Ohio Northern University Law Review

Volume 42 | Issue 2 Article 6

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Law Review

Woodworth Memorial Lecture

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I want to begin by saying that I consider it an honor to deliver a lecture named for Dr. Laurence Woodworth. As a former Chairman of the House Ways and Means Committee, I can attest to the fact that Dr. Woodworth's legacy lives on among the outstanding professionals on the staff of the Joint Committee on Taxation. While Dr. Woodworth's service predates my own years in the House of Representatives, as a former Chairman of the Joint Committee, I know that the staff continues to look to his example of public service and integrity. Larry Woodworth was highly respected by the members of the House and Senate tax-writing committees and the tax policy officials at the White House and the Treasury Department, as well as countless tax professionals in the private sectors.

I want to speak today about the fundamental need for the United States to reform its tax laws – and why we need to do it now in 2015.

The Scottish philosopher and economist Adam Smith, who is often credited as the father of political economic theory, summed up the challenge that the United States faces today in pursuing tax reform when he said:

> Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy

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> taxes, and a tolerable administration of justice: all the rest being brought about by the national course of things.[1]

Today, little about our Nation's tax laws would bring to mind Adam Smith's ideal of "easy taxes."

An understanding of the full adverse impact of today's U.S. tax rules must begin by acknowledging that the United States has the highest statutory corporate tax rate among major global economies. The top U.S. statutory corporate tax rate, including the average state corporate income tax, is 39.0%, more than 14 percentage points higher than the 2015 average (24.6%) for other OECD countries, and more than 10 percentage points higher than the average (28.4%) for the other G7 countries.[2]

U.S. effective tax rates also are high relative to other developed economies. For example, a recent report issued by the Tax Foundation found that the United States has the second highest marginal effective tax rate on corporate investment among the OECD countries at 35.3% – behind only France.[3]

For U.S. companies seeking to do business around the world, the outdated tax policy reflected in today's tax code is a barrier to success and leaves America falling further behind.

And when I say outdated, I'm not talking about the way we typically think of the term – as in having an iPhone 4s instead of the new 6 or 6-plus.

When I say our international tax policy system is outdated, I'm talking about an architecture dating back to the 1950s and 1960s. We have a tax system designed for a time of rotary phones while we carry smartphones with 1,000 times the processing power of the Apollo Guidance Computer that put a man on the moon.

The global economy has changed enormously since the 1960s. Globalization – the growing interdependence of countries' economies – has resulted from increasing international mobility and cross-border flows of trade, finance, investment, information, and ideas. Technology has continued to accelerate the growth of the worldwide marketplace for goods and services. Advances in communication, information technology, and transportation have dramatically reduced the cost and time it takes to move

1. Lecture in 1755, quoted in Dugald Stewart, Account Of The Life And Writings Of Adam Smith LLD, Section IV, 25.

2. OECD Tax Database and PwC calculations.

3. Jack M. Mintz and Duanjie Chen, *U.S. Corporate Taxation: Prime for Reform*, TAX FOUNDATION SPECIAL REPORT NO. 228 (Feb. 2015) http://taxfoundation.org/sites/taxfoundation.org/files/docs/TaxFoundation_SR_228.pdf. This measure includes federal and state corporate income taxes, sales taxes on capital purchases, and other capital-related taxes including franchise fees, asset-based taxes, financial transaction taxes, but excludes property taxes and temporary incentives such as bonus depreciation.

goods, capital, information, and people around the world. In this global marketplace, firms differentiate themselves by being nimble around the globe and by innovating faster than their competitors.

Just as the global economy has changed, tax systems around the world have also evolved. Governments in the developed and developing world have adopted policies that reflect a changing view of corporate income taxes. This modern view may have been occasioned by economics or practicality, but as discussed below, the result is a growing gap between the United States and the rest of the world.

Every other G7 country and twenty-eight of the other thirty-three OECD member countries have international tax rules that allow their resident companies to repatriate active foreign earnings to their home country without paying a significant second layer of domestic tax. This territorial system approach, sometimes referred to as a "participation exemption" or "dividend exemption" tax regime, differs markedly from the U.S. worldwide tax system, in which the foreign earnings of U.S. companies are subject to U.S. corporate tax with a credit for taxes paid to the foreign jurisdiction.

