NATIONAL TAXPAYERS UNION

To: Members of the House Committee on Ways and Means
From: Brandon Arnold, Executive Vice President; Andrew Lautz, Director of Federal Policy; Will Yepez, Policy and Government Affairs Associate; National Taxpayers Union
Date: September 13, 2021
Subject: Committee's Proposed Tax Increases in Subtitle I Would Significantly Harm American Workers and Businesses

I. Introduction and Key Taxpayer Considerations

On behalf of National Taxpayers Union (NTU), the nation's oldest taxpayer advocacy organization, I write to Committee Members and staff as you consider trillions of dollars in tax increases in Subtitle I of the Committee's fiscal year (FY) 2022 reconciliation legislation.

Subtitle I mostly consists of significant and, in the aggregate, unprecedented tax increases that would harm American workers and businesses and could stunt America's economic recovery from the COVID-19 pandemic. Among our significant concerns are the following:

- Increasing the corporate tax rate from 21 percent to 26.5 percent will disadvantage the U.S. as a place to do business when compared to economic peers around the world. It will also raise taxes by about $540 billion according to the Joint Committee on Taxation (JCT), and lower-income and middle-class households will bear a significant portion of those corporate tax increases (likely in the tens of billions of dollars over the next decade).
- Significantly increasing taxes on U.S. companies' foreign earnings will further disadvantage the U.S. relative to economic peers. Though the Committee's proposal is a small step in the right direction when compared to the Biden administration's proposals for Global Intangible Low-Taxed Income (GILTI), lawmakers should make many changes to the international tax proposals in Subtitle I.
- Making changes to the tax treatment of carried interest will negatively impact taxpayers' ability to invest in small American companies and promising start-ups. As NTU wrote in May, "...carried interest has been treated as capital gains for over fifty years. This tax structure has allowed partnerships of entrepreneurs and investors to funnel capital into startups and construction. Those seeking to raise taxes claim this legislation would 'close a tax loophole.' This is false. As a 2017 letter from 22 Members of Congress aptly points out, the classification of carried interest as capital gains is the correct one."
- Raising taxes on capital gains and the net investment income tax will harm American businesses at the worst possible time and stifle our economic recovery. This increase would have other harmful effects, like decreasing liquidity.

- The Committee’s proposed $78.9 billion boost to the IRS budget focuses almost exclusively on enforcement, and otherwise comes with no reasonable guardrails and no broader reforms to IRS activities and operations. Given the current state of the agency, any budget boost must come with safeguards for taxpayer rights and privacy (not just lip service), significant reforms to IRS operations, a real and detailed plan for spending additional appropriations at the agency, and Congressional oversight of efforts to reduce the tax gap.
- Significant tax increases on tobacco and nicotine products -- including, in some cases, tax hikes that raise rates 18- or 21-fold -- would ultimately be borne by consumers and violate President Biden’s pledge not to raise taxes on households making less than $400,000. A new tax on vape products could also negatively impact some smokers’ efforts to quit tobacco products and switch to safer products instead.
- The above-the-line deduction for union dues in Sec. 138514 would provide a special incentive in the tax code for union membership, which amounts to government putting its thumb on the scale for labor unions in negotiations and improperly subsidizing union membership.

Notwithstanding our opposition to most major provisions of Subtitle I, NTU appreciates the Committee’s attention to the impending expiration of business taxpayers’ ability to fully expense research and development (R&D) expenditures. While NTU strongly prefers simply repealing five-year R&D amortization, scheduled to go into effect in 2022, the Committee’s proposed delay in R&D amortization to 2026 would certainly be better than doing nothing at all regarding R&D amortization.

Absent ***significant*** changes to the Committee’s reconciliation title, NTU would urge all Committee Members to **OPPOSE** the legislation.[1]

II. Amendments That Could Improve the Committee’s Reconciliation Title

NTU is submitting several recommendations to Committee members for changes that would improve the reconciliation bill from the taxpayer’s perspective. ***Please note*** that the absence of recommendations on a particular provision does not amount to NTU’s tacit approval of a provision in the Committee’s legislation. Indeed the vast majority of provisions in the title give rise to great concern among NTU’s experts and advocates; that said, we wish to focus our limited time before the Committee’s markup on the provisions of Subtitle I that would impact American companies and workers most. The following amendments would improve the Committee’s reconciliation title from the taxpayers’ perspective:

Part 1

- **Strike Sec. 138101, increasing the top corporate tax rate from 21 percent to 26.5 percent**: Combined with the average 6.02-percent state and local corporate tax rate, a 26.5 percent federal corporate tax rate would give the U.S. the highest combined corporate income tax rate (32.52 percent) in the developed world. Currently we have the 12th highest of 37 OECD countries. This would make the U.S. less competitive when compared to its closest economic peers, especially in combination with the proposed changes to taxation of U.S.-based companies’ foreign earnings

[1] As a reminder and to avoid any confusion, NTU does ***not*** include Committee markup votes in our annual rating of Congress. That said, we weigh in at the markup level to improve legislation from the perspective of the taxpayer before it reaches the House and/or Senate floor.

