



**Testimony before the Joint Economic Committee hearing,
“Could Tax Reform Boost Business Investment and Job Creation?”**

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Thank you, Chairman Casey, Vice-Chairman Brady, and the members of the committee for the chance to appear today to discuss tax reform and the economy.

There is wide agreement that the tax code is long overdue for reform. Our current tax code is inefficient, overly complex, and unfair in myriad ways. Our tax code is also failing at its most fundamental purpose, which is to raise sufficient revenue to meet our needs as a country in an equitable way. Fundamental tax reform—a reform that broadens the tax base and eliminates economic distortions—is important for promoting long-term economic growth.

That said, tax reform simply cannot address the central economic challenge facing the United States right now—the severe and prolonged jobs crisis, which is a product of the lack of demand in the economy. At a time of 9 percent unemployment and vast unused resources, Congress should be focused above all else on boosting demand, reducing unemployment, and putting our economy back on a path toward healthy economic growth.

And so my testimony today will summarize briefly the reasons why I believe that fundamental tax reform is an important priority, but one that should not derail immediate and fast-acting measures to address our most pressing challenge—putting people back to work. My testimony will then discuss some of the critical issues and principles in tax reform, including:

- The fiscal context for tax reform
- The need to avoid tax policies that would shift a greater share of the tax burden on middle-class families
- The need for business tax reform that encourages investment and job growth in the United States, levels the playing field among competing businesses, and ensures that companies pay their fair share

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I. The immediate economic challenge

The most immediate and fundamental challenge facing the economy today is the jobs crisis. More specifically, it is the \$1 trillion hole in aggregate demand caused by the collapse of the housing bubble, the financial crisis, and continued mass unemployment.¹ The Great Recession is still taking its toll on the economy. The output gap—the difference between the economy’s actual output and its capacity to produce at full employment—is still at about 6.7 percent of potential GDP, or nearly \$1 trillion per year.² That gap has closed somewhat since the low point of the Great Recession, thanks in part to the American Recovery and Reinvestment Act and other policies, but the Congressional Budget Office projects it to remain at 5 percent below potential GDP through 2011, with an output gap persisting for several years to come and inflicting continued pain on workers.

The economy needs more aggregate demand to close the output gap and return people to work. CBO predicts that if we stay on the current policy path “a large amount of labor and capital resources [will] be unused for some time.”³ The fact that the economy is not performing at its potential is shown most dramatically and tragically in the fact that 14 million people remain unemployed, and long-term unemployment stands at record levels. The prolonged output gap means that business investments are not being made and worker skills are atrophying, which hurts our national economic competitiveness.

With excess capacity, businesses will be hesitant to hire and invest until they are confident there will be demand for their products and services. The most urgent problem is not a lack of capital, at least not for large businesses. The corporate sector has been enjoying strong profits and is flush with cash: Nonfinancial companies are holding more than \$2 trillion in cash and liquid assets in the United States, according to the Federal Reserve.⁴ The tax code is now strongly incentivizing business investment, with 100 percent expensing (full write-offs) of investments made this year. And despite the claims, “regulatory uncertainty” is not a real explanation for the lack of hiring.⁵ Both the economic data and business owners themselves point to a lack of demand as the major obstacle to job creation and economic growth.⁶

Though it is not the subject of my testimony today, my colleagues at the Center for American Progress have identified the most promising ways to boost consumer and business demand and create private-sector jobs while investing in the future. They include: investing in infrastructure, aiding the housing market by reducing the flood of foreclosed homes, providing aid to the states to prevent further public sector layoffs, and supporting the energy-efficient retrofitting of homes and businesses.⁷ Congress also cannot afford to *worsen* consumer demand by allowing the temporary payroll tax reductions and long-term unemployment assistance to expire. These ideas and others are encapsulated in the president’s American Jobs Act, which many independent forecasters predict will create as many as 1.3-1.9 million jobs.⁸

In sum, tax reform is a worthy goal. Done right, it can improve long-term economic growth, especially if it is part of a long-term growth strategy that also makes important public investments and strengthens the middle class.⁹ But it is not a response to the immediate and ongoing jobs crisis. And therefore discussions of tax reform should not be to the exclusion of immediate job creation measures like the American Jobs Act.

II. The context for tax reform: long-term fiscal challenges and growing inequality

a. The existing tax code does not raise adequate revenue to meet national needs under any realistic fiscal scenario

Any tax reform effort will have to be considered against the backdrop of the long-term fiscal challenges facing the United States. Those challenges are undeniable. The United States was running deficits even at the peak of the business cycle in the mid-2000s. Since 2008, the recession and Congress's policy responses caused a sharp fall-off in revenues. The short-term fiscal situation has improved, with deficits as a share of GDP declining for fiscal year 2012 and projected to decline further over the next several years. However, the more serious challenges are in 2021 and beyond, as an aging population, rising health care costs (even if the rate of growth slows), responsibilities to the millions of new Iraq and Afghanistan veterans, a decaying infrastructure in need of rebuilding, and other ongoing national needs exert pressures on the budget. The United States will also have to pay a growing amount of interest on the debts incurred from the wars, the 2001-03 tax cuts, and the larger deficits caused by the recession.

The fact is that our current tax policies do not raise nearly enough revenue to stop the accumulation of debt, even in scenarios with draconian spending cuts. If we maintain our current tax policies, revenues will only reach 18.1 percent of GDP in 2021 and will average just 17.7 percent over the next decade.¹⁰ That is not nearly enough to prevent continued deficits even under the House-passed budget, under which federal spending would decline to about 20 percent by the end of the decade. That budget would dramatically reduce public investments in education, infrastructure, and scientific research while tearing at the social safety net, including turning Medicare into an inadequate voucher program and slashing Medicaid.

