

TAX REFORM

Position

RILA supports tax policies that spur economic growth by maintaining low income tax rates to help taxpayers keep more of what they earn for savings, investment, and spending. RILA also supports tax policies that will improve the business climate for retailers, both domestically and internationally, by helping them continue creating jobs and bring price-competitive value to American consumers. Contrary to these goals would be a consumption-based tax system, such as a national sales tax.

Recent Activity

Several bills have been introduced in the 111th Congress concerning fundamental tax reform. Major initiatives include:

- The Flat Tax Act of 2009¹ (S. 741), introduced by Sen. Arlen Specter (D-PA), and the Simplified, Manageable and Responsible Tax (SMART) Act (S. 932),² introduced by Sen. Richard Shelby (R-AL), both of which would replace the current tax system with a flat tax for individual taxpayers and a modified value-added tax for businesses.
- The Freedom Flat Tax (H.R. 1040),³ introduced by Rep. Michael Burgess (R-TX) and the Optional One Page Flat Tax (S. 963),⁴ introduced by Sen. Lamar Alexander (R-TN), which would allow taxpayers to elect an alternative tax system that would replace the individual income tax with a flat tax and the business income tax with a modified value-added tax.
- The Fair Tax Act of 2009 (H.R. 25,⁵ S. 296⁶), introduced by Rep. John Linder (R-GA) and Sen. Saxby Chambliss (R-GA), which would replace the federal income tax with a national sales tax.
- The Fair Flat Tax Act (S. 1111 – 110th Congress), introduced by Senator Ron Wyden (D-OR), which models reform on the structure of the 1986 Tax Reform Act.⁷

Although some of these plans for fundamental tax reform are more specific than others, none of the proposals has the level of detail that would be required to make a plan completely operational, and significant transitional considerations have yet to be addressed.

While short of overall reform, House Ways and Means Committee Chairman Charles Rangel (D-NY) introduced a \$1.3 trillion tax measure in the 110th Congress, the Tax Reduction and Reform Act of 2007 (H.R. 3970),⁸ which focused heavily on reform of the Alternative Minimum Tax and modification of the international tax rules. Although the legislation did not receive a hearing or markup, it continues to serve as a marker for Chairman Rangel's broader reform agenda.

To date, the Obama Administration has not put forth a tax reform plan. However, on July 25, 2009, President Obama named former Federal Reserve Chairman Paul Volcker to head up a panel to review the current tax code, close loopholes, streamline the law, and generate revenue. The panel also includes Martin Feldstein, Laura D'Andrea Tyson, Roger Ferguson, and William Donaldson. While the panel has few constraints shaping its recommendations – namely, no tax increase in 2009 and 2010 and no tax increase on families earning less than \$250,000 a year – the serious deficit projections for the next ten years and ballooning national debt create significant pressure for the recommendations to raise substantial revenues, which could include proposals to supplement the current tax system, such as through a national sales tax. RILA submitted a letter to the panel in December 2009, detailing RILA's principles for tax reform.⁹ The letter also recommended a reduction in the corporate tax rate and preservation of low rates on capital gains and dividends, and opposition to a national retail sales tax. The panel is expected release recommendations early in 2010.

Action Needed

As part of any major tax reform proposal, it is important to recognize that the current rules governing individual taxation and domestic and international taxation are inexorably intertwined. Accordingly, fundamental tax reform must address all aspects of the tax system, and Congress should focus on the following principles:

- *Keep tax rates low* – Enabling individuals to keep more of what they earn encourages savings and enables them to make purchases of needed consumer products, which also has the benefit of providing a major stimulus to the economy including sustained, improved retail sales. Similarly, low tax rates help American businesses by increasing capital for investment and job creation.
- *Enact simple, predictable and easy to understand tax rules* – A tax system that individual and business taxpayers can easily understand will improve compliance and reduce the cost of tax administration.
- *Establish tax rules that are consistent with economic reality* – For business taxpayers in particular, tax rules need to result in appropriate timing and accurate reflection of income without arbitrary rules that, for example, delay deductions beyond the period in which the income is earned or set depreciation periods inconsistently with the real economic life of the property.
- *Ensure the tax system fosters business competitiveness and promotes economic growth* – In an increasingly global economy, the tax system should not hinder the ability of U.S. businesses to compete internationally as well as domestically against foreign firms. A tax code that treats business fairly and equitably will minimize burdens on compliance and decision-making, thereby enhancing the productive capacity of U.S. businesses and the U.S. economy.
- *Implement reforms that ensure industry-specific neutrality* – Business decisions should be based on economic benefits of the particular transaction, not driven by special tax benefits targeted to one industry versus another. The economy does not benefit when the government chooses winners and losers through the tax code. Accordingly, tax reform should allow the marketplace, not the tax system, to allocate capital and resources appropriately.
- *Avoid a whole-scale change in the tax base* – Dramatic shifts in tax policy, such as implementing a national retail sales tax, would be immensely disruptive to the economy and particularly detrimental to lower-income workers and families.
- *Make changes permanent and ensure certainty* – A new tax system must be permanent, not littered with expiring provisions that cause uncertainty for families saving for college and retirement and business striving to expand, create jobs, and remain competitive in the United States and abroad.
- *Provide realistic transitions rules* – Significant changes to the current tax system will create substantial burdens on taxpayers, especially in the business sector, to ensure compliance. Establishing transition rules that provide adequate time for implementation and that take into account existing agreements, practices, and other requirements is essential for the success of any new tax system.

RILA looks forward to working with policymakers at all levels of government to implement meaningful tax reform that includes provisions that support the retail industry, help it grow, and create jobs.

