Title of Hearing: "Creating Opportunity Through a Fairer Tax System"
Date of Hearing: April 27, 2021
Name of Individual: Andrew Lautz
Organization of Individual: National Taxpayers Union
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The Honorable Elizabeth Warren
Chair, Subcommittee on Fiscal Responsibility and Economic Growth
219 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Bill Cassidy
Ranking Member, Subcommittee on Fiscal Responsibility and Economic Growth
520 Hart Senate Office Building
Washington, D.C. 20510

Dear Chair Warren, Ranking Member Cassidy, and Members of the Subcommittee:

On behalf of National Taxpayers Union (NTU), the nation's oldest taxpayer advocacy organization, I wish to submit this statement for your hearing "Creating Opportunity Through a Fairer Tax System." NTU has advocated for a simpler, fairer, and more growth-oriented tax code for all 51-plus years of our existence, so we welcome your broad focus on reforming and improving the U.S. tax system. However, we are concerned that some of the proposals that may be discussed today -- such as a national wealth tax, a minimum tax on corporations' "book profits," and a swift and significant increase to the budget of the Internal Revenue Service (IRS) without accompanying reforms -- could make the tax code more complex, less fair, and, in turn, stunt economic growth at a fragile point in the country's recovery from the COVID-19 pandemic.

A National Wealth Tax Would Be Extremely Difficult to Administer, Could Adversely Bias Investment Decisions, and Raises Legal and Constitutional Concerns

My colleagues at NTU and NTU Foundation (NTUF) have written extensively on national wealth tax proposals, both in the abstract and in response to Chair Warren's specific wealth tax proposal. We have raised a number of concerns that your latest proposal falls short of addressing.

The first and perhaps foremost concern is the significant challenges the IRS would face in administering a wealth tax. Experts from across the ideological spectrum have raised legitimate questions over how the IRS would value intangible assets, how the agency would handle valuation appeals, and how those responsible for collecting the wealth tax would tackle tax planning and avoidance measures that reduce a taxpayer's base.

As Lawrence Summers, former Treasury Secretary under President Obama, co-wrote with law and finance professor Natasha Serin in a 2019 *Washington Post* op-ed:

> We suspect that to a great extent [the discrepancy between our estimate for wealth tax revenue and the estimate from economists Emmanuel Saez and Gabriel Zucman] reflects the myriad ways wealthy people avoid paying estate taxes that in some form will be applicable in any actually legislated wealth tax. These include questionable appraisals; valuation discounts for illiquidity and lack of control; establishment of trusts that enable division of assets among family members with substantial founder control; planning devices that give some income to charity while keeping the remainder for the donor and her beneficiaries; tax-advantaged lending schemes; and other complex devices known only to sophisticated investors. Except for reducing a naive calculation by 15 percent, Saez and Zucman do not seem to take account of these devices.[1]

Unfortunately, the "Ultra-Millionaire Tax Act of 2021," as currently written, defers all the work of developing a valuation methodology to the Department of Treasury, and instructs them to finish their work in a mere 12 months. This is an inordinate task to put on regulators in a short amount of time, and lawmakers should instead heed the lessons of multiple European countries that struggle to administer a wealth tax. As one report from *National Public Radio (NPR)* explained:

> In 1990, twelve countries in Europe had a wealth tax. Today, there are only three: Norway, Spain, and Switzerland. According to reports by the OECD and others, there were some clear themes with the policy: it was expensive to administer, it was hard on people with lots of assets but little cash, it distorted saving and investment decisions, it pushed the rich and their money out of the taxing countries—and, perhaps worst of all, it didn't raise much revenue.[2]

Indeed, experts at the Organisation for Economic Co-operation and Development (OECD) have found that wealth taxes "[reduce] the amount of capital available, which may in turn affect entrepreneurship and business creation as access to capital is an important determinant of an individual's propensity to start a business."[3]

NTUF's Andrew Wilford raised additional concerns over the potential impact a wealth tax could have on charitable contributions to private foundations and on market competitiveness (should smaller, start-up companies with reduced access to capital need to sell their businesses more often to larger competitors).[4]

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[1] Summers, Lawrence H., and Sarin, Natasha. "Opinion: A 'wealth tax' presents a revenue estimation puzzle." *The Washington Post*, April 4, 2019. Retrieved from: https://www.washingtonpost.com/opinions/2019/04/04/wealth-tax-presents-revenue-estimation-puzzle/?noredirect=on (Accessed April 21, 2021.)

[2] Rosalsky, Greg. "If a Wealth Tax is Such a Good Idea, Why Did Europe Kill Theirs?" *National Public Radio*, February 26, 2019. Retrieved from: https://www.npr.org/sections/money/2019/02/26/698057356/if-a-wealth-tax-is-such-a-good-idea-why-did-europe-kill-theirs (Accessed April 21, 2021.)