In light of these realities, every major bipartisan effort to propose solutions for the nation's long-term fiscal challenges has found it necessary to rely on both spending reductions and substantial revenue increases that boost revenues to at least 20 percent of GDP, or significantly higher.¹¹ It should be noted that federal revenues averaged about 20 percent of GDP over the four-year period from FY 1998-FY 2001, when the budget was last in balance—and spending needs were much less then, with a smaller pre-9/11 military budget, a younger population, and lower health-care costs per capita.

The fact that our current tax code is inadequate to fund our national needs without accumulating more debt means that tax reform must contribute to solving our long-term fiscal challenges. In other words, it must be revenue-positive. If our tax code cannot be reformed to raise additional revenue, the resulting deficits will drive debt-to-GDP ratios to unsustainable levels, with negative repercussions for the United States economy over the long term.

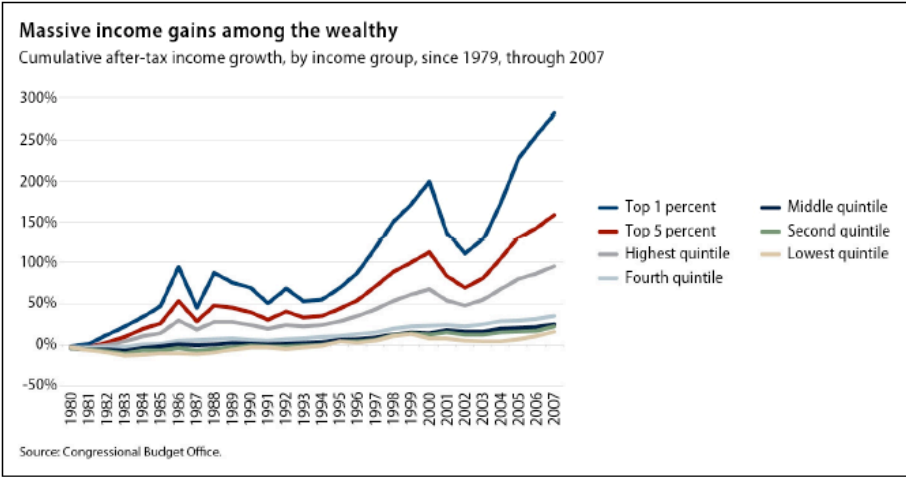
Many hold up the last major tax overhaul, the Tax Reform Act of 1986, as a model for today. TRA86 was ostensibly revenue neutral, achieving significant reductions in both corporate and individual tax rates in exchange for reductions in tax expenditures and loopholes. But today, our long-term budget challenges are much more severe than they were in 1986. And the large budget

deficits that persisted after 1986 were closed only through further deficit reduction efforts, including increases in the top marginal rates in 1990 and 1993.

The good news is that unlike some European countries that also have long-term fiscal imbalances, the United States is a low-tax country. Federal receipts as a share of GDP were under 15 percent for the last three years—the lowest since 1950. The United States also raises comparatively little revenue by international standards: Total revenues in the United States were 26.9 percent of GDP from 2004-2008, nearly 25 percent lower than the average OECD country. Within the OECD, only Mexico, Chile, Turkey, and South Korea had lower taxes as a share of their economies. By comparison, revenues total 33 percent of GDP in Canada and 36 percent in Britain. The bottom line is that there is ample room to increase revenues. We are a low-tax country now and will remain a relatively low-tax country even if we balance the federal budget entirely with new revenue.

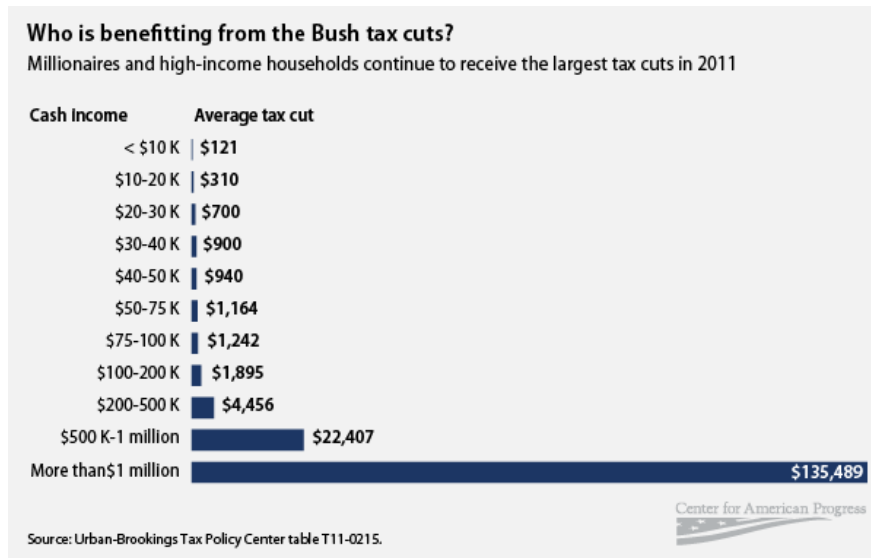
b. Tax reform must not exacerbate growing income inequality by shifting a greater share of the tax burden onto low-income Americans and the middle class

Another important part of the context for tax reform is that income inequality has dramatically widened in recent decades. Top income earners, most dramatically the top 1 percent, have pulled apart from those in the middle and at the bottom. In recent years, the share of income accruing to the top 1 percent reached levels not seen since the 1920s.¹² At the same time, real incomes for the middle class have barely grown.