The United Kingdom and Japan, in 2009, became the most recent major economies to adopt territorial tax systems, leaving the United States as one of the last modern economies that has not adopted a territorial tax system. Of the twenty-eight OECD countries with territorial tax systems, only two – New Zealand and Finland – have switched from territorial to worldwide tax systems, and both nations subsequently switched back to territorial tax systems.[4]

With the highest statutory corporate tax rate among OECD countries and a corporate income tax that repels repatriated foreign earnings, U.S.-based multinationals have a significant incentive to keep their foreign earnings abroad. The Obama Administration has cited reports[5] that over $2 trillion of accumulated foreign earnings of U.S. companies have been identified as permanently reinvested abroad. Although some of these earnings are in cash and liquid assets, a substantial amount has been reinvested in expansion of the foreign operations of U.S. businesses to serve emerging markets.

A territorial system similar to those in other advanced economies would encourage U.S. companies to reinvest their foreign earnings in the United States by removing the current repatriation tax that only U.S. headquartered

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4. PwC, *Evolution of Territorial Tax Systems in the OECD: Prepared For the Technology CEO Council* (Apr. 2, 2013) http://www.techceocouncil.org/clientuploads/reports/Report%20on%20Territorial%20Tax%20Systems_20130402b.pdf.

5. Audit Analytics Trend Reports, *Foreign Indefinitely Reinvested Earnings: Balances Held by The Russell 1000 - A 7 Year Snapshot* (Apr. 20, 2015).

companies must pay, putting domestic investments on a par with reinvestment abroad.

Beyond just adopting territorial systems, an increasing number of countries are acting to provide "patent boxes" and related incentives for innovation. As Dr. Laura Tyson, former Chair of President Clinton's White House Council of Economic Advisers, noted in her recent testimony before the Senate Finance Committee, other countries "are using tax policy as a 'carrot' to attract the income and the operations of U.S. companies with significant intangible assets and the positive externalities associated with them – including spillover effects boosting innovation, productivity, and wages."[6] That is one reason why I included a "carrot" for intangible income earned from foreign market sales by U.S. companies as part of the tax reform bill that I introduced last year.

The United States is operating in a global economy that increases both the competition American businesses and workers face and the opportunities available to them. As President Obama noted in his State of the Union address, 95% of the world's customers and 80% of the world's purchasing power reside outside the United States.

U.S. businesses can't serve those rapidly growing markets by staying home. Reforming our tax laws to help U.S. businesses better compete abroad increases the value of the assets of American companies and leads to increased American jobs.

Tax reform would help the economy grow and would benefit the average individual taxpayer. Over the past six years, hard-working, middle-class families have been squeezed. The number of people who are NOT in the labor force has grown, despite the working-age population increasing by 11.9 million. The labor force participation rate has not been this bad since the 1970s.

Meanwhile, wages have barely budged, and inflation-adjusted median household income has fallen from just over $54,000 in 2008 to just below $52,000 in 2013. A record number of young adults have moved back home to live with their parents instead of charting a course out on their own.

In terms of complexity, the current tax code is the exact opposite of Adam Smith's "easy taxes" – it certainly isn't easy for families to compute their tax liability. The tax professionals in this room can well appreciate the effort it takes to understand the 62-page IRS instructions on contributions to IRAs and the 60-page IRS publication on distributions from IRAs.

6. Testimony of Dr. Laura D'Andrea Tyson, U.S. Senate Committee on Finance Hearing on "Tax Reform, Growth, and Efficiency" (Feb. 24, 2015) http://www.charitableplanning.com/cpc_2127168-1.pdf.

And it certainly isn't easy for businesses to navigate the tax laws, let alone remain competitive in the global environment.

So, here we sit. We know America needs tax reform, and we know we need it now.

Now we know Washington, to put it mildly, faces a few challenges – from a record number of new members to heightened partisanship.

That brings me to some questions I often am asked. Do I think comprehensive tax reform is possible? Why should we spend our time evaluating the impact of tax reform proposals and engaging in dialogues with Congress and the Administration if nothing is going to happen?

It would be easy to say that this Congress isn't going to do anything. It's easy to say tax reform isn't happening anytime soon, so we might as well not undertake the hard work of developing a constituency for tax reform and not contribute your ideas on what tax reform should look like.