(see the subsequent bullet point). These changes could contribute to the U.S. losing the taxable profits, valuable assets, and jobs offered by multinational companies to any number of highly-developed countries with a more favorable tax environment. As NTU has also pointed out, any increase in the statutory corporate tax rate does, according to JCT, raise taxes on households making less than $100,000. While a 28-percent corporate rate would raise taxes on five-figure households by about $100 billion over a decade, there is little doubt that a 26.5-percent rate would also raise taxes on households making less than $100,000 per year by tens of billions of dollars over the ten-year window. Lawmakers should avoid efforts to raise the statutory corporate tax rate.

- **Strike Sec. 138121, increasing GILTI and Foreign Derived Intangible Income (FDII) rates**: NTU has warned for months that increasing the GILTI rate to anything above what is required to comply with a fully-agreed to and fully-implemented Pillar Two agreement would also disadvantage the U.S. relative to its economic peers and competitors. Though the Committee takes a better approach than the Biden administration in proposing to tax GILTI at a rate of 16.6 percent (compared to 10.5 percent under current law and 21 percent under the Biden proposal), this rate is still north of Pillar Two's proposed 15 percent global minimum tax rate. Effective GILTI rates will go higher in some cases with a foreign tax credit (FTC) haircut, which the Committee chooses to keep (albeit with a smaller haircut; more on that below). What's more, JCT has already estimated that under the 10.5-percent statutory GILTI rate under the Tax Cuts and Jobs Act (TCJA), U.S. multinational enterprises paid a median foreign tax rate of about 16 percent in 2018.[2] Lawmakers should not increase the GILTI rate beyond what is needed to comply with Pillar Two, and even then lawmakers should wait to increase the GILTI rate until other countries that are party to a global tax agreement fully lock themselves in to the deal. Otherwise, the U.S. could end up going it alone on GILTI -- especially if the global agreement falls through.

  As for FDII, the Committee is proposing significantly raising U.S. tax rates on export income derived from high-value intangible assets, punishing U.S. companies that successfully sell their goods and services abroad and locate their patents, trademarks, and other intangibles here in the U.S. (relative to their current law treatment). The Committee proposes raising the effective rate on FDII by nearly 58 percent, from 13.125 percent to 20.7 percent, even though, as two tax law experts recently put it, "a number of US MNEs repatriated IP [intellectual property] back to the United States in reliance on the benefits of the FDII incentive." Further, the Committee's decision to lower the substance-based carve-out for GILTI (from 10 percent to five percent) but keep a carve-out of 10 percent for calculating the FDII deduction would raise effective tax rates on FDII relative to GILTI. Since more QBAI reduces GILTI rates but increases FDII rates, the Committee's decision-making on QBAI further disadvantages the U.S. as a place to locate high-value intangible assets relative to economic peers and competitors.

[2] See page 63 of the document, or page 66 of the PDF.

- **Revise Sec. 138126, so that the qualified business asset investment (QBAI) substance-based carve-out remains 10 percent of net deemed tangible income return**: The Committee has proposed reducing QBAI from 10 percent to five percent of a net deemed tangible income return. While this is a step in the right direction from the Biden administration proposal to eliminate QBAI completely, the Committee's proposal still may leave the U.S. with a substance-based carve-out that is less generous than what will likely be allowed under Pillar Two. The Pillar Two agreement provides for a five-percent substance-based carve-out (7.5 percent in the first five years) of the carrying value of tangible assets ***plus payroll***. The Committee is instead proposing the equivalent of five percent of the carrying value of tangible assets. Lawmakers should keep QBAI at 10 percent until there is more clarity on the Pillar Two agreement, and if and when all countries in the Inclusive Framework lock in to a Pillar Two agreement lawmakers should maintain a substance-based carve-out that is as generous as Pillar Two will allow.
- **Revise Sec. 138127 to eliminate the foreign tax credit (FTC) haircut**: We appreciate that the Committee has proposed reducing the FTC haircut (currently 20 percent) to five percent in their reconciliation legislation. As NTU has noted before, "[t]he FTC haircut effectively raises the statutory GILTI rate," and current law adds insult to injury by prohibiting carryforwards of excess FTCs under GILTI. While the Committee's proposal is better than the Biden administration's proposal, which would likely leave an FTC haircut in place, we believe policymakers should still push to eliminate FTC haircuts entirely. Eliminating the FTC haircut would reflect the reality that U.S. MNCs operate in several countries, pay taxes in those countries, and should receive full credit for foreign taxes paid (for more, read here).
- **Strike Sec. 138149, changing the tax treatment of carried interest**: As NTU has argued before, though critics of the current tax treatment of carried interest refer to the provision of law as a 'loophole,' "...taxing carried interest as capital gains is appropriate. Carried interest is the share of long-term profits that flow to investment managers who partner with investors. There is an inherent risk in such arrangements and the current tax treatment of carried interest appropriately reflects the 'sweat equity' of fund managers." There is no good time to raise taxes on capital investment, but now is a particularly sensitive time in America's economic recovery.