As income inequality has continued to grow, and while middle-class incomes have stagnated, the tax rates paid by the well-off have plunged. Millionaires are now paying about one-quarter less in federal taxes as a share of their income as they were as recently as the mid-1990s.¹³ The top 1 percent of Americans has experienced a similar reduction in taxes.¹⁴ A principal cause of the lighter tax burden on the wealthy was the tax rate cuts enacted under President George W. Bush in 2001 and 2003: The average millionaire (whose incomes average \$2.9 million) will pay \$135,000 less this year because the 2001-03 tax cuts are still in effect, according to the

nonpartisan Tax Policy Center.¹⁵ The wealthy have also benefited greatly from historically low rates on income from capital gains and dividends.¹⁶



The end result is a federal income tax code that is generally progressive, but less progressive than it used to be, and one in which many very wealthy people pay lower effective rates than people below them on the income scale. And of course the federal income tax is only one component of a larger tax system; other kinds of taxes, including payroll taxes and consumption taxes (e.g., excise taxes, state and local sales taxes) fall harder on those at the bottom than those at the top. Families in the middle of the income spectrum pay 9.4 percent of their incomes in federal payroll taxes on average, while the top 1 percent pays only 1.6 percent.¹⁷ This is because the largest portion of federal payroll taxes only applies to a worker’s first \$106,800 in wages, and not to wages in excess of that amount or to investment income.

President Obama has said that one of the principles underlying tax reform should be the “Buffett rule.” The “Buffett rule” is not a specific tax code rule, but the general principle that no millionaires should be paying lower taxes as a share of their income than middle-class families. The current tax code often violates this principle. For example, there are nearly 100,000 millionaires (about one in four) who pay a tax rate of less than 26.5 percent—more than 10.4 million Americans earning less than \$100,000 pay.¹⁸ Statistics like these undermine the sense of basic fairness that should undergird the tax code.

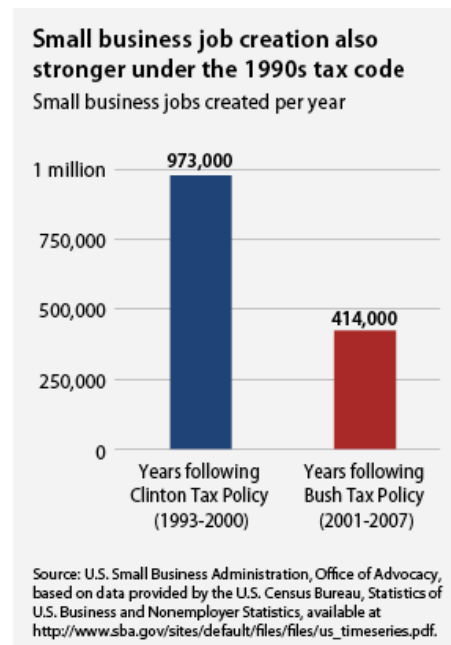
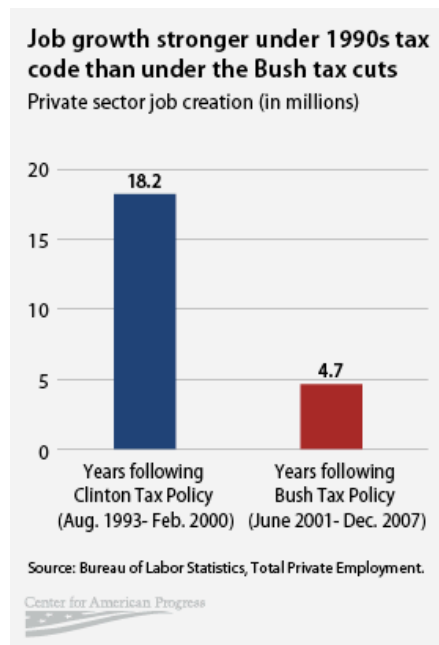
So in sum, we need additional revenues. And the group of Americans whose incomes have skyrocketed are now paying lower taxes than they were just a short time ago. These factors point toward allowing the Bush tax cuts on top-incomes to expire. Doing so would reduce the deficit over 10 years by about \$800 billion—two-thirds of the way toward the amount of deficit reduction that the Joint Select Committee on Deficit Reduction is charged with finding.

It is often claimed that allowing the high-end Bush tax cuts to expire—which would simply reinstitute the top marginal tax rates that were in effect during the 1990s economic expansion—would stifle job creation and harm small businesses. It is even said that the very prospect that tax

rates on the rich will return to 1990s levels—with the 33 percent bracket going to 36 percent and the 35 percent bracket going to 39.6 percent—is holding back hiring and business investment. Neither of these claims is true. Three facts underscore why.

The first is recent history. The expiration of the two top brackets would simply revert the top marginal tax rates to levels that were in effect from 1993-2001. The same claims about economic growth and the negative impact on small business were made in 1993, when the top marginal rate was raised from 31 percent to 39.6 percent, a much larger percent increase than is contemplated now. What followed, however, was a period of very strong economic growth and job growth, among both large and small employers. And the federal budget was balanced for the last four fiscal years the 1990s tax rates were in effect.

With higher tax rates on both ordinary income and capital gains in effect, business investment was stronger in the 1990s than in the period since the 2001-03 tax cuts.¹⁹ Millions of jobs were created and real incomes grew across the income spectrum. About 18.2 million private-sector jobs were created in the six years after the top tax rate was raised to 39.6 percent in 1993, compared to only 4.7 million private-sector jobs created in the corresponding period after the 2001 Bush tax cuts, which does not even include job losses from the Great Recession.²⁰ Small businesses created jobs at a much faster rate when the Clinton-era tax code was in effect. Between 1993 and 2000 small businesses (those with fewer than 500 employees) added nearly a million jobs per year on average (973,000). But in the period after the Bush tax cuts were enacted in 2001 until the onset of the recession in 2007, small business job growth was less than twice as rapid (414,000 per year).²¹

