when the statute extending the provision was enacted in December retroactive to the prior January.

Second JFNA Recommendation: Expand current law to include provisions contained in the “Public Good IRA Rollover Act of 2011.” Bi-partisan legislation to make permanent and expand the provisions of the current law IRA Charitable Rollover has been introduced in the Senate and the House. S. 577, introduced by Sens. Schumer and Snowe, with 11 cosponsors, and H.R. 2502, introduced by Reps. Herger and Blumenauer and others. The major provisions in the “Public Good IRA Rollover Act of 2011” would (1) make the rollover permanent; (2) remove the current \$100,000 annual cap on qualified charitable distributions; (3) allow donor advised funds, supporting organizations, and private foundations to receive qualified charitable distributions; and (4) provide IRA owners at age 59 ½ with a planned giving option such as using the rollover to fund a split-interest (life-income) gift through a charitable gift annuity or charitable remainder annuity trust. Although JFNA urges Congress to enact the “Public Good IRA Rollover Act of 2011” as introduced, we wish to provide specific comments regarding two of its main provisions:

- **Allow donor advised funds, supporting organizations, and private foundations to receive qualified charitable distributions.** Over the past several decades, the JFNA system has been proud of the growth in charitable giving that has been generated through planned giving vehicles. Of special importance have been participatory funds, such as donor advised funds and supporting organizations, which are essential in creating a broad base of support for the Jewish community to fulfill its social services mission, especially in times of economic distress. Participatory funds offer an efficient and economical means for those with sufficient charitable assets to both benefit the community through on-going partnership with public charities such as Federations and have been an indispensable tool in encouraging intergenerational involvement in Jewish charity through family philanthropy. In addition to providing financial resources for critical human service needs in the local Jewish and general communities, these charitable vehicles also advance the values and goals of the JFNA System through nurturing relationships between Jewish philanthropists and Federation lay and

professional leadership, as well through establishing priorities that consider the future needs of the Jewish community.

Such participatory vehicles provide a reliable pool of dollars to fund a variety of social service activities, in particular support of a Federation's annual campaign, which remains the top fundraising priority of Federations. Permitting, indeed encouraging, participatory funds to exist for extended periods provide greater opportunities for sponsoring organizations such as Jewish Federations to build a collaborative philanthropic relationship with the donor and the donor's family. One of the greatest strengths of the JFNA System lies in its unique ability to match donor interests with funding needs in the Jewish community. Because donor advised funds can continue for an extended period of time, including the lifetime of the donor and spouse, heirs and additional successors, this relationship continues to grow over time and succeeding generations of Jewish community leaders can be fostered. This provides the JFNA System with a valuable tool to educate future generations of donors so that they can become effective funders in the future. As the Committee continues to consider tax reform options in general, and charitable giving incentives in particular, JFNA urges that growth in participatory vehicles be allowed to flourish and urge that they be included in the definition of charities that are entitled to receive qualified distributions from IRA Charitable Rollovers.

- **Provide IRA owners at age 59 ½ with a planned giving option such as using the rollover to fund a split-interest (life-income) gift through a charitable gift annuity or charitable remainder annuity trust.** Expansion of the IRA Charitable Rollover to permit those age 59 ½ to fund life-income charitable gifts would also provide additional resources to America's charities, as well as provide a safe and reliable return on investment for donors who chose this option. Gift annuities have a long history as a well-regulated and popular method of fundraising for charitable institutions. Existing state and federal regulations will assure that proper benefits accrue to both the charity and donor and expansion of the IRA Charitable Rollover to cover such gift arrangements should not result in a significant revenue loss because of tax rules on annuity payments.

The Importance of Tax Incentives in the Tax Code: Similar to many other large national charities, the JFNA system has a sophisticated fund raising operation as well as highly-organized procedures for allocating such collected monies to fund a broad range of social service programs. Perhaps the primary mission of JFNA is to assist Federations as they inspire Jews to fulfill their religious duty to be charitable by securing the financial and human resources necessary to care for those in need, rescue Jews in danger, and ensure the continuity of the Jewish people. This critical fundraising task is essential to provide the strategic resources and direction to help local federations fulfill their

individual and collective responsibilities to improve the world, build community, and foster Jewish renaissance. As noted above, the two key elements of such fundraising is a highly-recognized annual campaign supplemented by a sophisticated planned giving operation that utilizes a number of established and highly-regulated charitable giving vehicles.

Because the JFNA system is one of the largest philanthropic networks in the nation, our perspective on charitable giving and the importance of tax incentives is grounded on years of experience. Although our donor base is large, with over 400,000 donors per year, as noted above, we also recognize that the overwhelming percentage of dollars raised come from a relatively small percentage of donors. As a result of this so-called “90-10” or even “95-5” rule, in which the overwhelming percentage of dollars raised flows from a small, but tax-sophisticated donor group who make large gifts either through the annual campaign or most importantly, through the use of planned giving vehicles that are discussed below. In either case, it is this tax sophistication that permits such individuals to structure gifts so that the maximum amount of funds flow to the JFNA system and then to the supported agencies, charities and beneficiary individuals and that flow to such charities today, rather than later.

We will leave it to tax economists to debate the relative responsiveness of sophisticated donors to tax incentives and will not enter the debate over “economic efficiency” and “elasticity of demand” of charitable giving. However, we see the impact of economic and tax factors on charitable giving every day. At a time when our social service partners are being asked to meet increasing demands for services and government funding at the federal, state and local level is shrinking, we know that charitable incentives in the tax code are more important today than ever.

Importance of Other Charitable Vehicles:

JFNA applauds the Senate Finance Committee for its deliberative process and several-year long study of the many issues that need to be considered in contemplating fundamental tax reform. As it pertains to charitable giving incentives, we remind the Committee that any proposals that could result in a decrease in private giving will have significant negative consequences for America’s charities, including JFNA. For example, current proposals submitted by the Administration over the past three years to limit the value of itemized deductions to 28 percent, including the charitable contribution deduction, represent a serious threat to charities that remain at the forefront of the fight to feed the hungry, cloth the naked, and heal the sick. JFNA remains committed to ensuring that federal tax policies continue to encourage private philanthropy.

I thank the committee for the opportunity to present this testimony. If you have any questions regarding this submission, please feel free to contact William C. Daroff, Vice President for Public Policy and Director of the Washington Office at 202-736-5868 or william.daroff@jewishfederations.org or Steven Woolf, senior tax policy counsel at 202-736-5863 or steven.woolf@jewishfederations.org



Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD-219
Dirksen Senate Office Bldg.
Washington, DC 20510-6200

Statement for the Record for the Hearing on "Extenders and Tax Reform"

February 3, 2012

The Honorable Max Baucus
Chairman, Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Baucus:

On behalf of MARS STOUT, Inc., our Missoula employees, and their families, we are writing to thank you for the Senate Finance Committee's hearing to examine the tax extenders package that expired in 2011. We strongly support the Work Opportunity Tax Credit and believe any extenders package must include retroactive extension of WOTC and we urge Congress to reach an agreement on a final package as soon as possible.

I am concerned that failure to retroactively extend WOTC and other tax extenders will severely impact the economic recovery by creating more uncertainty for businesses such as mine. Recent WOTC statistics from the Department of Labor for the full fiscal year 2011 show that 1.1 million workers found jobs using WOTC—these are workers with the highest unemployment rates in the nation. Failure to extend WOTC now for the entire year will create such uncertainty that the bulk of these jobs for the disabled and disadvantaged will be lost to the economy at a time when businesses large and small are struggling to grow again.

Additionally, we support a streamlined, electronic certification process for WOTC. The states' WOTC workload hit their highest level ever in FY 2010. Full electronic processing is now imperative—it will save states money and reduce administrative burden on WOTC employers.

Thank you for all you are doing for Montana.

Sincerely,

A handwritten signature in cursive script that reads "Teresa Anderson".

Teresa Anderson
President
MARS STOUT, Inc.
Phone: 406.721.6280
Fax: 406.728.5713



Lana Kaye Johnson
508 S 4th St W
Missoula, MT 59801

February 9, 2012

Senate Committee of Finance
Attn: Editorial and Document Section
Rm SD-219
Dirksen Senate Office Building
Washington, DC 20510-6200

RE: Extenders and Tax Reform: Seeking Long Term Solutions Hearing
United States Senate Committee on Finance
Tuesday, January 31, 2012 10:00AM
215 Dirksen Senate Office Building

Honorable Members of the Senate Committee on Finance:

Thank you for taking the initiative to propose renewal of WOTC in the first meeting of the conference committee on the payroll tax bill.

To begin, I would like to give you some background information. I feel honored to mention the company I have been employed with for over 23 years, MARS STOUT. We are a small, family owned business operating for 30+ years, located in Missoula, MT and believe me, we in Montana feel it is a privilege to live in our fine state. MARS STOUT has had lengthy experience with WOTC and can affirm its positive results for workers, families, and communities we serve. The WOTC program has also enabled our company to remain in business (which we hope to continue to do so) all these years, resulting in generation employees including my son who worked his way through college being employed with MARS STOUT screening for the WOTC program, graduating from the University of Montana and is now a Division HR Manager for a branch of Kiewit, Inc., in Dallas, TX.

Long experience and academic studies harkening back to the first Employment Act in 1946 demonstrate even in the best of times there is a

significant segment of population who have higher than average unemployment and lesser chance of finding a job, either due to limited skills or employer perceptions of a deficiency entailing severe risk of remaining unemployed. Such hard-to-place populations have been identified as people with disabilities, war veterans, welfare and food stamp recipients, high school dropouts, at-risk youth in impoverished communities, and the elderly poor.

Allowed to go unassisted these populations, conservatively estimated at 20 million people, represent a wasting national resource that contributes to alienation, homelessness, crime, poor health, and ultimately higher costs to governments at all levels. For more than three decades since President Reagan's Economic Recovery Tax Act of 1981, it has been the judgment of Congress that the most efficient way of tackling this distress and economic waste is to allow private sector employers a work opportunity tax credit (WOTC) as a financial incentive to hire workers from designated target groups of the chronically unemployed. From the standpoint of targeted workers, employers and organizations that assist the poor, veterans, at-risk youth, and the disabled, WOTC has been proven by several Federal and State evaluations to be an important tool for placing hard-to-hire workers into productive, private-sector jobs.

WOTC is highly cost-effective. Last year, more than 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data—all other employment costs are borne by the private employer. This figure doesn't include any offsetting saving from lower welfare, disability, and SSI payments, nor from the extra labor demand and taxes of the cost-lowering effect of the tax credit, nor from private-sector jobs allowing States to save TANF block grant funds which can cost up to \$15,000 per space for public sector employment. Using WOTC, more long-term welfare recipients—the most difficult cases—are being employed in the private sector than short-term, and 7 out of 10 welfare recipients are using WOTC to find private sector jobs.

Congress allowed WOTC to expire last year for all but veterans, and past experience demonstrates that the bulk of these 1.1 million jobs will be lost to disadvantaged workers with devastating impact on their job chances. From the standpoint of State Workforce Agencies, WOTC is the cornerstone of an efficiently functioning labor market for hard-to-place workers. WOTC originated in the appeals of veterans, mayors with large at-risk youth

populations, and parents of children with disabilities who wanted their child to live a normal life. Employer acceptance of WOTC is demonstrated by the fact that last year State Workforce Agencies received 3,750,000 employer requests to certify workers for WOTC, approving 1,160,000 and denying 1,227,000. More denials than approvals demonstrates the effectiveness of SWA's in maintaining program integrity, but a rapidly growing backlog shows the clear need for more streamlined processing, as called for in the Schock-Rangel bill, H.R. 2082.

Chairman Baucus and Honorable Members, please, I urge you to use the full weight of your office to see that WOTC is renewed in the payroll tax bill now in conference; this cannot wait till later in the year. WOTC is an integral part of an efficiently functioning labor market and must be continued regardless of tax reform because the problem of worker populations with below-average opportunity of being employed will still be with us. Be assured that were WOTC to be terminated, Congress will again be importuned by disabled and returning war veterans, parents seeking a full life for their disabled child, seniors needing a job to get by, governors and mayors dealing with the challenges of at-risk youth, and the likelihood of many jobs lost here at MARS STOUT. Far better to make WOTC a permanent part of the tax code than to demonstrate Congress has forgotten the lessons of the past.