[3] OECD. (2018). "The Role and Design of Net Wealth Taxes in the OECD." Retrieved from: https://read.oecd-ilibrary.org/taxation/the-role-and-design-of-net-wealth-taxes-in-the-oecd_9789264290303-en (Accessed April 21, 2021.)

[4] Wilford, Andrew. "Warren's Recycled Wealth Tax Plan Suffers From All the Same Faults as Previous Versions." NTU Foundation, April 1, 2021. Retrieved from: https://www.ntu.org/foundation/detail/warrens-recycled-wealth-tax-plan-suffers-from-all-the-same-faults-as-previous-versions

Wilford also noted the numerous legal or constitutional concerns with the proposed wealth tax as designed in the "Ultra-Millionaire Tax Act":

> The first major legal barrier, not unique to Warren's specific proposal but pertinent nonetheless, is the Constitutional requirement that "direct taxes" be apportioned equally among the states based on population. Back in 1895, the Supreme Court ruled in *Pollock v. Farmers Loan and Trust Company* that income taxes violated this Constitutional requirement that direct taxes be equally apportioned. Now, taxpayers are on the hook for income taxes today because the Sixteenth Amendment overrode this decision via the appropriate constitutional process, but it did so specifically for income taxes.
>
> Wealth taxes would still be subject to this constitutional requirement.
>
> ...Warren's framework does raise another unique problem, however. The right to exit a country has been recognized as a fundamental human right since the time of the Magna Carta, and was confirmed by the U.N. Universal Declaration of Human Rights in 1948. In the United States, the Supreme Court ruled in *Kent v. Dulles* (1958) that the Fifth Amendment protects the right to exit.[5]

For all of the above reasons and more, lawmakers should swiftly and completely abandon wealth tax proposals, which would likely fall well short of even the stated goal of developing a fairer U.S. tax system.

Minimum Taxes on Corporate "Book Profits" Would Cut Against Legitimate, Growth-Oriented Provisions of the Code, Potentially Reducing Investment and Harming Job, Wage, and Economic Growth

In a viral exchange you had with Dr. Kimberly Clausing at a recent Senate Finance Committee hearing, Chair Warren referred to legitimate provisions of the tax code such as expensing for research and development (R&D) costs, carryforwards for net operating losses (NOLs), and deductions for employee stock compensation as "loopholes and tax shelters."[6] With respect, we could not disagree more strongly with this assessment.

As Members of the Subcommittee well know, the tax code includes many cost recovery provisions for U.S. businesses, including a variety of tax deductions and credits for business activities that lawmakers have determined are worth incentivizing in the code. In the case of Amazon, the company discussed in this viral exchange, experts have shared in the pages of the *Wall Street Journal*[7] and at NTUF[8] that Amazon's delta between taxable profits and so-called "book profits" can be explained by a number of legitimate provisions of the code mentioned above, including R&D incentives and NOLs.

This brings us to your proposal, Chair Warren, to establish a minimum 15 percent tax on companies' "book income." As you know, President Biden has adopted this proposal for his "Made in America Tax Plan."[9]

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[5] *Ibid*.
[6] @SenWarren. (March 25, 2021). Twitter. Retrieved from: https://twitter.com/SenWarren/status/1375189145476288513 (Accessed April 21, 2021.)
[7] Rubin, Richard. "Does Amazon Really Pay No Taxes? Here's the Complicated Answer." *The Wall Street Journal*, June 14, 2019. Retrieved from: https://www.wsj.com/articles/does-amazon-really-pay-no-taxes-heres-the-complicated-answer-11560504602 (Accessed April 21, 2021.)
[8] Kaeding, Nicole. "Profitable Companies Aren't Always Profitable." NTU Foundation, January 28, 2020. Retrieved from: https://www.ntu.org/foundation/detail/profitable-companies-arent-always-profitable (Accessed April 21, 2021.)
[9] U.S. Department of the Treasury. (April 2021). "The Made in America Tax Plan." Retrieved from: https://home.treasury.gov/system/files/136/MadeInAmericaTaxPlan_Report.pdf (Accessed April 21, 2021.)