Part 2

- **Strike Sec. 138201:** This provision would increase the top marginal tax rate to 39.6 percent. Raising taxes in the midst of a global pandemic is not sound policy. There is little justification for this change besides attempting to pay-for a $3.5 trillion package of unnecessary spending.
- **Strike Sec. 138202:** This provision would increase the top capital gains rate to 25 percent. This tax hike would harm economic growth and decrease liquidity as holders of assets would be less inclined to sell. A higher tax rate on capital gains would negatively impact investment and harm American businesses. The Congressional Research Service has also pointed to an increase in the capital gains rate leading to reduced potential revenue.
- **Strike Sec. 138203:** This provision would expand the application of the net investment income tax (NIIT). As the Tax Foundation notes, NIIT leads to double taxation on corporate income. With the proposed increase to the capital gains rate in Sec. 138202, this would effectively make the top capital gains rate 28.8 percent. NTU and other free market groups have urged lawmakers to repeal NIIT and other harmful tax provisions that suppress economic growth.

- **Strike Sec. 138206:** This provision would implement a 3 percent tax on adjusted gross income (AGI) over $5 million. When analyzing a 10 percent surtax on $1 million or more in AGI, the Tax Foundation found the surtax would reduce economic output and lead to fewer jobs. While a different rate is proposed here, the harmful effects would likely be similar and should be avoided.
- **Strike Sec. 138205:** This would disallow business losses in excess of business income for non-corporate taxpayers. Tax treatment of net operating losses (NOLs) are routinely mischaracterized as "loopholes." Instead, as NTU explained, NOLs help individuals and businesses smooth profits and losses across tax years. This allows for individuals and businesses to be taxed on their economic output rather than on an arbitrary accounting timetable. The Tax Cuts and Jobs Act already limited NOLs for wealthy non-corporate taxpayers ($250,000 for single filers and $500,000 for married couples). By disallowing all business losses for non-corporate taxpayers, this provision targets individuals below those income thresholds and would affect taxpayers below President Biden's $400,000 pledge.

Part 4

- **Strike Sec. 138401, which provides significant new appropriations to the IRS without sufficient safeguards for taxpayers' rights and without sufficient instruction and oversight from Congress concerning how the agency spends its budget boost**: It is extremely disappointing to see the Committee spend all of one page providing instructions to the Treasury Department and the IRS on the $80 billion budget boost lawmakers propose to give the agency. To make matters worse, the Committee clearly wishes to focus ***almost all*** funding in the budget boost on enforcement, writing that even sorely-needed information technology (IT) improvements at the IRS must be made "to effectively support enforcement activities" (rather than additional IRS needs such as customer service and tax return processing). Clearly the reconciliation bill's authors have not provided the specificity needed to ensure an IRS budget boost is not wasted (and/or spent in a manner that threatens long-respected taxpayer rights and privacy). The Committee also does not provide an ironclad commitment to taxpayers making under $400,000 that they will not be the subject of increased enforcement activities; instead, the Committee merely states in its legislation that the IRS budget boost is not "intended to increase taxes on any taxpayer with taxable income below $400,000." The Committee needs to go back to the drawing board on its IRS budget plans, and should strike Sec. 138401 in its entirety.
- **Absent striking Sec. 138401, attach guardrails to Part 4 that 1) protect taxpayer rights and privacy, 2) ensure the agency spends new appropriations effectively, and not just on enforcement, 3) address the agency's numerous (enforcement and non-enforcement related) deficiencies, and 4) attempt to estimate the real, up-to-date tax gap**: Absent lawmakers completely striking Sec. 138401, they should attach significant guardrails to and prerequisites for an IRS budget boost that align with the four broad categories of NTU recommendations outlined above. We go into further detail in a June 2021 issue brief, highly relevant to the Committee's work today, that provides 14 recommendations for Congress and the IRS as they attempt to narrow the tax gap. For example, Congress should ensure that the IRS is regularly attempting to update its estimates of the tax gap. Lawmakers should also subject IRS estimates to a second opinion from nonpartisan experts, such as JCT or the Congressional Budget Office (CBO). Congress should also provide ironclad safeguards to taxpayer rights as the IRS receives any significant budget increase in order to protect middle-class taxpayers and small businesses from