Thank you for the opportunity to bring this matter to your attention.

Sincerely,


Laria Kaye Johnson
Missoula, MT

RE: Extenders and Tax Reform: Seeking Long Term Solutions Hearing

**Statement on behalf of the National Association of Home Builders
1201 15th St NW
Washington, DC 20010**

**Extenders and Tax Reform: Seeking Long-Term Solutions
United States Senate Committee on Finance**

January 31, 2012

On behalf of the 140,000 members of the National Association of Home Builders (NAHB), we respectfully submit this statement discussing the significance and impact of existing energy tax policies on housing and related industries and the difficulties created by short-term and retroactive extensions.

In 2005, Congress passed the *Energy Policy Act* (P.L. 109-58) and established a number of important tax incentives to promote greater energy efficiency in the built environment – single family, multifamily and commercial homes and buildings. These incentives acted as the only federal-level programs to address energy efficiency in new and existing homes and buildings with the intent of moving the market towards greater efficiency and the delivery of innovation and technology transfer in building design and practice. From the outset, the incentives enjoyed bipartisan support and were initially proposed at much higher dollar levels before being scaled down during final negotiations. Clearly, Congress' intent was to provide incentives to push the market towards greater efficiencies rather than enact rigid mandates that distort the market.

Two of these tax credits expired at the end of 2011: the credits for tax code Section 45L and Section 25C. While Congress has allowed the incentives to lapse before and has extended them retroactively, for consumers and businesses this uncertainty is extremely disruptive.

Retroactive extensions are particularly problematic for the consumer and small business-oriented tax provisions. In general, these taxpayers are more sensitive to tax uncertainty. Middle-class taxpayers, who are the primary beneficiaries for energy tax incentives, are particularly unlikely to purchase a more expensive, energy efficient product on the expectation that Congress will extend a tax credit retroactively. Likewise, manufacturers are unable to market those products as tax-credit eligible. As a result, when these types of credits are extended retroactively, the "winners" are more likely to have purchased the qualifying product anyway, while middle-class consumers will miss out.

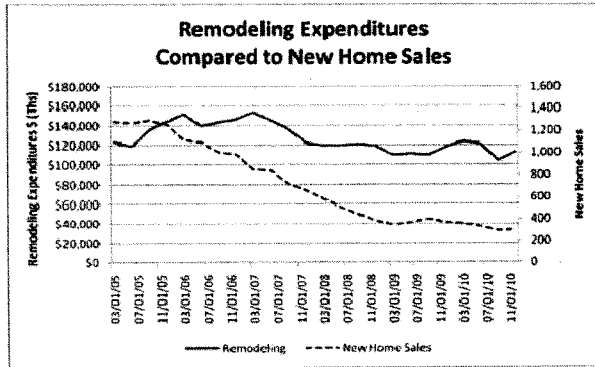
Section 25C – Qualified Energy Efficiency Improvements Tax Credit

The importance of certainty—and simplicity—is particularly evident when looking at taxpayers claiming the Section 25C tax credit. The 25C tax credit began as a modest incentive for the purchase of qualified energy efficiency improvements for existing homes, such as windows, doors, roofs, and HVAC equipment. Originally, the 25C credit provided 10% of the cost of the product (not including installation and labor costs) not to exceed \$500 but imposed various lower caps on specific energy efficient property, such as a maximum of \$200 for window purchases. At the outset, the credit offered little appeal to existing homeowners because the specifications for the qualified improvements had price tags that far exceeded the tax credit. Further, the various caps caused confusion and added complexity. In 2009, the American Reinvestment and Recovery Act (ARRA) expanded the original 25C program and increased the credit to 30% with a \$1,500 cap and included some labor and installation costs. All qualifying products now had the same cap, providing much needed simplicity. As a result, the appeal and popularity of this incentive soared and many retailers, manufacturers, and contractors advertised the newly-enhanced credit which encouraged business and fostered job growth in remodeling activity at the end of 2009 and 2010.

The success of the credit in those two years is unquestionable. IRS data for tax year 2009 also indicates that 25C was heavily used by middle-class homeowners. Of taxpayers claiming the credit, two-thirds had an adjusted gross income of \$100,000 or less; 93% of taxpayers claiming the credit earned less than \$200,000. Taxpayers in these income

classes tend to be very price sensitive, and 25C arguably tipped the scales in favor of energy efficient equipment. Consider a simple window replacement: most homes have an average of twelve windows. Just installing basic windows is a substantial investment. As a result, middle-class homeowners undergoing window replacement today are less likely to install energy efficient windows based on a hope and prayer that Congress will retroactively extend the 25C tax credit later this year.

The lapse in the 25C tax credit will also impact overall economic activity in the remodeling sector. For example, for tax year 2009, over \$5 billion of 25C tax credits were claimed. NAHB estimates that these tax credits were claimed in connection with over \$25 billion in remodeling expenditures. Remodelers often leverage this tax credit when working with clients. These tax credits helped support the remodeling industry (see graph below) during a period in which new home sales experienced dramatic declines. NAHB estimates that the remodeling activity generated by this tax credit in 2009 was associated with over 278,000 full-time jobs. NAHB estimates that every \$100,000 in remodeling expenditures creates enough work for 1.11 full-time equivalent jobs.¹ The programs supported approximately \$13.2 billion in wages for these workers and \$7.5 billion in net business income.



¹ THE DIRECT IMPACT OF HOME BUILDING AND REMODELING ON THE U.S. ECONOMY
 (HTTP://WWW.NAHB.ORG/GENERIC.ASPX?SECTIONID=734&GENERICCONTENTID=103543&CHANNELID=311),
 NAHB ECONOMICS PAPER.

NAHB strongly supports an extension of the Section 25C tax credit. To make it an effective incentive for 2012, action needs to be taken in the very near term. Long-term, NAHB would also urge Congress to simplify and modernize the new credit by increasing the \$500 cap to \$1,000; allow homeowners to claim installation costs for all eligible products; and remove the confusing lower caps. Adopting this 10% tax credit with a \$1,000 cap will greatly simplify the current tax credit and provide an incentive that middle-class homeowners will continue to utilize to improve the efficiency of their homes. Ideally, NAHB believes this credit would be most effective as a permanent provision of the tax code.

Section 45L – New Energy Efficient Home Tax Credit

Also expired as of January 1, the Section 45L tax credit provided a \$2,000 credit to builders of new homes that exceed a minimum energy code specification (2003 International Energy Conservation Code plus the 2004 supplement) by at least 50% in both heating and cooling efficiency. The efficiency performance must be independently verified by an authorized energy rater, and the credit is subject to both a basis adjustment and may not be claimed against alternative minimum tax (AMT) liability. Eligible homes include residences, single-family and multifamily, that are sold to owner-occupants or leased for rental purposes.

Although this credit has suffered from start-and-stop issues of short-term and retroactive extensions over the last five years, and has again expire at the end of 2011, the 45L program has managed to deliver the market transformation results that Congress intended to encourage. The chart below shows that from enactment in 2005 through the end of 2009 (most recent year with available data), the Section 45L credit went from 0.6% of the market to 10% of the market for new homes.

Year	New Homes Sold	45L-Certified Homes	% of Homes Sold
2006	1,052,000	7,110	0.6%
2007	776,000	23,702	3.1%
2008	485,000	21,939	4.5%
2009	374,000	37,506	10%

Data provided by Residential Energy Services Network (www.natresnet.org), 2009.

In 2009, 10% of all the new homes sold met the energy thresholds of the Section 45L credit and were 50% or more energy efficient, with a more than 5-fold increase in total certified homes.

With the current lapse of this credit, builders who utilize this tax credit face the difficult decision of whether to continue to offer the benefits of this credit to their customers without knowing if the credit will be extended. This decision is made more difficult due to the ongoing housing depression and incredibly small margins most builders currently operate on.

Home building is an industry driven by small, often family-owned businesses. According to NAHB's membership survey, 81% of home builders have fewer than 10 employees. Small business owners cannot afford to gamble on whether a tax credit will be extended retroactively. If a builder assumes the credit will not be extended, they may well lose a sale to another builder who assumes it will be and therefore quotes a lower price. The uncertainty created by the recent history of extending these tax provisions retroactively unfairly places small business owners between a rock and hard place. NAHB believes that Congress should not be placing businesses and consumers in the position of guessing the direction of tax policy. Congress has an obligation to create a degree of tax certainty rather than the current situation that leaves businesses to predict the future.

Uncertainty and Confusion Resulting from AMT Rules and the Annual Patch

There is little rhyme or reason behind whether any particular tax credit can be claimed against alternative minimum tax (AMT) liability. These tax rules can further change when Congress passes the annual "AMT patch."

First, the Section 45L credit cannot normally be claimed against alternative minimum tax (AMT) liability. However, the *Creating Small Business Jobs Act of 2010* (P.L. 111-240) allowed eligible small businesses to claim general business tax credits, including Section 45L, against the AMT. This applied only to tax credits determined in 2010, so credits earned from 2005 to 2009 that are carried-forward are not eligible for this AMT exemption. As the home building industry is largely comprised of small builders operating as pass-thrus (80% of NAHB builder members are organized as pass-thru entities), many home builders are trapped in AMT status year after year. While the AMT issue was dealt with for 2010, builders claiming 45L credits in 2011 once again had to determine whether the AMT would impact their ability to utilize the credit. The AMT limitation effectively deters small builders from participating in the program. NAHB believes that homebuyers and renters will be better served if Congress allows all home builders to take advantage of the Section 45L tax credit by allowing it to be claimed against the AMT.

NAHB would also note that taxpayers cannot automatically claim Section 25C tax credit against their AMT tax liability either. The annual AMT patch typically allows taxpayers to claim 25C against AMT, along with other personal, nonrefundable tax credits.

Roll of the Tax Code in Energy Policy

Although some of these incentives would benefit from updates, nearly all of these tax incentives are performing exactly as Congress intended when establishing them back in 2005. Despite the unprecedented downturn in housing and the resultant recession, the increased amount of economic activity associated with retrofit incentives under 25C, coupled with the stellar market penetration of new energy-efficient homes under 45L

confirm that federal policies promoting building efficiency are effective, necessary, and accomplish broad conservation goals.

Some have argued for elimination of all energy and efficiency tax incentives in an effort to let the market determine the direction of costs and savings for consumers. Unfortunately, families that do not have the economic resources to undertake a meaningful energy upgrade will be sidelined in this process—as the data shows for Section 25C, taxpayers who used the credit are overwhelmingly middle-class families. And with or without these incentives, the Department of Energy is on a mission to federalize and mandate aggressive energy code requirements for new homes and buildings that will further deteriorate housing affordability. Some of these new and proposed requirements will prove to be very expensive to the consumer and will take decades to recover the investment, a payoff few homeowners will see as the average homeowner remains in their home for about ten years while the average home remains in the housing stock for 60 years or more.

Those who suggest that Congress should eliminate incentives to offset these costs on the new construction side, plus remove incentives to upgrade older, less-efficient housing, cannot rely on the market to correct federal agency actions that are not based on a reasonable payback period and cost-benefit analysis. Further exacerbating the situation, appraisals often inappropriately or inaccurately value energy efficiency and energy-efficient features in homes, creating a regulatory disincentive for optional energy efficiency upgrades.

With an aging infrastructure and building stock, more American families are going to be relegated to living and working in less-efficient homes and buildings.² New construction is at historic lows, and even when the housing market begins to return to normal levels, consumers will be facing dramatically different mortgage qualification requirements and financing issues than before the downturn. The reality is that the oldest, least-efficient homes are the most affordable to families with lower and moderate incomes. Unfortunately, these families also bear the largest burden in energy costs, as a percentage of income.