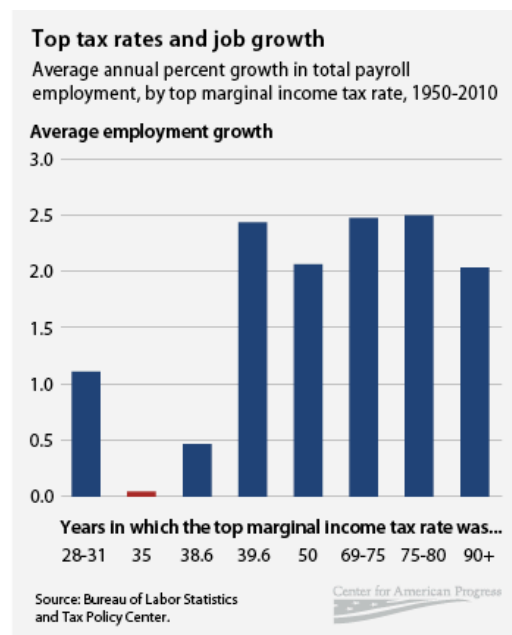
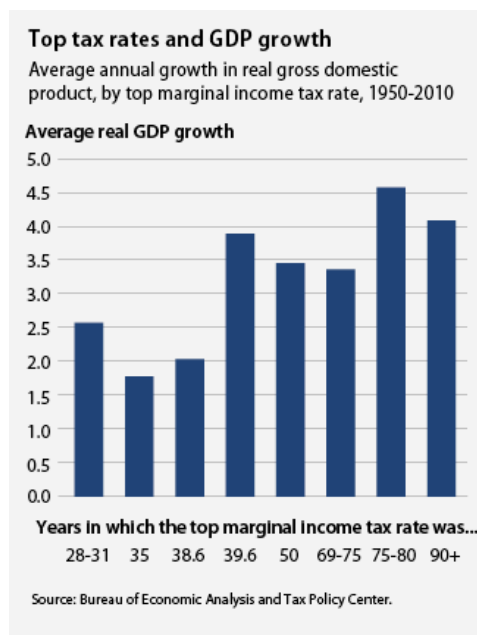


Also undermining the claim that small businesses will be harmed if the high-end Bush tax cuts expire on schedule is that only a very small percentage of small businesses owners are in the highest tax brackets. Only about 3 percent of small business owners are in the top two tax brackets.²²

And finally, the portion of the benefit of extending the high-end tax cuts going to small business employers is very small. A new Treasury report reveals that fully 92 percent of the tax benefit would go to corporate executives, investors, highly paid professionals, athletes, and other people who are not small business employers.²³

Two other points should be emphasized. First, even those in the 33 and 35 percent brackets would continue to benefit by about \$6,500 per year from extensions of the current *lower bracket* rates, which President Obama has proposed in each of his budgets. And they would only pay incrementally higher tax rates on dollars of income earned above the cutoffs for the top two brackets. A married business owner with \$300,000 in total income and \$250,000 in taxable income, for example, would pay only \$243 more under the rate structure in the president’s budget proposal than she is now—or less than 0.1 percent of her total income. A business owner with \$600,000 in total income and \$500,000 in taxable income would pay only about \$10,000 more—or only 1.5 percent of his total income. It is difficult to believe that a business owner would respond to these modestly higher personal tax bills by cutting payroll or foregoing promising investments. It is even more difficult to believe that the very prospect of such modest tax increases taking effect in 2013 would be chilling business investment today. It should also be emphasized that because labor costs are deductible, the marginal personal tax rate of the owners of a business has no impact on the business’s incentive to hire workers.

Top bracket rates of 36 and 39.6 percent are much lower than the top rates that existed for most of the history of the income tax, including the United States’s strongest periods of economic growth. The historical evidence shows that marginal rates higher than current rates are perfectly consistent with robust economic growth. As my colleague Michael Linden has found, the United States has experienced stronger economic growth and faster job creation in periods when top marginal tax rates were much higher than the current 35 percent.²⁴



In sum, there is little reason to believe that the expiration of the Bush-era marginal income tax rates on high-incomes will have a negative impact on economic growth or job creation. Rather, they will strengthen our economy's long-term prospects by contributing substantially to debt reduction. The expiration of the top two marginal rates is an important first step toward a fair and fiscally responsible tax code.

III. Corporate and business tax reform

Finally, I would like to address the corporate and business tax reform—in particular the need for tax reform that encourages rather than discourages job growth in the United States, levels the playing field among competing businesses, and ensures that U.S. companies pay their fair share.

The corporate tax is an important component of our tax system. It is the third largest federal revenue source, behind individual income and payroll taxes. It also provides a needed backstop to the individual income tax, preventing tax sheltering in corporations and helping to maintain the progressivity of the income tax. However, the corporate tax is in need of reform. In President Obama's words, "Over the years, a parade of lobbyists has rigged the tax code to benefit particular companies and industries. Those with accountants or lawyers to work the system can end up paying no taxes at all. But all the rest are hit with one of the highest corporate tax rates in the world. It makes no sense, and it has to change."

The president is right that the corporate tax code favors some industries over others, distorting investment and thereby impeding economic growth over the long-term. The corporate tax code is ripe for reform.

a. The corporate tax burden in context

As with individual taxes, the discussion of corporate tax reform must take into account the fiscal challenges facing the United States. Corporate taxes once contributed about 30 percent of federal revenues in the 1950s, but they have steadily declined and in recent years have averaged only about 10 percent of federal revenues. Corporate taxes represent a smaller portion of GDP in the United States than in other major economies.²⁵ With the diminishing corporate tax, the United States has relied more heavily on other taxes, in particular payroll taxes on wages. Payroll taxes, which were about 12 percent of federal revenues during the 1950s, have reached 40 percent of revenues.²⁶ The increasing share of business activity being conducted via "passthrough" entities, including S corporations and LLCs is partly responsible for the decline in corporate tax revenues. But also responsible is the fact that corporations are paying lower tax rates on their profits than they did in the recent past.²⁷

This is the case despite the fact that the United States's 35 percent statutory tax rate—the rate on the books—has not been lowered in 25 years and is now the second highest in the OECD. But solely focusing on the statutory rate leads to misperceptions about the overall tax rate actually paid by corporations, because it ignores the wide variety of tax preferences and loopholes that exist in the code. Corporate "tax expenditures," the special exemptions, deductions, and credits that companies use to reduce their tax bill, total roughly \$1.2 trillion over 10 years.²⁸ And not all

features of the tax code reducing corporate effective rates appear on the official tax expenditure lists.