We have numerous concerns with this proposed tax increase, as we outlined shortly after President Biden introduced the plan:

> To use an oversimplified example, a company that experiences a $100 million net operating loss in one year but a $10 million net operating profit over each of the next 10 years may ultimately pay nothing in corporate income tax under current law. Under Biden's plan, though, not only would that company have $0 in net profit over 11 years but they would pay an additional $15 million in minimum "book income" taxes over that period, reducing their net profits over the 11-year period to below zero.[10]

That oversimplified example only considers a business taking NOL carryforwards. Additional businesses could be punished under a minimum tax on "book income" simply for investing in R&D, or for providing their employees with a competitive level of compensation. Companies with high revenue but low profit margins would see profits further reduced under such a proposal, forcing difficult tradeoffs at those companies that could, in turn, negatively impact job, wage, and economic growth. The Tax Foundation estimated that an earlier version of President Biden's minimum tax proposal "would reduce long-run economic output by about 0.21 percent in combination with Biden's other tax proposals" (such as an increase in the corporate tax rate from 21 percent to 28 percent).[11]

For all of the above reasons and more, lawmakers should abandon plans to establish a minimum corporate tax on "book profits." Doing so could harm America's leading job creators at a fragile point in the country's economic recovery from a swift but severe recession.

<u>A Bloated IRS Budget Will Not Produce a Fairer Tax System Without Accompanying Reforms</u>

As NTU Foundation's Andrew Wilford noted in his analysis of the "Ultra-Millionaire Tax Act":

> Warren's solution to this problem is to throw money at the IRS and hope they can figure it out. Warren would spend $100 billion over ten years to "rebuild and strengthen" the IRS — more than eight times the agency's entire FY 2021 operating budget. Of this amount, 70 percent would be devoted simply to enforcing the wealth tax. Beyond that, there's little in the way of practical solutions to administrative difficulties Warren's wealth tax would face.[12]

Indeed, throwing money at the Internal Revenue Service (IRS) without accompanying reforms could have the opposite effect intended by lawmakers here, making the tax code less fair and less efficient. NTU and NTU Foundation have closely tracked IRS reform efforts for decades, and significant additional work is necessary before lawmakers hand the IRS a proverbial wad of cash that significantly outstrips current funding.

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[10] Lautz, Andrew; Aiello, Thomas; and Yepez, Will. "13 Reasons Why Biden's American Jobs Plan Is a Bad Deal for Taxpayers." National Taxpayers Union, April 1, 2021. Retrieved from: https://www.ntu.org/publications/detail/13-reasons-why-bidens-american-jobs-plan-is-a-bad-deal-for-taxpayers

[11] Watson, Garrett, and McBride, William. "Evaluating Proposals to Increase the Corporate Tax Rate and Levy a Minimum Tax on Corporate Book Income." Tax Foundation, February 24, 2021. Retrieved from: https://taxfoundation.org/biden-corporate-income-tax-rate/#Key (Accessed April 21, 2021.)

[12] Wilford, Andrew. "Warren's Recycled Wealth Tax Plan Suffers From All the Same Faults as Previous Versions." NTU Foundation, April 1, 2021. Retrieved from: https://www.ntu.org/foundation/detail/warrens-recycled-wealth-tax-plan-suffers-from-all-the-same-faults-as-previous-versions

NTU worked closely with the late Rep. John Lewis (D-GA) on IRS reform, who often noted the disproportionate impact tax compliance and enforcement had on small businesses and on communities of color. [13] In 2017, NTU President Pete Sepp issued several broad recommendations to then-Secretary of Treasury Steven Mnuchin on how to improve the IRS, including focusing on key areas of complexity and measuring tax compliance burdens more accurately.[14] While the IRS has no doubt made progress since then, in part due to the passage of the bipartisan Taxpayer First Act and in part due to the tax simplicity gains made under the Tax Cuts and Jobs Act (TCJA), much work remains to be done on all the recommendations NTU issued four years ago.

NTU and NTU Foundation have also expressed regular concern over "shifting positions and ambiguous regulations" from the IRS when it comes to enforcement. For instance, in the one area of conservation easement deductions:

> Despite cross-partisan congressional support for conservation easement deductions, the IRS has engaged in draconian enforcement actions, new rules issued without public input and applying retroactively, and zealous valuation denials against many taxpayers who claim them.[15]

Needless to say, developing, implementing, and administering a wealth tax regime (or even a minimum corporate tax) would likely be orders of magnitude more difficult than the current conservation easement debacle at the IRS, and significantly increasing the agency's budget to do so without necessary reform proposals should be a non-starter for lawmakers. While lawmakers and tax policy experts have legitimate concerns about the tax gap that may be addressed by IRS reform and a more efficient allocation of resources, a big budget hike for the IRS is not the solution some lawmakers think it is.

Alternatives to Building a Fairer Tax System

To the extent that lawmakers can reduce or eliminate tax provisions that make the code less efficient and/or provide a disproportionate amount of benefits to wealthy households *without corresponding economic benefits*, NTU believes that several reform options could accomplish the stated goals of this hearing without adversely impacting investment decisions or harming economic growth. Possible reform options include, but are not limited to:

- **Repealing the state and local tax (SALT) deduction**, which currently confers nearly 90 percent of benefits to households making six figures or more per year.[16] This deduction results in more than $20 billion per year in forgone revenue, and incentivizes states and municipalities to raise taxes on their residents and businesses.