² The average age of an owner-occupied home in the U.S. is now 35 years and climbing. See the following NAHB analysis for more detail ("An Aging Housing Stock," Eye on Housing blog, <http://eyeonhousing.wordpress.com/2012/01/31/an-aging-housing-stock/>)

Utilization of the tax code to promote energy efficiency and consumer savings is the most effective opportunity to truly shape an efficiency policy that is not punitive to the housing market as a whole, and creates jobs as a result. The use of the tax code to incentivize energy efficiency in buildings has a long history of bipartisan support. Much like other environmental rules and regulations, efficiency requirements are expensive, and ultimately the consumer bears the brunt of those costs. New home builders cannot absorb costly new mandates, and these costs will be passed onto new homebuyers. But to really improve home energy efficiency, we must look at the over 95 million rental and owner-occupied homes that were built before modern energy codes in 1991. Without effective tax incentives, those homes will continue to waste energy and cost the consumer money.



<p>National Biodiesel Board 605 Clark Ave. PO Box 104898 Jefferson City, MO 65110-4898 (800) 841-5849 phone (573) 835-7913 fax</p>	<p>National Biodiesel Board 1331 Pennsylvania Ave., NW Suite 512 Washington, DC 20004 (202) 737-8801 phone www.biodiesel.org</p>
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Written Testimony of Anne Steckel
National Biodiesel Board Vice President of Federal Affairs
Submitted to the U.S. Senate Committee on Finance
Hearing on Extenders and Tax Reform: Seeking Long-Term Solutions
January 31, 2012

Executive Summary: Biodiesel is a renewable, low-carbon diesel replacement fuel made from an increasingly diverse mix of feedstocks including agricultural oils, recycled cooking oil, and animal fats. It is the only domestically produced, commercial-scale Advanced Biofuel – as defined by the Environmental Protection Agency (EPA) – that is readily available and accepted nationwide. It meets a strict ASTM fuel specification and can be used in existing diesel engines.

In its short history, the biodiesel tax incentive has achieved its desired goal of stimulating U.S. biodiesel production – increasing the domestic manufacturing of a clean-burning, renewable fuel while generating jobs, reducing America’s reliance on foreign oil and improving the environment.

When the tax incentive was first enacted in 2005, the U.S. produced 75 million gallons of biodiesel¹. By comparison, in 2011, with support from the tax incentive and the RFS, the industry set a new production record of nearly 1.1 billion gallons, supporting more than 39,000 jobs across the country while generating at least \$750 million in federal, state and local tax revenues, according to a recent economic study².

The biodiesel industry is poised to continue that momentum in 2012 so long as Congress and the Administration continue supporting strong policies such as the biodiesel tax incentive for stimulating clean, domestic energy production.

However, the industry’s recent success should not be taken for granted, and the recent expiration of the \$1 per gallon biodiesel tax incentive poses a significant threat to the industry’s continued growth. U.S. biodiesel remains a young and vulnerable industry. In fact, we know from recent history what could happen without the biodiesel tax incentive and a strong Renewable Fuel Standard (RFS). When that occurred in 2010, the result was predictable: Plants closed and thousands of people across the country lost work. Specifically, U.S. biodiesel production plummeted by 42 percent, resulting in the loss of nearly 8,900 jobs and a drop in household income of \$485 million.

Only this year, after Congress reinstated the tax incentive and the RFS was fully implemented, did the industry regain its footing and begin ramping up production again, with record-breaking success.

With the ongoing economic downturn, now is not the time to allow another industry slump. Under projected expansion by 2015, biodiesel is expected to support more than 74,000 jobs, \$4 billion in income, and some \$7.3 billion in GDP, according to the economic study.

That growth will be severely jeopardized if Congress does not extend the biodiesel tax incentive, which also applies to bio-jet and renewable diesel production.

Chairman Baucus and Ranking Member Hatch, I appreciate the opportunity to submit written testimony on behalf of the National Biodiesel Board (NBB) regarding the economic impact of the biodiesel tax incentive.

As producers of America's only commercial-scale Advanced Biofuel that's sold and produced nationwide, the U.S. biodiesel industry looks forward to working constructively with this committee to ensure that our nation's Advanced Biofuel goals are met.

NBB applauds your efforts to review alternative energy tax incentives. History has shown that well-crafted and efficient tax incentives can be powerful policy mechanisms to achieve the nation's energy objectives and leverage private sector investment to promote the deployment and utilization of new energy resources. This is certainly the case with the tax credit for biodiesel, renewable diesel and bio-jet fuel. As with every other major U.S energy resource, effective tax policy has helped create domestic manufacturing jobs as well as significant economic and energy policy benefits.

Before the biodiesel tax incentive expired on Dec. 31, the U.S. biodiesel industry had a record year of production in 2011, producing nearly 1.1 billion gallons and creating good-paying jobs in nearly every state in the country. This success is in part attributed to the strong federal policies in place encouraging domestic energy production. While we understand the pressures facing Congress, we believe economic conditions are simply too weak today to pull support from a growing American industry that is a rare bright spot in this struggling economy.

The recent expiration of the \$1 per gallon biodiesel tax incentive poses a significant threat to the industry's continued growth, economic impact and job creation. Now, as much as ever, the biodiesel industry needs stability and support to continue its remarkable success story, and we encourage Congress to provide a retroactive extension of the biodiesel, renewable diesel, and bio-jet tax credit. Quickly reinstating the expired biodiesel tax incentive would provide needed certainty and protect against future disruptions and the loss of thousands of much-needed jobs.

Background and Industry Overview: Biodiesel is a renewable, low-carbon diesel replacement fuel. The EPA has determined, based on the performance requirements established by the *Energy Independence and Security Act* (EISA) (P.L. 110-140), that domestically produced biodiesel is an Advanced Biofuel under the RFS2 program. In fact, it is the only commercial-scale fuel sold and produced across the United States to achieve this designation.

Biodiesel is made from waste greases like recycled cooking oil and animal fats and secondary-use agricultural oils, and is refined to meet a specific commercial fuel definition and specification. The fuel meets the D6751 fuel specification set forth by ASTM International, the official U.S. fuel-certification organization. Biodiesel is one of the most- and best-tested alternative fuels in the country and the only alternative fuel to meet all of the testing requirements of the 1990 amendments to the Clean Air Act. There are approximately 195 domestic and foreign biodiesel plants registered with the EPA, representing a combined production capacity in excess of 2.7 billion gallons.

Biodiesel is primarily marketed as a five percent (B5) blending component with conventional diesel fuel, but can be used in concentrations up to twenty percent (B20). It is distributed utilizing the existing fuel

distribution infrastructure with blending occurring both at fuel terminals and “below the rack” by fuel jobbers.

Status and Background on the Biodiesel Tax Incentive: The biodiesel tax incentive was approved in 2004 as part of the American Jobs Creation Act (P.L. 108-357) and enacted in 2005. The incentive was subsequently extended through December 31, 2008 as part of the Energy Policy Act of 2005 (P.L. 109-190). H.R. 1424, the Emergency Economic Stabilization Act of 2008 (P.L. 110-343), again extended the incentive for one year through December 31, 2009, at which time the credit expired. After a year of being expired for all of 2010, Congress extended the tax credit through Dec 31, 2011 (P.L. 111-312).

It expired again on Dec. 31, 2011, and is currently lapsed.

While the impact of last month’s expiration is yet to be seen, the 2010 expiration of the tax credit had a severely detrimental impact on the domestic biodiesel industry. In fact, the industry’s decline resulted in the loss of nearly 8,900 jobs and a drop in household income of \$485 million.

The biodiesel tax incentive is designed to encourage the production and use of biodiesel by making the fuel price-competitive with conventional diesel fuel. In general, current law allows taxpayers to claim the biodiesel tax incentive as either a \$1.00 per gallon general business income tax credit or as a \$1.00 per gallon blenders excise tax credit. To qualify for the biodiesel tax incentive, the fuel must by statute meet both the ASTM D6751 fuel specification and the Environmental Protection Agency’s (EPA) registration requirements under Section 211 of the Clean Air Act.

The Internal Revenue Code provides a general business income tax credit to encourage the production and use of biodiesel, renewable diesel and bio-jet fuel. The credit is the sum of three credits – the biodiesel mixture credit; the biodiesel credit; and the small agri-biodiesel producer credit. The biodiesel mixture credit provides a \$1.00 per gallon credit for each gallon of biodiesel that is blended with conventional diesel fuel. The biodiesel credit provides \$1.00 per gallon for each gallon of pure B100 biodiesel that is used as a fuel. The small agri-biodiesel producer credit is a 10 cents per gallon credit for plants with a production capacity of less than 60 million gallons per year. The credit can be claimed on the first 15 million gallons of production.

Biodiesel Public Policy Benefits: The biodiesel tax incentive has helped achieve the worthwhile policy goal of creating jobs while increasing the production and use of biodiesel in the U.S. In 2004, before the incentive was initially enacted, the U.S. produced 25 million gallons. In 2011, with the tax credit reinstated and with a strong RFS program, the industry produced nearly 1.1 billion gallons. There are compelling public policy benefits associated with the enhanced production and use of biodiesel in the U.S.

Biodiesel Reduces our Dependence on Foreign Oil: Biodiesel can play a major role in expanding domestic refining capacity and reducing our reliance on foreign oil. The 3.4 billion gallons of biodiesel produced in the U.S. since 2005 have displaced an equivalent amount of imported diesel fuel with a clean-burning, efficient fuel that according to the EPA reduces lifecycle greenhouse gas emissions by as much as 86 percent compared to petroleum diesel fuel and creates 5.5 units of energy for every unit of energy that is required to produce the fuel.

Biodiesel is Good for the Environment: Biodiesel is an environmentally safe fuel, and is the most viable transportation fuel when measuring its carbon footprint, life cycle and energy balance. Since 2005,

biodiesel has reduced lifecycle greenhouse gas emissions by 41.6 billion pounds, the equivalent of removing 3.66 million passenger vehicles from America's roadways.

Biodiesel Reduces Diesel Emissions: Tailpipe emissions from traditional diesel – primarily from trucking fleets, school buses and other vehicles – are a significant health and air quality concern. In an update to its National-Scale Air Toxics Assessment earlier this year, EPA cited diesel exhaust as one of the nation's most dangerous pollutants, saying it is "among the substances that may pose the greatest risk to the U.S. population." Thousands of trucks and buses hit the road every day burning traditional diesel fuel. Substituting higher amounts of biodiesel for traditional diesel fuel is the simplest, most effective way to immediately improve emissions.

The Biodiesel Industry is Creating Jobs and Making a Positive Contribution to the Economy: In 2011, NBB estimates that the U.S. biodiesel industry supported more than 39,000 jobs in all sectors of the economy. This will add more than \$3.8 billion to the nation's Gross Domestic Product (GDP).

Biodiesel is America's first advanced biofuel and when compared to gasoline, diesel and ethanol, it is at a fundamentally different stage of development and should be treated as a new fuel in the marketplace. The petroleum industry has received a number of tax incentives for many years; and the ethanol industry has been around for decades and has had its tax break since 1980. In contrast, the biodiesel industry has had commercial-scale production for only about six years, and has had its tax credit only since 2005. The gasoline marketplace is approximately 140 billion gallons, the diesel pool is approximately 60 billion gallons and the ethanol marketplace is producing some 14 billion gallons. By comparison, biodiesel is on pace to produce about 1 billion gallons this year. Biodiesel is an up-and-coming industry and is in a far more fragile stage of development.

Conclusion: The biodiesel tax incentive has helped achieve the desired goal of increasing the domestic production and use of biodiesel, and in turn has helped the U.S. realize the energy security, economic and environmental benefits associated with displacing petroleum with domestically produced renewable fuels. These benefits, however, will be jeopardized if Congress does not act in a timely manner to address the immediate issue facing the industry and extend the biodiesel tax incentive.