The better measure of the actual tax paid by corporations is their effective rates. And corporate effective rates are much lower than the statutory 35 percent rate. Recent studies have found that the effective rates of large U.S. corporations are in line with or actually lower than their foreign counterparts.

- In 2007, a Treasury Department survey found that by one measure, the average tax rate paid by U.S. corporations from 2000-2005 was 13.4 percent—below the OECD average of 16.1 percent.²⁹ As the Treasury report summarized, “The contrast between [the United States’s] high statutory corporate income tax rate and low average corporate tax rate implies a relatively narrow corporate tax base, due to accelerated depreciation allowances, corporate tax preferences, and tax-planning incentives created by [the] high statutory rate.”³⁰
- A recent analysis of public company financial statements by Citizens for Tax Justice and the Institute for Taxation and Economic Policy, or CTJ/ITEP, found that 280 of the largest U.S. corporations paid an average effective tax rate of 18.5 percent over 2008-2010—just over half of the statutory rate.³¹
- A recent study of the effective tax rate paid by the largest 100 U.S. companies and 100 largest European Union companies over the last decade found that the American companies paid lower income tax rates, on average, than their European rivals.³²
- Other studies have found that corporate effective rates are closely in line with those in other large countries.³³

Because their success is bound to the success of the overall U.S. economy, U.S. corporations have a strong stake in our country’s fiscal sustainability and growth. They benefit greatly from U.S. government services, from law enforcement to product safety, to patent protection, to education and workforce development. Given these realities, the corporate sector should not be exempted from the process of deficit reduction. To take the corporate income tax off the deficit reduction table means that critical government services and public investments would face even deeper cuts, or that middle-class Americans would face a larger share of the tax burden. Neither alternative is desirable. The narrowness of the U.S. corporate tax base means that U.S. corporations can, on the whole, contribute a greater share of revenues. Accordingly, corporate tax reform should be at least revenue-neutral. Given the potential savings from broadening the corporate tax base, it should be possible to achieve deficit reduction from the corporate tax while still lowering the statutory rate.

b. International tax reform

The corporate tax code is replete with explicit subsidies and other preferences that cause economic distortions. One of the most significant distortions in the corporate code is its fundamental bias toward foreign investment over investment in the United States.

The debate over international taxes is often framed as a choice between “worldwide” and “territorial” tax systems. I would maintain that these labels obscure the more fundamental issues of whether our tax system encourages investment and job creation in the United States and whether it protects our revenue base.

Despite the fact that the United States nominally has a “worldwide” tax system, foreign profits are taxed very differently than domestic profits. Because of the feature known as “deferral,” U.S. multinationals can delay paying U.S. taxes on overseas profits indefinitely; whereas they pay taxes on domestic profits in the year they are earned. Overseas profits are taxed only when and if they are returned to the United States, as when they are paid out as dividends from overseas subsidiaries to U.S. parents. At that point corporations do not pay the U.S. corporate rate, but rather the difference between the U.S. corporate rate and the effective rate of foreign taxes they have paid. (This is because corporations are entitled to a credit for foreign taxes.)

Our current deferral system provides tax incentives for overseas investments. In fact, it encourages U.S. companies to make job-creating investments offshore even if similar investments in the United States (absent tax considerations) would be more profitable. As a result of “deferral” and other aspects of the U.S. international tax system, U.S. multinational corporations pay much lower tax rates on foreign investments than on domestic investments: In 2008, the Government Accountability Office, or GAO, found that corporations pay a 16.1 percent rate on foreign-source income (combining both the source country tax and the residual U.S. tax), and a 25.2 percent rate on U.S. source income.³⁴ In recent years, companies have become more adept at lowering the effective rate on foreign investments, and thus their overall effective tax rates, through complex tax strategies enabled by U.S. policy changes.³⁵ These strategies are only available to large multinationals.

The tax differential between foreign and domestic income not only puts a thumb on the scale in favor of offshore investment; it also creates enormous incentives for companies to use complex legal and accounting techniques to move income-producing assets to low-tax countries or tax havens, especially assets like valuable intellectual property that exist only on paper.³⁶ U.S. companies report their largest profits in small countries like the Netherlands, Luxembourg, and Bermuda—even though that is clearly not where the most real economic activity is taking place.³⁷ The U.S. Treasury, the Government Accountability Office, the Joint Committee on Taxation, and numerous independent researchers have published studies pointing to strong evidence of tax-motivated income shifting.³⁸ The resulting phenomenon has been called “stateless income”—profits that migrate to low-tax or no-tax jurisdictions, eroding the tax bases of the countries where the income is actually generated (*i.e.*, where the R&D is performed, the business decisions are made, where the customers are, and so on).

Corporate income shifting decimates the corporate revenue base, draining the United States of tens of billions of dollars in revenue every year. By one estimate, the U.S. government lost about \$90 billion in revenue in 2008 from corporate income shifting—up from \$60 billion in 2004.³⁹ To put that figure in perspective, the corporate income tax only raised an average of \$300 billion per year during the 2004-08 timespan.

These two problems—the bias toward overseas investment and the erosion of the tax base due to income shifting—could be made worse if the United States moves in the direction of a “territorial” tax system without more fundamental reforms. Under a territorial system, overseas profits would be tax-exempt, not just tax-deferred. The only remaining backstop against profit shifting, the tax upon repatriation, would be removed.