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[13] Sepp, Pete. "An Appreciation: Congressman John Lewis, 1940-2020." National Taxpayers Union, July 27, 2020. Retrieved from: https://www.ntu.org/publications/detail/an-appreciation-congressman-john-lewis-1940-2020

[14] Sepp, Pete. "NTU's Pete Sepp Outlines Tax Reform." National Taxpayers Union, August 3, 2017. Retrieved from: https://www.ntu.org/publications/detail/ntus-pete-sepp-outlines-tax-reform

[15] Bishop-Henchman, Joe. "NTUF Amicus Brief: Taxpayers Harmed by IRS's Shifting Positions and Ambiguous Regulations on Easements." NTU Foundation, February 2, 2021. Retrieved from: https://www.ntu.org/foundation/detail/ntuf-amicus-brief-taxpayers-harmed-by-irss-shifting-positions-and-ambiguous-regulations-on-easements

[16] Congressional Research Service. (December 2020). "Tax Expenditures: Compendium of Background Material on Individual Provisions." Retrieved from: https://www.govinfo.gov/content/pkg/CPRT-116SPRT42597/pdf/CPRT-116SPRT42597.pdf#page=1087 (Accessed April 21, 2021.)

- **Limiting the new, generous Child Tax Credit (CTC) and Child and Dependent Care Tax Credit (CDCTC) to households making less than six figures per year.** As NTU has written before, "[i]f the goal of CTC expansion is to reduce child poverty, it is not necessary to direct an extraordinarily generous benefit to six-figure households."[17] Congressional Research Service (CRS) estimates from before the American Rescue Plan's CTC expansion indicate that 40.1 percent of the CTC benefit in 2020 went to households making six figures or more per year, likely totaling tens of billions of dollars in foregone revenue.[18] The CDCTC is even more regressive, with 73.5 percent of the benefit in 2020 going to households making six figures or more per year.[19]
- **Limiting the current-law electric vehicle (EV) credit, or future expansions and extensions of the EV credit, to households making less than six figures per year**: CRS estimates that "[i]n 2018, more than half of the plug-in vehicle credits were claimed on tax returns with adjusted gross income (AGI) of $200,000 or more."[20] This is a regressive credit that should be pared back, notwithstanding a push from the Biden administration and some lawmakers to make the EV credit more generous.
- **Repealing or rolling back tax credits that serve as subsidies for narrow, parochial, or temporal interests**: As former NTU Foundation Vice President Nicole Kaeding put it in 2019, some of the provisions regularly considered as so-called tax extenders "are not ideal." Kaeding went on: "Many of the extenders involve subsidies for energy projects, such as credits for biofuel, biodiesel, and electric vehicles. These industries should not be penalized by the U.S. tax code, but they shouldn't get a leg up either."[21] To sum up: not all extenders are created equal, nor are all credits, deductions, and expensing provisions in the tax code made equal.

<u>Conclusion</u>

We appreciate your attention to and consideration of NTU's views and positions on a proposed wealth tax, a corporate minimum tax, IRS reform and enforcement, and a number of additional issues addressed in this submission. To the extent you and your colleagues agree with our ideas of how to (and how to *not*) make the tax code simpler, fairer, and more oriented to economic growth, we would be pleased to answer any questions you may have and to work with you further.

Sincerely,

Andrew Lautz, Director of Federal Policy

CC: The Honorable Ron Wyden, Chair, Senate Committee on Finance
The Honorable Mike Crapo, Ranking Member, Senate Committee on Finance
The Honorable Richard Burr, Member, Subcommittee on Fiscal Responsibility and Economic Growth

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[17] Lautz, Andrew. "Lawmakers Want to Make the Child Tax Credit Expansion Permanent. They Should Pay For It." National Taxpayers Union, March 16, 2021. Retrieved from: https://www.ntu.org/publications/detail/lawmakers-want-to-make-the-child-tax-credit-expansion-permanent-they-should-pay-for-it
[18] Congressional Research Service. (December 2020). "Tax Expenditures: Compendium of Background Material on Individual Provisions." Retrieved from: https://www.govinfo.gov/content/pkg/CPRT-116SPRT42597/pdf/CPRT-116SPRT42597.pdf#page=835
[19] *Ibid*, page 788.
[20] *Ibid*, page 174.
[21] Kaeding, Nicole. "Not All Extenders Are Created Equal." NTU Foundation, September 25, 2019. Retrieved from: https://www.ntu.org/foundation/detail/not-all-extenders-are-created-equal