But, I would also note, it is easy to be wrong. My personal view is that 2015 is a very important year for tax reform, notwithstanding the political challenges.

Keep in mind that President Obama was more forward-leaning in his State of the Union than he has been in years past. In February, President Obama included more tax reform details in his budget than in the past. And Treasury Secretary Lew's testimony before the Ways and Means Committee and the Senate Finance Committee seems to suggest an "open door" on tax issues. Reports indicate he is engaged more than in years past.

Now I can be accused of being an optimist. I guess if you choose to spend twenty-six years asking the public to vote for you, you have to be optimistic.

Some recent events make me think that perhaps there may be cause for optimism with this new Congress. For example, you can be sure that doctors who care for Medicare patients would have had little reason to be optimistic. They had good cause to doubt that Congress would ever permanently "fix" a physician pay system that has required seventeen temporary "doc fix" measures since 1997. And yet, legislation permanently reforming the Medicare physician pay system was recently signed into law by President Obama. And what may be even more astounding is that the legislation was the product of bipartisan negotiations between Speaker Boehner and Leader Pelosi. Not even the most optimistic person might have seen that coming.

The House Ways and Means Committee and the Senate Finance Committee recently approved a bipartisan agreement on Trade Promotion Authority, a plan to grant the President the ability to negotiate trade agreements with the guarantee of an up-or-down Congressional vote. House and Senate leaders are optimistic that Congress will provide a U.S.

President with enhanced trade negotiating authority for the first time since 2007.

Both the House and Senate have passed budgets for the first time in years. And a joint budget resolution provides for the tantalizing prospect of reconciliation – which means legislation can pass the Senate with fifty-one votes, instead of needing sixty votes.

All of this legislative momentum appears to have been noticed by the press. *The Washington Post* recently featured an article entitled "Congress is doing its job! What's next?"[7] And *The Wall Street Journal* noted that "Signs of Comity are Mounting in the Senate."[8]

Let's take a look at past history in trying to identify a path to tax reform in this Congress. Senate Finance Chairman Hatch recently noted that enacting the Tax Reform Act of 1986 represented a three-year legislative effort. On several occasions over that period, most participants concluded that reform efforts would not succeed, but they were wrong. Today, potential obstacles to reform include heightened partisanship coupled with a wave of new Members who have not had the experience of reaching big legislative agreements requiring compromise. And that is true in both the House and the Senate.

Also, the 1980s and 1990s were years when "big things" happened in bipartisan ways. From rescuing Social Security in 1983 to enacting tax reform in 1986, to welfare reform in 1996 and The Balanced Budget Act in 1997 – Washington worked in a bipartisan manner. But that is not to suggest it was pretty . . . I certainly remember the 1996 government shutdown.

The last fifteen years have been a bit different:

- The 2001 tax cuts were passed under one-party control of Congress, using budget reconciliation rules that allowed the bill to pass in the Senate with fewer than the sixty votes typically required.

- There was total Republican control when the 2003 tax bill passed under reconciliation with Vice President Cheney breaking a tie-vote in the Senate, as well as the

7. Al Kamen and Colby Itkowitz, *Congress is doing its job! What's Next?*, WASHINGTON POST (April 23, 2015) http://www.standard.net/frontpage/2015/04/23/Congress-is-doing-its-job-What-next.html.

8. Kristina Peterson and Siobhan Hughes, *Signs of Comity Are Mounting in the Senate*, WALL STREET JOURNAL (April 23, 2015) http://www.wsj.com/articles/signs-of-comity-are-mounting-in-the-senate-1429744683.

2003 Medicare prescription drug benefit, otherwise known as Part D.

- Later, Democrats were in total control for passage of major legislation including the 2009 stimulus bill, the Affordable Care Act, which was passed under reconciliation, and Dodd-Frank.

Today, we not only have a relatively "new" Congress – at least in terms of years served by many members – we also have a relatively "new" way of doing big bills. This is important to remember when we look back on how Congress succeeded in passing major tax reform in the past.