It is often said that the United States must move to a territorial system to maintain competitiveness with other countries that have adopted territorial taxation. But there is little evidence that U.S. firms’ global competitiveness is actually being undermined by the existing deferral system, which (because of the combination of deferral and other aspects of the tax code) often allows them to pay lower taxes than they would under a properly functioning territorial system.⁴⁰ Of course, the competitiveness of a company is determined mostly by nontax factors; but to the extent taxes matter, the key figure is the company’s relative effective tax rate. The most recent comprehensive survey of the effective tax rate paid by the largest 100 U.S. companies and 100 largest European Union companies over the last decade found that the American companies paid about the same or lower effective tax rates, on average, than their European rivals.⁴¹

As one of the authors of that study notes, the reason that EU companies have the same or higher effective rates is that EU countries have a broader tax base. Specifically, those countries have stronger antiabuse rules that deter the shifting of profits into tax havens.⁴² Rather than moving headlong toward territoriality, the United States should address income shifting directly. A good place to start would be to enact a rule requiring current U.S. taxation of income reported in low-tax countries or tax-havens. Many countries with “territorial” tax systems already have such rules.⁴³

c. Leveling the playing field among business investment by reducing inefficient tax code subsidies

Finally, corporate tax reform provides an opportunity to level the playing field between businesses and reduce the economic distortions caused by special tax preferences. The tax code contains some \$130 billion in annual tax expenditures benefitting businesses.⁴⁴ The approximately \$100 billion for corporations represents a significant share (one-quarter to one-half) of all corporate tax revenues.

The relative generosity of these types of subsidies helps lead to vast differentials in the relative tax burdens of various industrial sectors. For example, according to financial statement research by New York University professor Aswath Damodaran, drug and biotechnology firms paid a small fraction of the statutory rate (effective rates of 4.5 and 5.6 percent, respectively); while heavy construction and trucking firms paid close to 35 percent (33.8 percent and 30.9 percent, respectively). Financial services firms paid 16.5 percent, while petroleum producers paid 11.3 percent.⁴⁵ The recent CTJ/ITEP analysis of corporate effective rates also found that corporate effective tax rates vary widely by industry: Financial firms, for example, paid 15.5 percent effective rates; miscellaneous manufacturing paid 23.1 percent; and engineering and construction paid 27.4 percent. CTJ/ITEP found that 56 percent of total tax subsidies went to four industries: financial; utilities; telecommunications; and oil, gas, and pipelines.⁴⁶

By reducing unjustified preferences, Congress can level the playing field for competing investments. Removing tax-caused distortions can improve long-term economic growth; it can also reduce the deficit and potentially help pay for a corporate rate reduction.

To be sure, however, some business tax expenditures have economic justifications. The low-income housing tax credit, for example, helps address the dearth of affordable housing in many communities and cannot simply be eliminated. There is also a strong theoretical justification for the research tax credit, in that one firm's research and experimentation expenses may lead to innovations that benefit other firms and the broader economy. Congress should, however, conduct ongoing reviews of the credit's effectiveness in increasing innovative research above the levels that would exist in its absence. In general, Congress should apply the same level of scrutiny to these kinds of special tax breaks as it does to programs that spend taxpayer dollars directly. After all, as economists across the ideological spectrum recognize, tax "expenditures" are the economic equivalent of spending programs.⁴⁷

In reviewing the tax expenditure budget, the critical question is not whether the sectors that receive special tax breaks support jobs or economic activity—of course they do—but whether there is a strong enough public policy reason to give them taxpayer subsidies not available to other businesses. A useful framework for evaluating special tax provisions is whether, if they were structured as direct-spending programs, they would make economic sense or represent the best use of taxpayer dollars.

The need to scrutinize the effectiveness of business tax expenditures highlights one final point: Tax reform is hard. Fiscally responsible reforms to corporate taxes are probably not possible without reforms to other aspects of the tax code, potentially affecting individuals and noncorporate businesses. Reform is extremely complex, and must be done right, which will take time.

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That brings me back to my central point, which is that while tax reform has the potential to enhance our economy's growth prospects over the long-term, it should not distract Congress from the urgent jobs crisis facing America today.

Thank you once again for the opportunity to appear today.

¹ See Adam Hersh, *Misery is not an option: Economy needs more demand*, MarketWatch, July 29, 2011, http://www.marketwatch.com/story/misery-is-not-an-option-economy-needs-more-demand-2011-07-29?link=MW_story_latest_news.

² Congressional Budget Office, Detailed Economic Projections, CY 2011-2021; Actual Data, 1950-2009, <http://cbo.gov/doc.cfm?index=12316>.

³ Statement of Congressional Budget Office Director Douglas Elmendorf, “Confronting the Nation’s Fiscal Policy Challenges,” before the Joint Select Committee on Deficit Reduction, Sept. 13, 2011, <http://www.cbo.gov/ftpdocs/124xx/doc12413/09-13-FiscalPolicyChallenges.pdf>.

⁴ Ben Casselman & Justin Lahart, *Companies Shun Investment, Hoard Cash*, Wall St. Journal, Sept. 17, 2011.

⁵ See Lawrence Mishel, *Regulatory Uncertainty: A Phony Explanation for Our Jobs Problem*, (Washington: Economic Policy Institute, Sept. 27, 2011); Kristina Costa & Michael Linden, *Five Canards About Job-Killing Regulations*, (Washington: Center for American Progress, Oct. 21, 2011, http://www.americanprogress.org/issues/2011/10/regulation_canards.html).

⁶ Small business owners have identified “poor sales” as the single most important problem facing their businesses in recent surveys of small business owners conducted by the National Federation of Independent Businesses (NFIB). See Mishel, *Regulatory Uncertainty*, pp. 6-8.