About NBB: NBB is the national trade association representing the biodiesel industry as the coordinating body for research and development in the U.S. It was founded in 1992, and since that time, NBB has developed into a comprehensive industry association which coordinates and interacts with a broad range of cooperators including industry, government and academia. NBB's membership is made up of biodiesel producers; state, national and international feedstock organizations and feedstock processor organizations; fuel marketers and distributors; and technology providers.

Chairman Baucus and Ranking Member Hatch, I again appreciate having the opportunity to submit written testimony on this issue of significant importance to the U.S. biodiesel industry. We look forward to serving as a resource for the Committee on issues related to biofuels tax policy as the committee proceeds.

¹ In 2004, prior to the tax credit being enacted the biodiesel industry produced only 25 million gallons.

² Cardno ENTRIX June 8, 2011, Economic Impact of Removing the Biodiesel Tax Credit for 2010 and Implementation of RFS2 Targets Through 2015.



REPRESENTING THE RESTAURANT INDUSTRY

The Cornerstone of the Economy, Career Opportunities and Community Involvement

Statement for the Record

Of

**Dave Koenig, Vice President, Tax and Profitability,
National Restaurant Association**

For The Hearing On

**“Extenders and Tax Reform:
Seeking Long-Term Solutions”**

Before

**The U.S. Senate
Committee on Finance**

Tuesday, January 31, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of the National Restaurant Association. We applaud the Chairman, Ranking Member, and Committee's leadership on tax reform.

Looking ahead, tax reform presents an opportunity to provide taxpayers with certainty, simplicity, and fairness, while encouraging economic growth and job creation. Done properly, a comprehensive and nuanced review of the tax system would eliminate those tax policies that detract from these objectives, while promoting those that advance them.

In this regard, as Congress and this Committee undertake the tax reform effort, we wanted to bring to your attention a few tax policies that meet these objectives and are important to the restaurant industry. Specifically, the U.S. economy would benefit from reform efforts that make permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements, which would advance these goals. We also urge continued support for the Work Opportunity Tax Credit ("WOTC"), the deduction for donations of food inventory, and an increase in the deduction for business meals. These provisions provide significant benefits to the economy and should be continued as permanent aspects of the Internal Revenue Code ("tax code").

Moreover, in the interim, we urge immediate and seamless extension of expired tax provisions, which is essential to continuing the tax relief and access to capital that is critical to our nation's economic and financial recovery.

Restaurants: Small Businesses with a Large Impact on Our Nation's Economy

The restaurant industry plays a significant role in our nation's economy. In 2011 alone, the restaurant industry generated an estimated \$604 billion in sales, with an overall economic impact of more than \$1.7 trillion. Every dollar spent in restaurants generates an additional \$2.05 spent in our nation's economy. The restaurant industry is one of the nation's largest private job creators, employing approximately 12.8 million people, representing nearly ten percent of the U.S. workforce. We are truly the cornerstone of this nation's economy.

Moreover, it is important to stress that the restaurant industry is an industry of small businesses. There are 960,000 restaurant and foodservice outlets in this country. Seven out of ten restaurants are single-unit operators. Most eating and drinking establishments, 93 percent of the industry, have fewer than 50 employees. Restaurants also serve as the conference rooms for many of the self-employed and other small businesses.

15-year Depreciation Schedule for Leasehold Improvements, Restaurant Improvements and New Construction, and Retail Improvements

One principle of the tax code is that costs of assets are allocated over the period in which they are used. Assets with longer expected lives are depreciated over a longer period of time, while assets with shorter lives are depreciated over a shorter period of time. As a reflection of this principle, the tax code contains a provision under which leasehold improvements, restaurant

when the overall economy was contracting, restaurant industry construction spending created nearly 400,000 jobs (see Figure 2 below).

Figure 2.
Restaurant Spending on New Construction

Year	Billions (\$)	Jobs Created In Overall Economy
2004	5.2	145,000
2005	7.4	208,000
2006	6.6	185,000
2007	10.4	292,000
2008	7.6	214,000
2009	6.2	174,000

Source: U.S. Census Bureau and National Restaurant Association

However, the 15-year depreciation schedule is temporary and must be extended annually. Most recently, it was extended by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“2010 Act”) retroactive to the beginning of 2010 and through the end of 2011. Consequently, the provision has expired again. The piecemeal and temporary approach to the 15-year depreciation schedule, requiring extension every couple of years, presents taxpayers with unnecessary uncertainty and complexity.

Making permanent the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements would address this issue, providing taxpayers with predictability, simplicity, and fairness. Until there is comprehensive tax reform, the 15-year depreciation schedule should be extended. Our nation’s businesses are looking forward by planning capital expenditures to improve and expand their businesses. The ability to plan for these expenditures and know what the tax treatment will be in the future is important to those who are making such decisions right now.

Work Opportunity Tax Credit

Another important, but largely expired, aspect of the tax code is WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC-targeted employee groups include veterans who either are food stamp recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program (“TANF”).

The restaurant industry employs close to 13 million people, many of whom may not have been hired if WOTC had not been in place. WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients – the most difficult cases – are being employed in the private sector and 7 out of 10 welfare recipients are using WOTC to find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that

individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance.

Further, WOTC works. In 2011, more than 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

Allowing this provision to expire at a time of intransigent unemployment is a significant setback for job creation and the provision should be extended. Moreover, in the longer term, Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Deduction for Charitable Donation of Food Inventory for Small Businesses

Each day, 35 million Americans are at risk of hunger. At the same time, billions of pounds of food are wasted each year. America's restaurants give back to their communities in major ways, the most significant of which is through food donation. According to National Restaurant Association research, 73 percent of restaurants donate food to individuals or charities.

The deduction for charitable donation of food inventory is a critical tool in alleviating hunger. Without the provision, taxpayers get the same tax treatment for throwing out surplus food as they do for giving it to charity. The enhanced deduction instead encourages donating the food to charity, by helping to offset the costs associated with storing and transporting the extra food. Absent the enhanced deduction for the charitable donation of food inventory, these charities would be hard-pressed to meet critical demands, putting our nation's most vulnerable families at risk for hunger.

However, the impact of the deduction could be improved. For nearly 30 years since its inception in 1976, the tax deduction for contributions of food inventory was limited to C corporations. In 2005, the provision was temporarily expanded to include pass-through entities (i.e., Subchapter S corporations, limited liability companies) and has been extended on subsequent occasions. Making permanent the now-temporary component of the deduction would make it more effective, while advancing the objectives of providing taxpayers with simplicity and predictability.

The National Restaurant Association strongly encourages its members to donate more food and has partnered with Food Donation Connection ("FDC") to strengthen this effort. Founded by a former restaurant executive, FDC serves as the liaison between the restaurants interested in donating food and the social service agencies adept at getting that food to people in need. FDC helps restaurants develop and implement programs designed to provide an alternative to discarding surplus food, while capitalizing on the economic benefits of those donations through the tax savings. Since 1992, FDC has helped facilitate the donation of over 140 million pounds of food to non-profit, hunger-relief agencies.

Business Meal Deduction

Under current law, the business meal deduction is limited to only 50 percent of costs incurred. By way of background, business meals previously were fully deductible. In 1986, the deduction was reduced to 80 percent and, in 1993, the deduction was further reduced to its current level of 50 percent.

The business meal deduction should be reformed to better reflect the basic principle that business expenses should be fully deductible. Full deductibility would appropriately bring the business meal deduction in line with other ordinary and necessary business expenses, but even increasing the limitation to 80 percent would better align the provision with these objectives.

According to National Restaurant Association research, increasing the business meal deduction to 80 percent would increase business meal sales by over \$7 billion and provide an additional 200,000 jobs. Moreover, the impact of the restaurant industry on the nation's economy is considerable and felt in every state (Figure 3 provides the state-level economic and jobs data for an increase in the deduction limitation from 50 percent to 80 percent; Figure 4 provides the same information for full deductibility). We service more than 130 million guests every day. Each dollar spent dining out generates \$2.05 in business to other industries, totaling more than \$1.7 trillion in overall economic impact.

Increasing the business meal deduction would also benefit small businesses. America's restaurants are small businesses' conference rooms, and the restaurant table is often where business is conducted. Increasing the deduction is a benefit not only to restaurateurs and their employees, but to their guests and the many small business owners across the country. For many small companies, the ability to conduct business over a meal is their only means of advertising and marketing their business.

Conclusion

Thank you for the opportunity to submit this statement on behalf of the National Restaurant Association. Although we welcome tax reform as an opportunity to inject predictability and fairness into the tax code; in the interim, expired tax policies should be extended to provide taxpayers with the certainty necessary to encourage economic growth and job creation. As Congress considers tax reform, we are happy to be a resource for Congress and the Committee.

Figure 3.

Estimated Impact of Increasing Business Meal Deductibility from 50% to 80%

State	Increase in Business Meal Spending 50% to 80% Deductibility (in millions)	Total Economic Impact In the State (in millions)	Total Employment Impact In the State (number of jobs created)
Alabama	\$92	\$186	2,952
Alaska	\$19	\$33	452
Arizona	\$151	\$300	3,984
Arkansas	\$50	\$101	1,689
California	\$967	\$2,267	26,315
Colorado	\$136	\$313	3,943
Connecticut	\$88	\$165	2,019
Delaware	\$24	\$43	499
District of Columbia	\$39	\$53	313
Florida	\$472	\$957	12,522
Georgia	\$230	\$532	6,732
Hawaii	\$54	\$104	1,402
Idaho	\$28	\$55	933
Illinois	\$313	\$744	8,786
Indiana	\$135	\$278	4,272
Iowa	\$51	\$102	1,669
Kansas	\$56	\$112	1,606
Kentucky	\$90	\$183	2,618
Louisiana	\$98	\$193	2,888
Maine	\$29	\$55	848
Maryland	\$148	\$307	3,594
Massachusetts	\$193	\$388	4,649
Michigan	\$191	\$380	5,872
Minnesota	\$119	\$272	3,714
Mississippi	\$50	\$95	1,630
Missouri	\$134	\$298	4,084
Montana	\$21	\$40	710
Nebraska	\$35	\$73	1,190
Nevada	\$83	\$147	1,974
New Hampshire	\$34	\$63	784
New Jersey	\$205	\$442	4,993
New Mexico	\$45	\$82	1,331
New York	\$482	\$954	11,251
North Carolina	\$222	\$467	6,849
North Dakota	\$12	\$22	373
Ohio	\$252	\$540	8,081
Oklahoma	\$74	\$157	2,491
Oregon	\$94	\$194	2,611
Pennsylvania	\$258	\$582	7,688
Rhode Island	\$29	\$53	706
South Carolina	\$108	\$221	3,329
South Dakota	\$15	\$30	509
Tennessee	\$143	\$322	4,191
Texas	\$576	\$1,405	17,036
Utah	\$50	\$113	1,682
Vermont	\$13	\$22	335
Virginia	\$200	\$423	5,312
Washington	\$157	\$340	4,160
West Virginia	\$32	\$54	950
Wisconsin	\$107	\$224	3,629
Wyoming	\$12	\$19	346

Source: National Restaurant Association estimates, 2011

Figure 4.