Background

Retail is vital to our nation's economy, representing one of the largest industry sectors in the United States with 15 million jobs and \$3.96 trillion in annual sales in 2008. The industry pays billions of dollars in federal, state, and local income taxes, and collects and remits billions more in state and local sales taxes.

Many policymakers contend that the current federal tax system is overly complex and in dire need of reform. The last major overhaul of the system occurred with the enactment of the Internal Revenue Code of 1986, which compressed 15 individual income tax brackets down to two and restructured much of the corporate tax system as well.

Since 1986, Congress has made thousands of changes to the tax code increasing its complexity and the resulting compliance burdens for individuals and businesses alike. Periodically, over the past two decades efforts to reform the tax code have been started, but none have reached fruition.

One recent example was the President's Panel on Federal Tax Reform, established by President Bush. On November 1, 2005, the Panel released its final report, which recommended two options to reform the tax code.¹⁰ The first, the Simplified Income Tax Plan, would eliminate most of the current targeted tax deductions and hidden taxes like the Alternative Minimum Tax, and lower tax rates. It also proposed an updated corporate tax regime to help American corporations compete in global markets. The second option, the Growth and Investment Tax Plan, expanded on the Simplified Income Tax Plan by seeking to eliminate the tax on individual savings and businesses investments by establishing a single, low tax rate on dividends, interest, and capital gains and allowing businesses to expense their investments immediately. Notably, the Panel's report did not include a recommendation for a National Retail Sales Tax (NST) or Value Added Tax (VAT).

Two years later, on December 20, 2007, the Treasury Department released a study outlining three broad approaches to overhauling the corporate tax code.¹¹ The first approach would replace the corporate income tax with a business activity tax (BAT) with a tax rate between 5 percent and 6 percent to achieve revenue neutrality. Companies would be taxed on gross receipts, minus the cost of goods and services purchased from other businesses. Because wages would no longer be deductible, this approach would raise business taxes on labor. Treasury estimated this approach would improve economic performance, ultimately increasing the size of the economy by roughly 2.0 percent to 2.5 percent over the long term.

The second option would lower the maximum corporate tax rate (currently 35 percent) by eliminating the majority of business tax deductions, including the research and development tax credit, deduction for charitable contributions, and low-income housing tax credit. Of particular importance to retailers, this approach did not contemplate changes to the last-in, first-out method of accounting. This approach would also implement a territorial system for the taxation of U.S. companies' foreign earnings. Treasury estimated that to maintain revenue neutrality the rate could be lowered to 28 percent with full business-tax base broadening or 31 percent if accelerated depreciation was retained. However, the report noted that at such tax rates, this approach would not provide much, if any, net gain to the U.S. economy. In addition, U.S. statutory business tax rates would still be higher than those of most Organisation for Economic Cooperation and Development (OECD) countries. Treasury estimated that business tax rates would have to be cut dramatically (e.g., 20 percent) or greater equipment expensing would have to be provided in order to achieve more significant benefits to the U.S. economy.

Third, short of full reform of the tax code, the Treasury study offered a package of proposals aimed at specific areas of the business tax system that could be modified, including elimination of multiple taxation of corporate profits through a corporate capital gains rate and dividends received deduction, modification of the tax bias favoring debt financing, improvements to the taxation of international income, broader allowance of losses, improvements to book-tax conformity, and other areas to improve tax administration.

Contact

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Additional References

- RILA Issue Brief: International Tax Reform
- RILA Issue Brief: National Retail Sales Tax
- RILA Issue Brief: Streamlined Sales Tax

¹ Flat Tax Act of 2009, S. 741, 111th Cong., 1st Sess. (Mar. 30, 2009) – available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s741is.txt.pdf.

² Simplified, Manageable and Responsible Tax Act, S. 932, 111th Cong., 1st Sess. (April 30, 2009) – available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s932is.txt.pdf.

³ Freedom Flat Tax Act, H.R. 1040, 111th Cong., 1st Sess. (Feb. 12, 2009) – available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1040ih.txt.pdf.

⁴ Optional One Page Flat Tax Act, S. 963, 111th Cong., 1st Sess. (May 4, 2009) – available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s963is.txt.pdf.

⁵ Fair Tax Act of 2009, H.R. 25, 111th Cong., 1st Sess. (Jan. 6, 2009) – available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h25ih.txt.pdf.

⁶ Fair Tax Act of 2009, S. 296, 111th Cong., 1st Sess. (Jan. 22, 2009) – available at: http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s296is.txt.pdf.

⁷ Fair Flat Tax Act of 2007, S. 1111, 110th Cong., 1st Sess. (April 16, 2007) – available at:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s1111is.txt.pdf.

⁸ Tax Reduction and Reform Act of 2007, H.R. 3970, 110th Cong., 1st Sess. (Oct. 25, 2007) – available at:

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3970ih.txt.pdf.

⁹ Letter from Katherine Lugar, Executive Vice President, Public Affairs, Retail Industry Leaders Association, to the Honorable Paul Volker, Chairman, President's Economic Recovery Advisory Board, regarding tax reform proposals (Dec. 31, 2009) – available at: <http://www.rila.org/governmentaffairs/Government%20Documents/PERABTaxReform123109.pdf>.

¹⁰ President's Advisory Panel on Federal Tax Reform, Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System (Nov. 1, 2005) – available at: <http://govinfo.library.unt.edu/taxreformpanel/>.

¹¹ U.S. Department of the Treasury, Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century (Dec. 20, 2007) – available at: http://www.treas.gov/press/releases/reports/hp749_approachesstudy.pdf.