⁷ Michael Ettlinger et al, *Spurring Job Creation in the Private Sector*, (Washington: Center for American Progress, Aug. 26, 2011), http://www.americanprogressaction.org/issues/2011/08/private_sector_jobs.html.

⁸ See Mark Zandi, *An Analysis of the Obama Jobs Plan*, Moody’s Analytics, Sept. 9, 2011, http://www.economy.com/dismal/article_free.asp?cid=224641; Macroeconomic Advisers, *American Jobs Act: A Significant Boost to GDP and Employment*, Sept. 8, 2011, <http://macroadvisers.blogspot.com/2011/09/american-jobs-act-significant-boost-to.html>.

⁹ The Center for American Progress recently proposed a comprehensive plan for balancing the budget, reforming the tax code, and promoting long-term growth. See Michael Ettlinger, Michael Linden & Seth Hanlon, *Budgeting for Growth and Prosperity* (Washington: Center for American Progress, May 2011), http://www.americanprogress.org/issues/2011/05/budgeting_for_growth.html. The plan was developed as part of the Solutions Initiative convened by the Peter G. Peterson Foundation.

¹⁰ This scenario would extend all of the 2001-03 tax cuts, “patch” the AMT, and maintain all current “tax extenders.” The current payroll tax holiday is not extended under this scenario.

¹¹ The co-chairs of the President’s Commission on Fiscal Responsibility and Reform (“Bowles-Simpson”) proposed to increase revenues to 20.5 percent of GDP by 2021; the Bipartisan Policy Center’s Debt Reduction Task Force (“Rivlin-Domenici”) raised revenues to 21.4 percent of GDP by 2021; and the rough outline from the Senate’s “Gang of Six” would raise revenues to 19.9 percent of GDP by 2021. See Michael Linden, *Obama Plan Lighter on Taxes than Bipartisan Plans*, (Washington: Center for American Progress, Sept. 26, 2011), http://www.americanprogress.org/issues/2011/09/obama_plan_revenue.html.

¹² Thomas Picketty & Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, Quarterly Journal of Economics, 118(1), 2003, 1-39 (and 2008 update), available at <http://elsa.berkeley.edu/~saez/>.

¹³ Seth Hanlon, *Making More, Contributing Less* (Washington: Center for American Progress, Aug. 4, 2011), http://www.americanprogress.org/issues/2011/08/millionaire_tax_rates.html.

¹⁴ Congressional Budget Office, *Average Federal Taxes by Income Group* (June 2010).

¹⁵ Tax Policy Center, Table T11-0207. “Millionaires” are households with more than \$1,000,000 in cash income.

¹⁶ At 15 percent, the tax rate on long-term capital gains is the lowest since the 1930s; the 15 percent rate on qualified dividends is the lowest ever.

¹⁷ Congressional Budget Office, *Average Federal Taxes by Income Group* (June 2010) (2007 figures). CBO attributes employer-side payroll taxes to workers.

¹⁸ These figures include all federal taxes. See Thomas L. Hungerford, *An Analysis of the “Buffett Rule”* (Congressional Research Service, October 7, 2011); Sarah Ayres, *The Three Things You Need to Know About Millionaire Tax Rates* (Washington, Center for American Progress, Oct. 14, 2011), http://www.americanprogress.org/issues/2011/09/millionaire_fast_facts.html.

¹⁹ See Michael Ettlinger & John Irons, *Take a Walk on the Supply Side* (Washington, Center for American Progress, Sept. 12, 2008), http://www.americanprogress.org/issues/2008/09/supply_side.html.