Estimated Impact of Increasing Business Meal Deductibility from 50% to 100%

State	Increase in Business Meal Spending 50% to 100% Deductibility (in millions)	Total Economic Impact In the State (in millions)	Total Employment Impact In the State (number of jobs created)
Alabama	\$167	\$336	5,334
Alaska	\$34	\$59	817
Arizona	\$273	\$542	7,198
Arkansas	\$91	\$182	3,052
California	\$1,748	\$4,095	47,543
Colorado	\$245	\$565	7,124
Connecticut	\$160	\$298	3,648
Delaware	\$43	\$77	901
District of Columbia	\$70	\$96	565
Florida	\$854	\$1,729	22,623
Georgia	\$416	\$961	12,162
Hawaii	\$97	\$188	2,533
Idaho	\$50	\$99	1,685
Illinois	\$565	\$1,344	15,874
Indiana	\$243	\$501	7,718
Iowa	\$92	\$185	3,015
Kansas	\$101	\$202	2,902
Kentucky	\$163	\$331	4,730
Louisiana	\$177	\$348	5,219
Maine	\$53	\$100	1,533
Maryland	\$267	\$554	6,493
Massachusetts	\$348	\$701	8,399
Michigan	\$345	\$686	10,610
Minnesota	\$216	\$492	6,710
Mississippi	\$90	\$171	2,944
Missouri	\$241	\$539	7,379
Montana	\$38	\$72	1,282
Nebraska	\$64	\$132	2,149
Nevada	\$150	\$266	3,566
New Hampshire	\$62	\$114	1,416
New Jersey	\$370	\$799	9,022
New Mexico	\$81	\$148	2,405
New York	\$871	\$1,724	20,328
North Carolina	\$401	\$844	12,374
North Dakota	\$22	\$40	673
Ohio	\$455	\$976	14,601
Oklahoma	\$133	\$284	4,500
Oregon	\$170	\$350	4,717
Pennsylvania	\$467	\$1,052	13,890
Rhode Island	\$52	\$95	1,276
South Carolina	\$195	\$400	6,014
South Dakota	\$28	\$54	920
Tennessee	\$258	\$582	7,571
Texas	\$1,041	\$2,539	30,778
Utah	\$91	\$204	3,039
Vermont	\$23	\$40	606
Virginia	\$362	\$764	9,598
Washington	\$284	\$614	7,516
West Virginia	\$57	\$98	1,717
Wisconsin	\$193	\$405	6,556
Wyoming	\$22	\$35	626

Source: National Restaurant Association estimates, 2011



Statement of Colleen M. Kelley
National President
National Treasury Employees Union

On

“Extension of Employer Provided Mass Transit Benefit”

Submitted to

SENATE FINANCE COMMITTEE

January 31, 2012

Chairman Baucus, Ranking Member Hatch, and distinguished members of the Committee, on behalf of the National Treasury Employees Union (NTEU), I would like to thank you for allowing me to submit comments on the importance of extending the employer provided mass transit benefit.

As you know, in 2010, as part of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," Congress included a provision that kept the mass transit portion of the commuter benefit at \$230 per month for 2011, preventing a reduction to \$125 per month, and keeping it equal to the parking tax benefit. Unfortunately, because Congress did not again extend the transit benefit before it expired at the end of 2011, the monthly maximum transit amount was reduced to \$125 per month on January 1, 2012.

In the meantime, the monthly limit for the parking portion of the commuter benefit was increased from \$230 per month to \$240 per month due to an automatic cost of living increase, further exacerbating the disparity between the transit and parking benefits.

NTEU believes it is critical that Congress quickly act to reinstate parity between the transit and parking portions of the commuter benefit. Many working people that use public transportation to get to and from work, rely on the transit benefit which has provided much needed relief in their commuting costs. Many of these workers are struggling in the current economic climate, and a reduction in these benefits is imposing a severe financial burden on them.

Reinstating the monthly transit subsidy to a level equal to the parking benefit also encourages greater transit ridership, which helps lessen congestion on roadways, reduces pollution and conserves energy. Furthermore, it certainly makes no sense for the government to provide workers using environmentally helpful mass transit a lesser benefit than those driving and parking personal vehicles.

In addition to providing economic relief to workers and positively impacting the environment, extending the mass transit benefit also provides tax relief for the employers that offer the benefit. Because the mass transit is a pre-tax benefit, employers do not have to pay taxes on it, providing savings which can be reinvested in the company. It is estimated that in 2010, employers saved over \$300 million by offering this critical benefit to their employees.

Mr. Chairman and distinguished members of the Committee, NTEU asks that as Congress considers a tax extenders package, you include an extension of the mass transit benefit that will restore parity with the parking portion of the commuter benefit, allow working families to save money on their daily commute, reduce traffic congestion, and improve air quality.

We would also ask for your support for stand-alone legislation introduced by Sen. Schumer, S. 1034, the "Commuter Benefits Equity Act of 2011," which would permanently establish parity between the parking and mass transit portions of the transportation fringe benefit.

NTEU appreciates the opportunity to discuss the importance of extending the mass transit benefit, and stands ready to do all it can to ensure this critical benefit for workers and employers is extended in the near future.



NYS Citizens' Coalition for Children

Statement for the record by:

NYS Citizens' Coalition for Children (NYSCCC)

Sarah Gerstenzang, M.S.W.
Foster and adoptive parent
Executive Director, NYSCCC

Before the:

United States Senate Committee on Finance

For the hearing:

**Extenders and Tax Reform: Seeking Long-Term Solutions
January 31, 2012**

Thank you very much for giving us the opportunity to offer this testimony to the Senate Committee on Finance. Your time and attention are greatly appreciated. As a statewide organization that supports foster and adoptive families, we would like to raise an issue that impacts tens of thousands of foster parents and children in their care across the country.

As the primary voluntary caretakers of children in foster care, the Internal Revenue Service (IRS) allows foster parents to claim the children in their care on their federal taxes. However, in the past decade, in an effort to prevent divorced parents from both claiming children on their taxes, the IRS has begun requiring all parents to provide the children's social security numbers on their tax forms. According to a senior IRS official, this has resulted in a dramatic decrease in "double dipping" by divorced parents.

This new requirement has inadvertently prevented foster parents from claiming children in their care on their federal taxes because the Social Security Administration has a memorandum of understanding with states that prevents the states from sharing social security numbers with foster parents in an effort to protect children's privacy. Foster parents cannot claim children without access to social security numbers. This means that any birth family member with the child's social security number may claim the child on his taxes and there is no way to track or stop this. Only when a counter claim is made by the person actually providing the daily care for the child can the situation be investigated.

This oversight in the regulations needs to be changed to ensure that a child's actual caretaker, rather than a person who simply has access to the child's social security number, receives the tax benefit. Fortunately, there is a straightforward solution that will fix the situation: expand the availability of Adoptive Temporary Taxpayer Identification Numbers (ATIN) to foster parents.

ATIN's are routinely issued by the Internal Revenue Service as temporary taxpayer identification numbers where the pre-adopting taxpayers will be adopting within the next two years and do not have and/or are unable to obtain the child's Social Security Number. Allowing foster parents to request and receive ATIN's would eliminate the need to obtain the child's original social security number and permit foster parents to legitimately and appropriately claim tax deductions for children in their care. It would also protect the children's privacy by limiting access to their social security numbers. This simple change would increase tax fairness for foster families, protect children, eliminate fraudulent claims by non-custodial parents and would not have a large federal fiscal impact.

R&D Credit Coalition
1331 Pennsylvania Avenue, NW
Suite 600
Washington, DC 20004
202-637-3076

STATEMENT OF THE R&D CREDIT COALITION

SUBMITTED FOR THE RECORD OF THE HEARING

ON

“EXTENDERS AND TAX REFORM: SEEKING LONG-TERM SOLUTIONS”

BEFORE

UNITED STATES SENATE COMMITTEE ON FINANCE

ON

JANUARY 31, 2012

Introduction

The R&D Credit Coalition welcomes the opportunity to provide comments for the record of the January 31, 2012 Senate Committee on Finance (“Committee”) hearing to examine “extenders and tax reform: seeking long-term solutions.”

The R&D Credit Coalition would like to thank Chairman Baucus and Ranking Member Hatch for their leadership in sponsoring, S. 1577, legislation that would provide for a strengthened and permanent R&D tax credit. The credit expired on December 31, 2011, and we look forward to working with them this year to ensure that U.S. businesses have the certainty and incentives they need to maintain and increase their R&D jobs here in the U.S.

The R&D Credit Coalition is a group of more than 100 trade and professional associations along with hundreds of small, medium and large companies that collectively represent millions of American workers engaged in U.S.-based research throughout major sectors of the U.S. economy, including aerospace, agriculture, biotechnology, chemicals, electronics, energy, information technology, manufacturing, medical technology, pharmaceuticals, software and telecommunications.

Although the make-up of the R&D Credit Coalition is diverse, the member companies share a major characteristic— they collectively spend billions of dollars annually on research and development (“R&D”), which provides for high-wage and highly-skilled, domestic jobs. Companies must decide where they are going to invest their research dollars— here in the U.S. or abroad. The high U.S. corporate tax rate and the temporary nature of the U.S. R&D tax credit, compared to the lower corporate tax rates and more attractive research incentives, often permanent, in most other developed countries, are key factors that companies consider in determining where they are going to create R&D jobs. Today, a company claiming the U.S. R&D credit on average only realizes an effective credit rate of 6%. In addition, the U.S. requires that the deduction for R&D expenses be reduced by the amount of any R&D credit.

Thus, corporate tax reform proposals limiting or eliminating research and development tax incentives could have a dramatic impact on both the number and location of R&D jobs in the U.S., as well as the ability of our companies to compete effectively in the global marketplace. Given the Committee’s focus on finding a long-term solution for tax extenders within the context of tax reform, the R&D Credit Coalition would urge that the credit be strengthened and made permanent, and in the short term be seamlessly extended to ensure that R&D jobs remain here in the U.S.

Discussion

The R&D tax credit was originally enacted in 1981 and has provided an important incentive to spur private sector investment in innovative research by companies of all sizes and in a variety of industries. The enactment of this incentive helped establish the U.S. as a leader in cutting-edge research. In fact, during the 1980s, the U.S. was the leader among OECD countries in providing the best R&D incentives for companies. However, many of our foreign competitors have since instituted more generous R&D incentives in the decades following, causing the U.S. to drop below the top 10, and today ranks 24th in research incentives among industrialized countries¹. The temporary nature of U.S. R&D incentives is a strain on U.S. companies, causing uncertainty that negatively influences future company R&D budgets. Providing the certainty of a strengthened, permanent credit, especially in a tax reform environment, is critical to maintaining U.S. leadership in advanced research and ensuring that U.S. companies will continue to do their R&D here in the U.S. In addition, a recent study by the Center for American Progress finds that, “the credit is effective in the sense that each dollar of foregone tax revenue causes businesses to invest at least an additional dollar in R&D.”²

Many other countries offer *both* lower tax rates and more attractive R&D incentives³, proving that the U.S. should not engage in an “either/or” debate with respect to lower marginal rates and boosting U.S. job creation through R&D incentives when looking at options to reform the corporate tax code.

The R&D credit is a *jobs* credit—with seventy percent of credit dollars used for salaries of high skilled R&D workers in the U.S. A study by the Information Technology and Innovation Foundation (ITIF), “estimates that expanding the Alternative Simplified Credit (ASC) from 14 percent to 20 percent would spur the creation of 162,000 jobs in the short term and an additional, but unspecified, number of jobs in

¹ OECD, “Science, Technology and Industry Scorecard,” December 2009, p. 79.

² Center for American Progress, “The Corporate R&D Tax Credit and U.S. Innovation and Competitiveness,” by Laura Tyson and Greg Linden, January 2012, p.2.

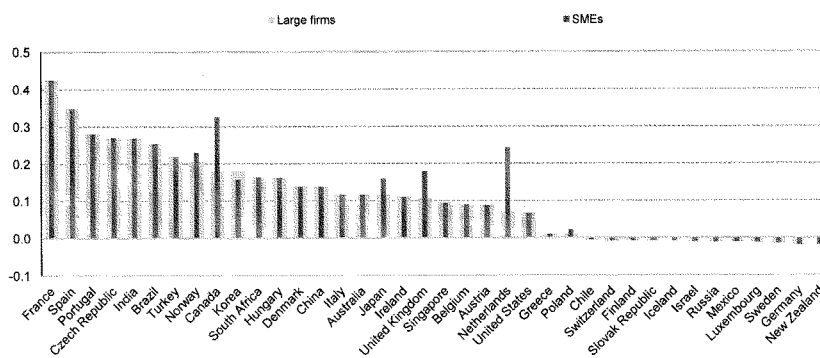
³ Deloitte, “Global Survey of R&D Tax Incentives,” July 2011.

the longer run.”⁴ The U.S. must ensure that our tax system supports high-skilled, high-paying jobs, here in the U.S. We cannot let our tax system put these jobs at risk of moving abroad.

