SEPTEMBER 17, 2012

Developments in Tax Reform

A Focus on Capital Gains and Corporate Tax Rate

Looking ahead to the lame duck session of Congress after the November elections and into the new year when the new 113th Congress will be seated and we will have either a second Obama administration or a new Romney administration, there are increasing developments on the expected debate on tax reform. While nothing will happen on this issue during the current legislative work period – just 8 days in September before breaking until after the elections – the lame duck and new year are certain to see action.

Senate Finance & House Ways and Means to Hold Hearing on Capital Gains

On September 20 the Senate Finance Committee and the House Ways and Means Committee will hold a hearing on “Tax Reform and the Tax Treatment of Capital Gains.” Providing testimony at the hearing will be David Brockaway, Partner at Bingham and McCutchen, LLP; Dr. Lawrence Lindsay, President and CEO of The Lindsey Group; Dr. Leonard Burman of the University of Syracuse; David Verrill, Founder of Hub Angels Investment Group LLC; and William Stanfill, General Partner at Montegra Capital Income Fund. Both committees are currently working to develop their proposals on capital gains and other tax reform issues.

Joint Committee on Taxation Report

On September 14, in preparation for the September 20 hearing on capital gains, the Joint Committee on Taxation (JCT) released a report titled, “Present Law and Background Information Related to the Taxation of Capital Gains.” The report can be found here. The report provides an overview of present law, as well as a legislative background on capital gains, and discusses several questions related to differentiated rates for income realized from capital gains and other sources of income, including:
Does a differential rate promote improved efficiency of the capital markets?

Does a differential rate promote the socially optimal level of risk taking?

Does a differential rate promote long-run economic growth?

Is income from capital gains properly measured?

Is a differential in rates consistent with policy makers’ equity goals?

Does a differential rate create tax administration issues?

**CRS Report on Corporate Tax Reform**

On September 13 the Congressional Research Service (CRS), a legislative branch agency within the Library of Congress that provides reports to the U.S. Congress, issued a report titled “The Corporate Income Tax System: Overview and Options for Reform.” The report provides a brief review of the U.S. corporate tax system, discusses factors that may be considered in future debates on corporate tax reform, and offers policy options including the current proposals for reform of the corporate income tax system. The report can be found here.

Noting that deductions, exemptions, deferrals, and tax credits have reduced the effective tax rate of many corporations to less than 35%, CRS says that just 8.9% of federal tax revenue came from corporate tax in 2010 – significantly less than the peak in 1952 when 32.1% of federal tax revenue came from corporations. The report also states that, while much attention is given to the United States’ high statutory corporate tax rate of 35%, the effective corporate tax rate here is comparable to the Organization for Economic Cooperation and Development (OECD) average.

Options for reform touched on in the report include: 1) reducing the top corporate tax rate and offsetting the revenue loss by increasing the amount of income subject to tax; 2) integrating the corporate and individual tax systems; 3) addressing the “double taxation” of corporate income by reducing or eliminating taxes for shareholders on dividends and/or capital gains; 4) subjecting pass-through income as corporate tax; and 5) implementation of a territorial tax system.

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