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- ²⁰ Bureau of Labor Statistics, Total Private Employment (comparing August 1993 – February 2000; June 2001 – December 2007).
- ²¹ U.S. Small Business Administration, Office of Advocacy, based on data provided by the U.S. Census Bureau, Statistics of U.S. Business and Nonemployer Statistics, available at http://www.sba.gov/sites/default/files/files/us_timeseries.pdf.
- ²² See Joint Committee on Taxation, *President Law and the President's Fiscal Year 2011 Budget Proposals Related to Selected Individual Income Tax Provisions Scheduled to Expire under the Sunset Provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001* (JCT 36-10, July 14, 2010), p. 10; Urban-Brookings Tax Policy Center, Table T10-0186 (finding that only 2.5 percent of tax units reporting business income of any kind, and 3.2 percent of those reporting positive business income, would have fallen into the top two tax brackets in 2011 under President Obama's proposal to allow the 2001-03 tax cuts to expire for top earners).
- ²³ This figure was derived by economist Martin A. Sullivan (Tax Notes, Sept. 12, 2011) from recent Treasury data in Knittel et al, *Methodology to Identify Small Businesses and Their Owners*, Office of Tax Analysis, Technical Paper 4, Aug. 2011.
- ²⁴ Michael Linden, *The Myth of the Lower Marginal Rates* (Washington: Center for American Progress, June 20, 2011), http://www.americanprogress.org/issues/2011/06/marginal_tax_charticle.html; Linden, *Rich People's Taxes Have Little to Do with Job Creation* (Washington: Center for American Progress, June 27, 2011), http://www.americanprogress.org/issues/2011/06/marginal_tax_employment_charticle.html.
- ²⁵ U.S. Dep't of Treasury, *Treasury Conference on Business Taxation and Global Competitiveness, Background Paper* (July 23, 2007), table 5.3, <http://www.treasury.gov/press-center/press-releases/Documents/07230%20r.pdf>.
- ²⁶ OMB Historical Tables, table 2.2.
- ²⁷ Citizens for Tax Justice and the Institute for Taxation and Economic Policy have been analyzing the financial statements of the largest U.S. corporations since the early 1980s. The corporations included in their study paid an average effective tax rate of 14.1 percent in 1981-83, which rose to 26.5 percent shortly after the Tax Reform Act of 1986. In 1996-98 the average effective rate fell to 21.7 percent; and in 2002-03 it had fallen to 17.2 percent. The latest study, based on 280 profitable companies over the years 2008-10, found that the corporations paid an average effective rate of 18.5 percent. See Citizens for Tax Justice and the Institute for Taxation and Economic Policy, *Corporate Taxpayers & Corporate Tax Dodgers, 2008-10*, <http://ctj.org/corporatetaxdodgers/>, p. 9.
- ²⁸ See U.S. Dep't of Treasury, *Treasury Conference on Business Taxation and Global Competitiveness, Background Paper* (July 23, 2007), table 2.1, <http://www.treasury.gov/press-center/press-releases/Documents/07230%20r.pdf>.
- ²⁹ U.S. Dep't of Treasury, *Treasury Conference on Business Taxation and Global Competitiveness, Background Paper* (July 23, 2007), table 5.3, <http://www.treasury.gov/press-center/press-releases/Documents/07230%20r.pdf>. Using OECD data, the Treasury study divides corporate operating surplus by corporate remittances to derive a measure of average tax rates in each country.
- ³⁰ *Treasury Background Paper (2007)*, p. 43.
- ³¹ The CTJ/ITEP analysis only included companies that reported profits in all three years.
- ³² Reuven Avi-Yonah & Yaron Lahav, *The Effective Tax Rates of the Largest U.S. and E.U. Multinationals* (draft of Oct. 24, 2011), available at <http://ssrn.com/abstract=1949226>.
- ³³ A summary of such studies is found in Jane Gravelle, *International Corporate Tax Rate Comparisons and Policy Implications* (Washington: Congressional Research Service, Mar. 31, 2011).
- ³⁴ Government Accountability Office, *U.S. Multinational Corporations: Effective Tax Rates Are Correlated with Where Income Is Reported* (GAO-08-950, Aug. 2008), <http://www.gao.gov/new.items/d08950.pdf>.
- ³⁵ Roseanne Altshuler & Harry Grubert, *The Three Parties in the Race to the Bottom: Host Governments, Home Governments, and Multinational Companies*, 7 Fla. Tax Rev. 154 (2005) (attributing the decline to tax planning strategies developed after the introduction of the U.S. Treasury's "check the box" regulations in 1997); Edward D. Kleinbard, *Stateless Income*, 11 Fla. Tax Rev. __ (2011) (forthcoming), pp. 33-57 (also discussing the enactment of IRC section 954(c)(6) in 2004).
- ³⁶ Several illustrative (anonymous) examples of these techniques are described in Joint Committee on Taxation, *Present Law and Background Related to Possible Income Shifting and Transfer Pricing* (JCX 37-10, July 20, 2010).
- ³⁷ See Kimberly A. Clausing, *The Revenue Effects of Multinational Firm Income Shifting*, Tax Notes (March 30, 2011).
- ³⁸ Dep't of the Treasury, *Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties* (Nov. 2007); GAO (2008); Joint Committee on Taxation, *Present Law and Background Related to Possible*

Income Shifting and Transfer Pricing (JCX 37-10); Michael McDonald, *Income Shifting from Transfer Pricing: Further Evidence from Tax Return Data* (Dep't of Treasury, Office of Tax Analysis Technical Working Paper 2, July 2008); Statement of Martin A. Sullivan, "Transfer Pricing Issues in the Global Economy," before the Committee on Ways and Means, U.S. House of Representatives, July 22, 2010; Kimberly A. Clausing, *The Revenue Effects of Multinational Firm Income Shifting*, Tax Notes (Mar. 28, 2011).

³⁹ Kimberly A. Clausing, *The Revenue Effects of Multinational Firm Income Shifting*, Tax Notes (March 30, 2011). Martin Sullivan cites \$28 billion annually as a "lower bound" estimate. Sullivan, 7/22/10 testimony.

⁴⁰ J. Clifton Fleming Jr., Robert J. Peroni & Stephen E. Shay, *Worse than Exemption*, 59 Emory L.J.79 (2009).

⁴¹ Reuven Avi-Yonah & Yaron Lahav, *The Effective Tax Rates of the Largest U.S. and E.U. Multinationals* (draft of Oct. 24, 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1949226.

⁴² Avi-Yonah & Lahav, p. 7.

⁴³ Joint Committee on Taxation, *Background and Selected Issues Related to the U.S. International Tax System and Systems that Exempt Foreign Business Income* (JCX 33-11, May 20, 2011).

⁴⁴ President's Economic Recovery Advisory Board, *The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation* (Aug. 2010).

⁴⁵ Professor Damodaran's complete chart is available at <http://www.stern.nyu.edu/~adamodar/pc/archives/dbtfund09.xls>

⁴⁶ See Citizens for Tax Justice and the Institute for Taxation and Economic Policy, *Corporate Taxpayers & Corporate Tax Dodgers, 2008-10*, <http://ctj.org/corporatetaxdodgers/>, p. 8.

⁴⁷ Several economists and tax experts emphasized this point at a recent Senate Finance Committee hearing. Former Federal Reserve Board Chairman Alan Greenspan said: "Cuts in tax expenditures can be alternatively structured, and viewed, as cuts in outlays rather than a reduction in revenues. The deduction for interest on home mortgages, for example, could just as easily have been reconstituted as a subsidy payment to homeowners. Similarly, oil and gas depletion allowances could be restructured as subsidies to producers." President Ronald Reagan's chief economic advisor, Martin Feldstein, testified that when tax expenditures are reduced, "the economic effect is the same as any other reduction in government outlays." Edward Kleinbard, former director of Congress's Joint Committee on Taxation, explained that "deliberate Congressional subsidy programs baked into the tax code ... are a form of government spending, not tax reductions." Senate Finance Committee Hearing, "Examining Whether There is a Role for Tax Reform in Comprehensive Deficit Reduction and U.S. Fiscal Policy," Sept. 13, 2011.