International R&D Tax Incentives

The number of OECD countries offering some sort of incentive for research has grown dramatically in recent years as countries attempt to become leaders in research. The U.S. share of global R&D fell from 39 percent in 1999 to 33 percent in 2007.⁵ In addition, the following OECD chart shows that in 2009, the United States ranked 24 among 38 industrialized countries offering R&D tax incentives.⁶

OECD Science, Technology and Industry Scoreboard 2009 - OECD © 2009 - ISBN 9789264063716
Tax subsidy rate for USD 1 of R&D, large firms and SMEs, 2008



A recent National Science Board report concluded that the United States' lead in science and technology is "rapidly shrinking" as R&D jobs and overall R&D spending continue to increase faster outside the U.S. than here at home. The report shows that "between 1999 and 2009...the U.S. share of global research and development (R&D) dropped from 38 percent to 31 percent, whereas it grew from 24 percent to 35 percent in the Asia region during the same time."⁷

⁴ Information and Technology Innovation Foundation, "Create Jobs by Expanding the R&D Tax Credit," by Robert D. Atkinson. January 26, 2010 (page 1)

⁵ OECD, Ministerial Report on the OECD Innovation Strategy, May 2010, p. 8.

⁶ OECD, "Science, Technology and Industry Scorecard," December 2009, p. 79.

⁷ National Science Foundation press release, "New Report Outlines Trends in U.S. Global Competitiveness in Science and Technology," January 17, 2011.

Bipartisan Support for a Strengthened, Permanent Research & Development Incentive

Every Administration has supported the R&D tax credit since its enactment. More recently, a March 25, 2011, Treasury Department study stated, “Two years ago, the President set an ambitious goal of achieving a level of research and development that is the highest share of the economy since the space race of the 1960’s – 3 percent of GDP – a commitment he re-emphasized in his State of the Union address in 2011. The R&D tax credit is a vital component of achieving this goal and helping us out-innovate our competition. This is why, in addition to making it permanent, the President proposed on September 8, 2010, to expand and simplify the credit, making it easier and more attractive for businesses to claim this credit for their research investments. This proposal was subsequently included in the President’s FY 2012 Budget and should be part of the reform of our corporate tax system currently under consideration.”⁸

Moreover, Congress has extended the credit 14 times since it was first adopted in 1981. In 2011, Ways and Means Committee members Kevin Brady (R-TX), John Larson (D-CT) and many others introduced H.R. 942, The American Research and Competitiveness Act of 2011. Similar to S.1577, this legislation would provide important certainty for U.S.-based research spending by making the R&D tax credit permanent as well as simplifying and strengthening it, thereby increasing its effectiveness.

We urge Congress to seamlessly extend, strengthen and make permanent the R&D credit.

Conclusion

It is vitally important that U.S. policy makers support a strengthened and permanent research and development incentive as part of any tax reform measure and seamlessly extend the credit right now until more fundamental tax reform changes are legislated. A robust and permanent research and development tax credit is critical to competitiveness, innovation and U.S. jobs. Congress must recognize that in the global economy many companies have a choice as to where they are going to do their research—and with many other countries offering *both* lower corporate income tax rates and more robust R&D incentives, the U.S. must ensure that R&D incentives are included as part of any tax reform package. The R&D Credit Coalition looks forward to assisting members of the Committee and their staffs to gain a more detailed understanding of the research and development tax credit and its impact on U.S. jobs.

⁸ “*Investing in U.S. Competitiveness: The benefits of Enhancing the Research and Experimentation (R&E) Tax Credit*,” U.S. Department of the Treasury, March 25, 2011, page 1.

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SCS UNLOADING

1900 N. 18th St., Suite 701, Monroe, LA 71201 (318) 387-1727

Statement for the Record

Of

**Jeff Olsen, President
SCS Unloading
1900 N. 18th St., Suite 701, Monroe, LA 71201**

For The Hearing On

**“Extenders and Tax Reform:
Seeking Long-Term Solutions”**

Before

**The U.S. Senate
Committee on Finance**

Held: Tuesday, January 31, 2012

**SCS UNLOADING**1900 N. 18th St., Suite 701, Monroe, LA 71201 (318) 387-1727

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of SCS Unloading.

As Congress and this Committee undertake the tax reform effort, we wanted to bring to your attention a tax policy that is important to our company. The Work Opportunity Tax Credit ("WOTC"), this provision provides a benefit to the economy and should be continued as permanent aspects of the Internal Revenue Code ("tax code"). This expired provision is essential to our nation's economic and financial recovery.

Work Opportunity Tax Credit (WOTC)

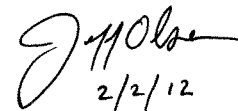
WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC; - targeted employee groups include veterans who either are food stamp recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients; the most difficult cases are being employed in the private sector and 7 out of 10 welfare recipients are using WOTC to find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependent on public assistance. Further, WOTC works. In 2011, more than 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

Allowing this provision to expire at this time in our nation with unemployment rates as they are is a significant setback for job creation and the provision should be extended. In the longer term, Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who

might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Thank you for the opportunity to submit this statement. We encourage the extension of the WOTC program to encourage economic growth and job creation.


2/2/12



Statement for the Record

Of

**Steven M. Koehler, President and COO
SD&A Teleservices, Inc.
5757 W. Century Blvd., Suite 300
Los Angeles, CA 90045**

For The Hearing On

**“Extenders and Tax Reform:
Seeking Long-Term Solutions”**

Before

**The U.S. Senate
Committee on Finance**

Held: Tuesday, January 31, 2012

Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of **SD&A Teleservices, Inc.**

As Congress and this Committee undertake the tax reform effort, we wanted to bring to your attention a tax policy that is important to our company. The Work Opportunity Tax Credit ("WOTC"), this provision provides a benefit to the economy and should be continued as permanent aspects of the Internal Revenue Code ("tax code"). This expired provision is essential to our nation's economic and financial recovery.


Work Opportunity Tax Credit (WOTC)

WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC; -targeted employee groups include veterans who either are food stamp recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients; the most difficult cases are being employed in the private sector and 7 out of 10 welfare recipients are using WOTC to find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependant on public assistance. Further, WOTC works. In 2011, more that 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

Allowing this provision to expire at this time in our nation with unemployment rates as they are is a significant setback for job creation and the provision should be extended. In the longer term, Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

Thank you for the opportunity to submit this statement. We encourage the extension of the WOTC program to encourage economic growth and job creation.

Sincerely,

Steven M. Koehler
President & COO

Rebecca E. Schmitz

February 9, 2012

Senate Committee on Finance
Attn: Editorial and Document Section
Rm SD-219
Dirksen Senate Office Building
Washington, DC 20510-6200

RE: Extenders and Tax Reform: Seeking Long-Term Solutions Hearing
United States Senate Committee on Finance
Tuesday, January 31, 2012, 10:00AM
215 Dirksen Senate Office Building

Honorable Members of the Senate Committee on Finance:

I am writing to you today to ask for your support of an extension of the Work Opportunity Tax Credit Program. For nearly fourteen years I've worked for MARS Stout, located in Missoula, Montana. We're a family-owned company that provides employment with good benefits for nearly 40 people and has been in business for nearly 30 years; just about the same amount of time since WOTC was first proposed in the Economic Recovery Tax Act of 1981. Our business has had lengthy experience with this program and can affirm its positive results for the workers, families, and communities we serve. Decades of experience and academic studies going back to the first Employment Act in 1946 demonstrate even in the best of times there is a significant segment of our population who have higher than average unemployment and lesser chances of finding a job, due to limited skills or employer perceptions of a deficiency. Such hard-to-place people are those with disabilities, war veterans, welfare and food stamp recipients, high school dropouts, at-risk youth in impoverished communities, and the elderly poor. For more than three decades it has been the judgment of Congress that the most efficient way of tackling their distress and economic waste is to allow private sector employers a tax credit as a financial incentive to hire

workers from these populations of the chronically unemployed. Several Federal and state evaluations, in addition to the experiences of targeted workers, employers, and organizations that assist the underprivileged, have shown WOTC is an important tool for placing hard-to-hire workers in productive private sector jobs.

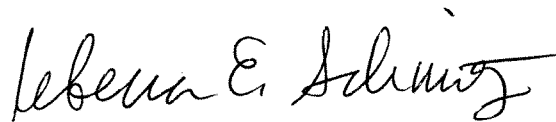
WOTC is highly cost-effective. Last year, more than 1.1 million citizens found jobs thanks to the tax credit, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data; all other employment costs are borne by the private employer. This figure doesn't include the offsetting savings from lower welfare, disability, and SSI payments; the extra labor demand and taxes of the cost-lowering effect of the tax credit; and the private sector jobs that allow states to save TANF block grant funds which can cost up to \$15,000 per space for public sector employment. Using WOTC, more long-term welfare recipients—the most difficult cases—are being employed in the private sector; seven out of ten welfare recipients are using WOTC to find private sector jobs.

Congress allowed WOTC to expire last year for all but veterans. Past experience demonstrates the bulk of those 1.1 million jobs won't go to disadvantaged citizens, and this will have a devastating impact on their job chances. According to State Workforce Agencies, WOTC is the cornerstone of an efficiently functioning labor market for hard-to-place workers. It originated in the appeals of veterans, mayors with large at-risk youth populations, and parents of children with disabilities who wanted their child to live a normal life. Employer embrace of WOTC is demonstrated by the fact that last year State Workforce Agencies received 3,750,000 employer requests to certify workers for WOTC, approving 1,160,000 and denying 1,227,000. More denials than approvals demonstrates the effectiveness of SWA's in maintaining program integrity, but a rapidly growing backlog shows the clear need for more streamlined processing, as called for in the Schock-Rangel bill, H.R. 2082.

Chairman Baucus, Honorable Members, please use the full weight of your office to see that WOTC is renewed in the payroll tax bill now in conference; this cannot wait till later in the year. This tax credit is an integral part of an efficiently functioning labor market and must be continued regardless of larger tax reform because the problem of worker populations with below-average chances of being employed will still be with us. If this program is allowed to end, Congress will

need to somehow meet the demands of disabled and returning war veterans, parents seeking a full life for their disabled child, seniors needing a job to get by, and governors and mayors dealing with the challenges of at-risk youth. It's important to disadvantaged Americans to make WOTC a permanent part of the tax code. It's important to the survival of our Montana-based company.

Thank you for the opportunity to bring this matter to your attention.

A handwritten signature in black ink, reading "Rebecca E. Schmitz". The signature is written in a cursive style with a prominent initial 'R' and a long, sweeping underline.

Rebecca E. Schmitz
Missoula, Montana

RE: Extenders and Tax Reform: Seeking Long-Term Solutions Hearing

180

STATEMENT OF
RHONE RESCH, PRESIDENT & CEO
SOLAR ENERGY INDUSTRIES ASSOCIATION

SUBMITTED TO THE
UNITED STATES SENATE COMMITTEE ON FINANCE

HEARING ON
EXTENDERS AND TAX REFORM: SEEKING LONG-TERM SOLUTIONS

JANUARY 31, 2012



Solar Energy Industries Association
575 7th Street NW, Suite 400
Washington, DC 20004
(202) 682-0556
www.seia.org

The Solar Energy Industries Association (SEIA) is the national trade association for the U.S. solar energy industry. On behalf of our 1,100 member companies and the 100,000 American taxpayers employed by the solar industry, I appreciate having the opportunity to submit a written statement for the record on this hearing regarding tax extenders and tax reform.

History has shown that well-crafted and efficient tax incentives can be powerful policy mechanisms to promote the nation's energy objectives and leverage private sector investment for the deployment and utilization of new energy resources. As with every other major U.S. energy resource, effective and stable tax policy has helped yield significant economic and energy policy benefits in the solar industry. Accordingly, as the Senate Finance Committee considers a host of expiring tax provisions and fundamental tax reform, it is appropriate to review existing energy tax incentives and, in particular, to focus on long-term solutions that promote economic growth and stability.