improper and/or intrusive enforcement activities without substantive and speedy due process. NTU would be pleased to work with Committee members further on our numerous recommendations that should accompany IRS budget boost, which are based in part on decades of expertise in and engagement with IRS reform and restructuring matters.

- **Strike Sec. 138403, imposing new restrictions and enhanced penalties on conservation easement deductions**: In a previous communication on proposed legislation seeking to impose new restrictions on conservation easement deductions, NTU President Pete Sepp wrote that excessive retroactivity for changes to conservation easement tax law (and few guardrails against IRS overreach) would "create dangerous precedents for the entire system of tax administration" and run "contrary to most notions of sound tax policy and due process." Similar principles apply to the Committee's proposal, which limits deductions retroactively to December 2016. The Committee's proposal amounts to an attempted revenue grab on conservation easements while failing to address, as Sepp wrote, the IRS' "controversial strategy against certain easement deductions facilitated through partnerships of taxpayers, beginning with a listed transaction notice in 2016 and continuing today with aggressive auditing and litigation." Lawmakers should strike this section.
- **Strike or substantially modify Sec. 138404, which repeals a requirement that assessment of IRS penalties must be approved by the assessor's supervisor**: If lawmakers have issues with the approval requirement from the IRS Restructuring and Reform Act of 1998, they should consider minor and forward-looking modifications. This retroactive repeal of a tax provision, first passed in 1998 and made effective for 2001, seems designed to raise revenues with insufficient consideration of its impact on taxpayer protections.

Part 5

- **Strike Sec. 138504, imposing significant new and increased taxes on nicotine products**: In addition to doubling the tax rate on cigarettes, this provision applies roughly equivalent taxes on "taxable nicotine," such as e-cigarettes, vapor, and heat-not-burn products. Enormous tax increases on tobacco and nicotine products would not only represent a violation of President Biden's pledge to not raise taxes on people making less than $400,000 it would also have a negative impact on public health. Americans making less than $400,000 would shoulder the vast majority of this $97 billion tax hike. Even worse, the provision attempts to equalize taxes across all tobacco and nicotine products. This could encourage consumers to purchase more harmful products, like combustible cigarettes, in lieu of less harmful alternatives, like e-cigarettes or heat-not-burn products. This, unfortunately, could hinder efforts to eradicate cigarette use and have a significant, negative impact on public health.
- **Strike Sec. 138514, providing a special deduction for union dues**: This provision would provide a significant tax benefit for union members by making up to $250 in union dues tax deductible. This would be an above-the-line deduction, meaning it could be utilized by all taxpayers regardless of whether they itemize their taxes or not. The Tax Cuts and Jobs Act eliminated a similar special-interest tax benefit for tax years 2018 through 2025, and there are no sound economic justifications for restoring it and giving unions a targeted $4.3 billion tax break.

- **Strike Sec. 138517, providing a payroll tax credit for wages paid to local journalists**: This provision would provide a significant payroll tax credit to newspaper and media companies hiring local journalists. While only having a budget impact of around $1.2 billion over the next decade, this specific tax break advantages just one type of employee in one industry, and is not available to most companies, industries, or sectors of the U.S. economy. This is an unnecessary tax break that distorts economic activity. Lawmakers should instead strike Sec. 138517.

III. NTU's Current Thinking on the Combined Reconciliation Package

As the authorizing committees in Congress work on separate reconciliation bills, NTU wishes to inform Members and their staff that we have several significant concerns with the current framework of the overall, combined reconciliation effort. This proposed legislation would spend a staggering $3.5 trillion—possibly adding trillions to the national debt and impacting America's economic recovery effort from the COVID-19 pandemic. If the combined reconciliation bill came to the House or Senate floor today, we would advise Members to vote "NO" on the legislation. The bill would be heavily weighted in NTU's annual rating of Congress.

IV. Contact Information

Should you have any questions about the recommendations in this memo, please do not hesitate to reach out to Brandon Arnold at barnold@ntu.org, Andrew Lautz at alautz@ntu.org, and Will Yepez at wyepez@ntu.org.