What was a three-year, bipartisan effort in '86 – before Twitter, before Facebook, before email and Gmail, before cable news – clearly today, is taking more time. And while tax reform may eventually happen in a more partisan way, right now it is too early to say whether a Republican-controlled Congress can pass a tax reform bill in 2015 that a Democratic President will sign.

The fact is we just don't know.

What we do know is that just over a year ago, I released the most comprehensive rewrite of the tax code since 1986. That was a multi-year effort in and of itself.

At its core, my objective was to make the tax code simpler and fairer for hardworking taxpayers. The legislation proposed to make the Code more effective and efficient by getting rid of narrowly targeted provisions to lower tax rates across the board for both individuals and corporations. This was to enable small and large businesses alike to expand operations, hire new workers, and increase benefits and take-home pay.

Over the four years that preceded my introduction of the Tax Reform Act of 2014 as H.R. 1, the Ways and Means Committee held over thirty public hearings, including the first joint hearings with the Senate Finance Committee on tax policy since World War II. Ways and Means Ranking Member Sandy Levin – my home state colleague – and I formed eleven bipartisan working groups to tackle different areas of the tax code. In that time, I also launched TaxReform.Gov, which received more than 14,000 public comments and suggestions, while then-Senate Finance Committee Chairman Max Baucus (D-MT) and I escaped the confines of Washington, D.C. to go out and talk with taxpayers all across the country.

In the process, tax reform went from just a handful of us talking about it, to one of the dominant debates in Washington. The debate went from about "whether" to do tax reform to "how" to do tax reform.

The RATE (Reforming America's Taxes Equitably) Coalition was formed; other groups now include the Coalition for Fair Effective Tax Rates, LIFT (Let's Invest for Tomorrow) America,, TIE (Tax Innovation Equality), BUILD (Business United for Interest and Loan Deductibility), and ACT (Alliance for Competitive Taxation).

Because of these coalitions and the strong interest of many members of Congress, numerous Congressional hearings, bipartisan working groups, discussion drafts and white papers in both the House and Senate – a solid foundation has been built for tax reform.

In 1985, then Ways and Means Chairman Dan Rostenkowski famously said, "Don't let yourself get misled. . . the tax reform train is moving. . . and there's a real danger that doubters will be left behind at the station."

His words still ring true today.

We know that the two new Chairmen of the tax-writing committees want to do tax reform. While we don't know when they will complete this project, make no mistake – a new tax code is being built in Washington.

That is why I believe 2015 is a very important year for tax reform. With recent GDP reports showing the U.S. economic growth stalling, we simply can't wait longer to reform our tax laws to promote more, better-paying jobs here at home and make U.S. businesses more competitive globally. 2017 or 2018 is too long for the American people to wait.

And there is a lot of work being done right now. For example, the new House rules instruct the staff of the Joint Committee on Taxation to use dynamic scoring for tax reform. This is something I was able to include in the House rules. It is a much more accurate way of measuring the true impact of major tax legislation.

Independent economists agree: well-designed tax reform results in stronger economic growth, more jobs, and higher wages. When I proposed a comprehensive tax reform last year, independent, non-partisan analysts at the Joint Committee projected that it could increase the size of our economy by up to $3.4 trillion – that's equivalent to 20% of today's economy.

Based on that stronger growth, JCT staff estimated that we could see up to two million new jobs created, and there could be up to $700 billion in additional federal revenues that could be used to lower taxes even further or reduce the debt.[9]

On the Senate side, Senators Hatch and Wyden have established bipartisan working groups, which is an approach I used very effectively in

9. JOINT COMMITTEE ON TAXATION, JCX-22-14, MACROECONOMIC ANALYSIS OF THE "TAX REFORM ACT OF 2014," (Feb. 26, 2014) https://www.jct.gov/publications.html?func=startdown&id=4564.

the House. Finance Committee Members are speaking to each other and are starting to define what the next layer of tax reform looks like.

In another hopeful sign, just last month Chairman Ryan and Chairman Hatch reaffirmed their united commitment to comprehensive, revenue-neutral tax reform to benefit families, pass-through businesses, and corporations. They said that because President Obama is unwilling to reduce individual statutory tax rates, some aspects of tax reform will have to be deferred until after the 2016 Presidential election. But in the meantime, they do not believe we can wait until 2017 to take steps to promote a stronger U.S. economy. I share their view. Tax reform can't wait.