When evaluating the efficacy of specific energy tax incentives, there are several fundamental considerations for policymakers. For example, an incentive's rate of return for taxpayers and whether or not a tax preference is effective in meeting the nation's short, medium, and long term energy policy objectives should be carefully considered by Congress. By any objective measure, in the case of the U.S. solar industry, tax policy has proven to be an efficient and cost-effective way of promoting an activity that is fully consistent with the nation's energy policy goals. Retention of stable, reliable tax policy that maintains tax incentives provided under current law and improves the liquidity and efficiency of existing incentives will allow the U.S. to reap the significant economic and energy security benefits associated with a vibrant U.S. solar industry.

Existing tax incentives supporting the solar industry have been successful in meeting these requirements. The 30% investment tax credit (ITC) has provided the necessary certainty to promote consistent growth in the U.S. solar market in the five years since its enactment. Even in the face of an historic economic downturn that severely weakened the tax equity market for energy investment, the 1603 Treasury Program promoted strong growth in the U.S. solar market by allowing businesses to continue monetizing the ITC and ensuring a high rate of return for American taxpayers.

Background on Solar Tax Incentives

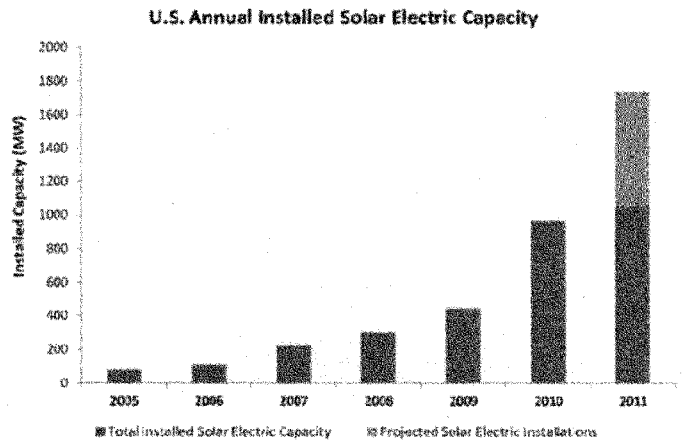
The *Energy Policy Act of 2005* (P.L. 109-58) created tax incentives for solar energy – a new 30% investment tax credit (ITC) for commercial and residential solar energy systems that applied from January 1, 2006 through December 31, 2007. These credits were extended for one additional year in December 2006 by the *Tax Relief and Health Care Act of 2006* (P.L. 109-432). In 2007, global investment in clean energy topped \$100 billion, with solar energy as the leading clean energy technology for venture capital and private equity investment. The solar tax credits helped to create unprecedented growth in the U.S. solar industry from 2006-2007. The amount of solar electric capacity installed in 2007 was double that installed in 2006.

In response to the dramatic downturn in the economy in 2008, Congress enacted the *Emergency Economic Stabilization Act of 2008* (P.L. 110-343). Among other provisions, this legislation included an eight-year extension of the commercial and residential solar ITC, eliminated the monetary cap for residential solar electric installations, and permitted utilities and alternative minimum tax (AMT) filers to utilize the credits.

Solar ITC a Resounding Policy Success

Increasing U.S. Solar Installations

The market certainty provided by a multiple year extension of the residential and commercial solar ITC has helped the rate of solar power installations grow by 800% since the ITCs were implemented in 2006 through 2010 - a compound annual growth rate of 74%. Cumulative solar capacity in the U.S. now exceeds 3,650 megawatts (MW), enough to power more than 730,000 homes. In Q3 2011, the U.S. installed an additional 449 MW, a 140% increase over Q3 2010.



Growing U.S. Solar Manufacturing Capacity

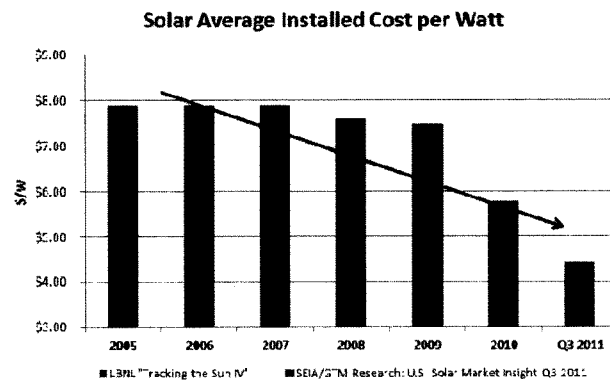
The sharp growth in project installations after passage of the ITC jump-started domestic U.S. solar manufacturing. Between enactment of the ITC through the end of 2010, U.S. solar manufacturing capacity quadrupled from 726 MW in 2007 to 2,887 MW.

Today, there are at least 92 domestic facilities in 27 states manufacturing the primary components of solar PV systems, including solar-grade polysilicon, ingots, wafers, cells, solar modules, and inverters. The U.S. was a \$2 billion net exporter of solar products in 2010.

The Falling Cost of Solar for Consumers

The existence of the ITC through 2016 provides market certainty for companies to develop long-term investments in manufacturing capacity that drives competition, technological innovation, and ultimately lowers costs for consumers.

In 2011 alone, the price of solar panels dropped by 50%, and costs continue to fall, making solar even more affordable for residential and business consumers. This is part of an ongoing trend that has shown consistent declines in solar pricing in the marketplace.



Source: LBNL Tracking the Sun IV; SEIA/GTM Research Solar Market

An Engine for U.S. Job Creation

Due in large part to the availability of the multi-year ITC, the solar industry grew by 140% in Q3 2011 over Q3 2010, making it one of the fastest growing industry sectors in the U.S. economy – in contrast to the 1.7 % GDP growth of the U.S. economy overall in 2011.

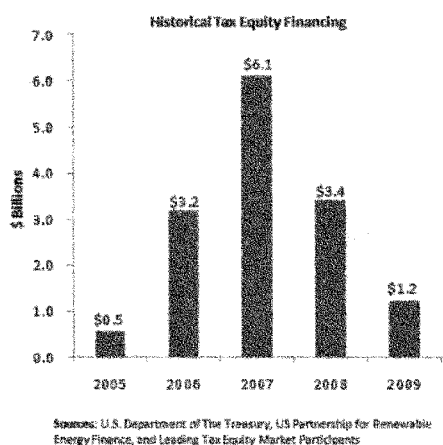
Today, the solar industry employs more than 100,000 Americans, more than double the number in 2009. They work at more than 5,600 companies, the vast majority being small businesses, in all 50 states. Additional job growth is expected as the industry continues to grow in the future.

Importance of Tax Equity Financing and Credit Liquidity

The 2008 economic crisis rendered solar and other renewable energy tax incentives of little immediate value. Prior to the financial crisis, many large-scale renewable energy projects relied

upon third-party tax equity investors to monetize the value of federal renewable energy incentives. The economic downturn drastically reduced the availability of tax equity, severely limiting the financing available for renewable energy projects.

Tax equity is the term used to describe the passive financing of an asset or project by large tax-paying entities that can utilize tax incentives to offset future tax liabilities. Tax equity investors in renewable energy projects receive a return on investment based not only on the income from the asset or project, but also on federal income tax deductions (through the utilization of tax credits). Renewable energy developers themselves typically do not have sufficient taxable income to benefit directly from these tax credits and must partner with tax equity investors in order to finance projects. For example, they participate in a partnership structure in which ownership of the project is transferred from the tax equity investor to the developer-owner once the tax benefits are realized. Leasing structures akin to those commonly found in many sectors of the economy are also utilized.



The pool of tax equity investors is typically limited to the largest and most sophisticated financial firms and utilities, and the 2008 economic crisis significantly reduced the market demand among these entities for tax equity. A report released by the Bipartisan Policy Center on March 22, 2011, noted that the number of tax equity investors in renewable energy projects declined from approximately 20 in 2007 to 13 in 2008 and only 11 in 2009. The associated decline in overall tax equity financing provided to renewable energy projects was equally dramatic, falling from \$6.1 billion in 2007 to \$3.4 billion in 2008 and \$1.2 billion in 2009.

Section 1603 Treasury Program

In response to the dramatic decline in capital available for renewable energy projects, the *American Recovery and Reinvestment Act* (ARRA)(P.L. 111-5) included important modifications to the ITC and other renewable energy tax incentives to address the lack of available tax equity financing, including the Section 1603 Treasury Program. This program allows solar and other renewable energy developers to receive a direct federal grant in lieu of taking the ITC that they are otherwise entitled to receive. The goals of this modification were to simplify financing for renewable energy projects and to provide access to capital during a time when project developers' tax burdens were inadequate to capitalize on tax incentives and tax equity

financing was both scarce and expensive. The program has been very successful in achieving these goals.

It is important to note that the Section 1603 Treasury Program does not significantly increase the overall cost to the federal government of tax incentives for solar energy projects. Instead, the program primarily affects the timing of when ITCs for solar projects can be utilized.

Section 1603 Treasury Program has been a Proven Success

The Section 1603 Treasury Program has been an effective finance mechanism that allows taxpayers and small businesses to maximize the return and value of existing energy tax incentives. The program has provided the liquidity needed for the further development of a wide variety of domestic energy technologies, of which solar is one of a dozen. As of November 2011, the program has leveraged more than \$22.8 billion in private sector investment for more than 22,000 clean energy projects in a wide range of technologies in all 50 states. Since enactment, the program has awarded \$1.5 billion in grants for solar projects, driving over \$3.5 billion in private sector investment in the solar industry across 47 states.

In its preliminary evaluation of the Section 1603 Treasury Program, conducted at the request of the House Ways and Means Committee, DOE's Lawrence Berkley National Laboratory, noted:

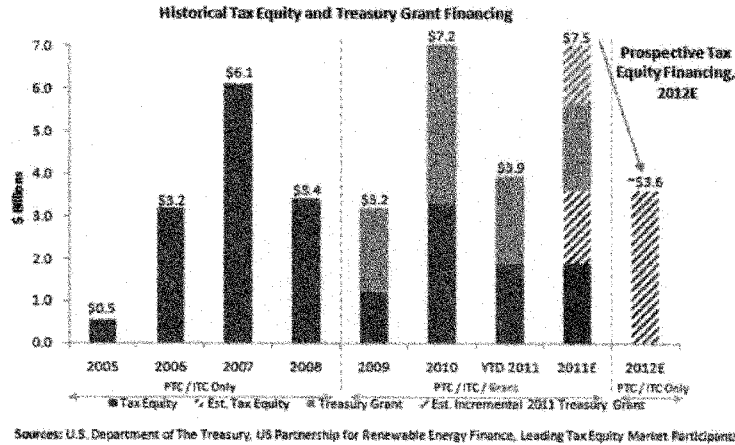
[T]he Section 1603 program provides significant economic value to many renewable power projects, relative to the PTC or even ITC. Specifically, the grant program reduces the market's dependence on scarce and/or costly third-party tax equity, and also in many cases provides more direct or face value to renewable power projects than does the PTC. In addition, a number of indirect or ancillary benefits favor the grant from a renewable project developer's perspective, potentially helping to drive additional renewable capacity additions.

Congress Should Extend the Section 1603 Program

Tax equity financing has still not recovered to the levels available prior to the recession and the rates of return that are being demanded in today's marketplace by investors remain prohibitively high. In December 2011, tax equity investors in solar projects required returns from 7.5% to as high as 17% compared to pre-recession levels of 6% to the low teens.

Due to global economic conditions, a large gap persists between the total amount of financing renewable energy developers need to build a thriving U.S.-based clean-tech industry and what money is available. Expiration of the 1603 Treasury Program is projected to reduce the availability of tax equity financing from an estimated \$7.5 billion in 2011 to approximately \$3.6 billion in 2012 – a reduction of more than 50%. This will stifle job creation and severely restrict the market's ability to leverage private sector capital to finance new domestic energy projects. Therefore, to continue this successful, job-creating program, SEIA encourages Congress to

extend the 1603 Treasury Program and explore ways to improve the liquidity and efficiency of the solar ITC.



Conclusion

As the brief duration of federal solar tax incentives demonstrates, effective federal tax policy can yield significant energy and economic policy benefits. SEIA and the U.S. solar industry looks forward to working constructively with the Finance Committee to extend the 1603 Treasury Program and craft effective tax policy that is consistent with the nation’s energy and economic policy objectives.



Scott Waters
President

Statement for the Record

Of

**Scott Waters, President
South Shore Restaurant Management
2005 Merrick Road #321
Merrick, NY 11566**

For The Hearing On

**"Extenders and Tax Reform:
Seeking Long-Term Solutions"**

Before

**The U.S. Senate
Committee on Finance**

Held: Tuesday, January 31, 2012



Chairman Baucus, Ranking Member Hatch, and members of the Senate Committee on Finance, thank you for the opportunity to submit this statement for the record on behalf of **South Shore Restaurant Management**.

As Congress and this Committee undertake the tax reform effort, we wanted to bring to your attention a tax policy that is important to our company. The Work Opportunity Tax Credit ("WOTC"), this provision provides a benefit to the economy and should be continued as permanent aspects of the Internal Revenue Code ("tax code"). This expired provision is essential to our nation's economic and financial recovery.

Work Opportunity Tax Credit (WOTC)

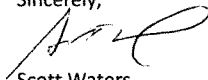
WOTC, a tax credit provided to employers who hire individuals from several targeted groups who face significant barriers to employment. Examples of WOTC-targeted employee groups include veterans who either are food stamp recipients or are unemployed and suffering a service-connected disability, former felons, disconnected youth, and members of families receiving benefits under the Temporary Assistance for Needy Families Program ("TANF").

WOTC encourages employers to hire certain categories of individuals with barriers to employment, enabling these workers to move into self-sufficiency as they earn a steady income and become contributing taxpayers. Through WOTC, more long-term welfare recipients; the most difficult cases are being employed in the private sector and 7 out of 10 welfare recipients are using WOTC to find private sector jobs. A 2011 study by Peter Cappelli of the Wharton Business School at the University of Pennsylvania found that individuals hired under WOTC go on to become productive employees who are no longer dependant on public assistance. Further, WOTC works. In 2011, more than 1.1 million workers found jobs through WOTC, at an average cost of approximately \$1,300 based on Joint Committee on Taxation data. It is important to note that this figure does not reflect any offsetting saving from lower welfare, disability, and social security payments. The Cappelli study found that WOTC is one of the most successful and cost effective federal employment programs.

Allowing this provision to expire at this time in our nation with unemployment rates as they are is a significant setback for job creation and the provision should be extended. In the longer term, Congress should make WOTC permanent, since it has proven to be an efficient incentive for businesses to provide jobs for workers who might otherwise fall through the cracks. Doing so would further provide taxpayers with predictability and certainty in the tax code.

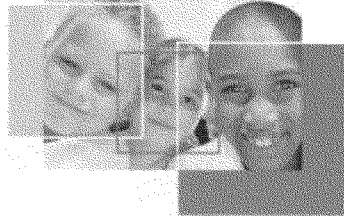
Thank you for the opportunity to submit this statement. We encourage the extension of the WOTC program to encourage economic growth and job creation.

Sincerely,



Scott Waters
President

Voice for Adoption
SPEAKING OUT FOR OUR NATION'S WAITING CHILDREN



Statement for the record by:

Voice for Adoption

Before the:

United States Senate Committee on Finance

For the hearing:

**Extenders and Tax Reform: Seeking Long-Term Solution:
January 31, 2012**

**Voice for Adoption
1220 L. Street, NW
Suite# 100-344
Washington, DC 20005**

Chairman Max Baucus and Ranking Member Orrin Hatch and members of the Senate Finance Committee, Voice for Adoption (VFA) is pleased to submit this statement for the record regarding the federal adoption tax credit. VFA¹ is a membership advocacy organization. We speak out for our nation's 107,000 waiting children in foster care and the families that adopt children with special needs. VFA members, who are spread across the country, recruit families to adopt children and youth in foster care who are waiting for a permanent family. Our members also provide vital support services both before and after adoption finalization to help adoptive families through the challenges they often face post-adoption. VFA members are dedicated to finding permanent, loving families for every waiting child in foster care. We are also committed to ensuring that those children continue to have their needs met after they find their permanent families.

VFA appreciates the opportunity to submit this statement for the record regarding ways to continue to make the adoption tax credit work for families who adopt from foster care. We would like to thank the leaders of this committee for exploring this issue. The adoption tax credit was enacted in 1996 through the Small Business Job Protection Act. Given that the original goal of the adoption tax credit was to promote adoptions from foster care, legislators should examine the gap in the beneficiaries of the adoption tax credit by adoption type (prior to the credit becoming refundable in 2010).

VFA has long supported the adoption tax credit and has advocated making it work better to promote adoptions of waiting children in foster care and to provide accessible support for families who adopt children with special needs. Data from an IRS report² on the adoption tax credit revealed that the vast majority (82 percent) of adoption tax credit recipients completed private or foreign adoptions rather than adoptions from foster care. Almost all international adoptions benefited from the tax credit, compared to only approximately 25 percent of domestic foster care adoptions. Additionally, higher-income

¹ Voice for Adoption is a coalition whose Board of Directors is composed of Adopt America Network, Adoption Exchange Association, The Adoption Exchange Inc., Casey Family Services, Child Welfare League of America, Children Awaiting Parents, EMQ FamiliesFirst, Family Builders Network, Kinship Center, Latino Family Institute, Lilliput Children's Services, North American Council on Adoptable Children, Spaulding for Children-Michigan, and Three Rivers Adoption Council.

² U.S. Department of the Treasury Office of Tax Analysis, "Federal Income Tax Benefits for Adoption: Use by Taxpayers 1999 – 2005." June 2007.

families disproportionately benefit from the tax credit; families with incomes above \$75,000 received two-thirds of the dollars claimed through the credit.

One of the significant barriers that prevents families who adopt foster children from receiving the benefits of the adoption tax credit is that these families tend to have lower incomes and therefore do not have enough of a tax liability to be able to claim the full value of the tax credit. For the adoption tax credit to be effective in supporting adoptions from foster care, it must be structured in a way that allows lower-income families to claim the credit, even if they do not have a high tax liability.

As one family who adopted before the credit was refundable explains,
“It is a shame that working families like ours can’t benefit from the adoption tax credit. We are adopting three siblings with special needs from foster care and would have used the credit to buy a van so that our whole family could fit in one vehicle. We also could have used it to offset some of the costs of making our house better able to accommodate a family of two adults and seven children. With three bedrooms, it’s really tight!”

If the credit is not refundable it will not benefit many lower- and middle-income families. Little information is gathered nationally on the incomes of families who adopt from foster care, but we do know that the vast majority (85 percent) of foster children are adopted by their foster parents or relatives³. Children’s Bureau research on foster parents’ income found that foster parents are significantly more likely than the general population to earn less than \$50,000 per year⁴. In fact, 2000 census data showed that the income in households with foster children is significantly lower than the average income in all households with children; 37 percent of households with at least one foster child earn less than \$50,000 and 15 percent earn less than \$20,000⁵. Urban Institute data found that 54

³ U.S. Department of Health and Human Services, Administration for Children and Families, Adoption and Foster Care Analysis Reporting System (AFCARS), Preliminary Estimates for FY 2010 as of June 2011.

⁴ U.S. Department of Health and Human Services, Administration for Children and Families. “National Survey of Child and Adolescent Well-Being (NSCAW)” November 2003. Retrieved from http://www.acf.hhs.gov/programs/opre/abuse_neglect/nscaw/reports/nscaw_oyfc/oyfc_report.pdf

⁵ O’Hare, William P. “Data on Children in Foster Care from the Census Bureau.” The Annie E. Casey Foundation, Kids Count. June 2008.

percent of kinship families have incomes below 200 percent the poverty level⁶.

For tax years 2010 and 2011, the Patient Protection and Affordable Care Act of 2010 made the adoption tax credit refundable and set the maximum credit at \$13,170 for 2010, with the maximum amount for 2011 indexed for inflation to \$13,360. The credit is scheduled to revert to a nonrefundable credit with a \$12,650 maximum for tax year 2012. After 2012, the credit will only be available to families who have expenses related to adopting children with special needs and who have tax liability—a tiny portion of adoptive families overall. VFA members urge Congressional leaders of the Senate Finance Committee to examine how to continue making the credit accessible for *all* adoptive families, including those who do not have tax liability high enough to claim the credit.

It is especially important for Congress to find a solution that ensures foster care adoptive families can claim the adoption tax credit since a primary goal of the original legislation was to ensure the adoption of waiting foster children. One reason that the credit was made flat for special needs adopters, beginning in tax year 2003, was that Congress acknowledged that families who adopt children with special needs have more ongoing expenses than upfront adoption costs. These families often have ongoing costs for specialized treatment, therapy, tutoring to overcome educational disabilities or delays, medications, etc. If the credit is not both flat and refundable, a large portion of the special needs adopters will never benefit. Encouraging adoption from foster care is not only good for children, but it saves U.S. government funds by eliminating foster care and ongoing court supervision costs.

It is also important for this Committee to understand the widespread public confusion surrounding this credit due to the number of times the credit has been changed over the years. The adoption tax credit has been expanded several times since originally

⁶ The Urban Institute “Children in Kinship Care”. October 2003. Retrieved from <http://www.urban.org/publications/900661.html>

created in 1996.⁷ Congress should consider making the credit permanent, as continuing changes have created enormous uncertainty related to the credit—not only for parents seeking to access the credit, but also for professionals informing adoptive families about the credit’s existence and tax preparers who assist families with their taxes.

One of VFA’s board members had this to share:

“The adoption process is lengthy; some families are under enormous pressure to finalize their adoptions within certain time constraints based on the accessibility of the adoption tax credit. [Consider this] a family begins the adoption process and a child is placed in their home in December 2010, however adoption finalization does not occur until January 2012 (1 year and 1 month later). The family is informed about the adoption tax credit at the beginning of their adoption process with one set of tax code rules and finalizes with an entirely different set of rules. Because finalization happened in January 2012 and not in December 2011 access to the credit differs drastically for this family, by just one month.”

Through the Fostering Connections to Success and Increasing Adoptions Act (P.L. 110-351), state agencies are required to inform prospective parents about the adoption tax credit. Voice for Adoption and our member organizations have also worked to inform eligible families of the credit’s existence. We have found, through our experiences serving adoptive families, that the Fostering Connections provision was very helpful and states seem to be increasingly informing parents about the credit.

Conclusion

As Congress contemplates tax reforms it should consider the importance of including the adoption tax credit in these important discussions. Specifically, legislators should extend the adoption tax credit beyond a year or two at a time and continue to

⁷ United States Government Accountability Office (GAO) Report To Congressional Requesters, “Adoption Tax Credit: IRS Can Reduce Audits and Refund Delays”. October 2011. Appendix I: Adoption Tax Credit Provisions, 1996 to the Present.

make it accessible for families that are committed to caring for adopted children with special needs. To ensure that the credit benefits those who adopt foster children with special needs, Congress must ensure that the adoption tax credit is:

- Refundable, so that all adoptive families can claim the credit
- Flat for families who adopt children with special needs, meaning that they can claim the credit without having any expenses in the adoption process
- Permanent or at least extended for several years at a time

As you work to improve tax reform issues VFA members hope you will keep in mind the love, commitment, and sometimes solace adoptive families provide for their children, but more importantly, the time, patience and tenacity it takes to raise children who often come with painful pasts. For families who adopt from foster care, many expenses result after adoption finalization and the adoption tax credit provides a critical lifeline to meet those children's needs. Adoptive families need our support as they care for our most precious children, raising them to be successful, productive individuals.

We would like to thank the committee for its interest in hearing perspectives for improvements to tax reforms that work on behalf of children and families. In closing we appreciate the dedication of this Committee, as your work on children's issues remains a priority across party lines. We look forward to your continued efforts on behalf of waiting children in foster care.