Accordingly, they are seeking to find common ground on business income tax reform, which will lower the U.S. corporate tax rate and provide effective tax rate relief for "pass-through" businesses whose owners are subject to the individual tax rates. They know that non-corporate business taxpayers can't be left behind, since they account for more than half of net business income.[10]

The narrowing of the scope of near-term tax reform efforts may well make legislative action this year more likely. In their recent joint letter, the two chairmen have asked taxpayers to submit tax reform ideas by the end of this month.

And, we know there may be several opportunities to move tax reform in the near future – everything from the Highway bill to the debt limit are potential catalysts.

For example, Chairman Ryan recently commented that he is working with leaders of the House Transportation Committee to provide a temporary continuation of highway funding beyond a May 31 deadline, so that efforts to provide additional resources for infrastructure can be better lined up with the effort to enact tax reform legislation later this year.

Whether tax reform happens this year or after the next Presidential election, the point is that decision makers are talking about the issues you confront in your work as tax professionals and what the next layer of tax reform will be. The question is – are you shaping that conversation or are others shaping it for you?

While the so-called Super Committee, on which I was a member, did not reach a final agreement, many of the ideas we discussed in 2011 – the building blocks we formed – found their way into future legislation. So, I can tell you this: sooner or later tax reform will happen. For the sake of the country, I hope it is sooner. The economics demand it. And the American people will demand it.

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10. Internal Revenue Service, Statistics of Income.

From a business standpoint, we must have tax reform. The current system tilts the playing field against U.S. companies competing for acquisitions of foreign companies and U.S. companies with foreign operations. Our current worldwide tax system essentially places a premium on the value of U.S. companies' assets in the hands of a foreign bidder.

The recent wave of inversions and foreign takeovers show that, one way or another, corporate America will seek to accomplish "tax reform" for itself. But allowing that trend to continue represents a failure of Washington to protect the U.S. economy and the jobs it creates. And that is something the American people will tolerate for only so long.

In the absence of action by Congress to enact a more competitive U.S. tax system, there will be an increase in the pace of U.S. companies being acquired by foreign competitors, and our current worldwide tax system will continue to effectively subsidize the treasuries of the world's richest countries seeking to tax U.S. multinationals.

As we are seeing from the OECD and its efforts to address profit shifting, the international community also will not accept the status quo.

The OECD's BEPS project, launched in 2012 by G20 governments, including the United States, presents a challenge for the U.S. Treasury negotiators and for U.S. businesses and a threat to the U.S. tax base. As you are aware, the BEPS project is intended to forge a global consensus on how to address base erosion and profit shifting.

In July 2013, the OECD issued a fifteen-point BEPS Action Plan[11] that is scheduled to be completed by December 2015. Several reports have already been issued, and the OECD is on track to issue the plan's final reports this year.

Although nominally a project aimed at a narrow problem – the erosion of governments' tax bases and profit shifting – the reality is that the fifteen-point action plan opens the door to rewriting the rules of international taxation in nearly every respect, and doing so in a period of only two years.

While the BEPS project was intended to shore up the global consensus on the rules of international taxation, which was perceived to be unraveling, many governments have not waited for the BEPS process to play out and consensus rules to emerge. Even our close ally and proponent of the BEPS project, the United Kingdom, moved ahead of the project, proposing a "diverted profits tax" that took effect on April 1.

The rapid changes in global tax policy constitute both a challenge and a threat as the United States considers a long-overdue reform of our nation's tax laws.

11. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING.(2013) http://www.oecd-ilibrary.org/taxation/action-plan-on-base-erosion-and-profit-shifting_9789264202719-en.

The bottom line is that change is coming – if not here at home, then it is certainly coming from overseas.

So now is the time to engage. 2015 is a very important year. We need tax reform now.

Finally, I want to conclude by again recalling the example of Larry Woodworth. He was a life-long believer in the benefits of tax reform and he left the Joint Committee on Taxation to join the Carter Administration as a proponent of tax reform. Unfortunately, his life was cut short after only one year at Treasury, and the country suffered when efforts to enact tax reform were delayed for nearly another decade. Let's not delay today in providing the United States with the tax code we need for the 21st century.

Thank you for inviting me to speak to you today.