Reforming the U.S. Corporate Tax Code to not Just be Simple, but be Sensible:

The First Steps

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"This is too difficult for a mathematician. It takes a philosopher.

The hardest thing in the world to understand is the income tax."

--Albert Einstein[1]

"The difference between death and taxes is

death doesn't get worse every time Congress meets."

--Will Rogers[2]

I. Introduction

The complexity of people's efforts to tax themselves has bedeviled minds for generations. Taxation has developed to raise revenue so that our governments' can function. Throughout time, it has come to be an expedient way to pursue other policies as well. Yet, using the tax code to pursue other policies has complicated the code itself excessively. In this paper, we will examine ongoing efforts to simplify the tax code, explore countervailing policy interests such as fairness and generating wealth, and consider whether the simultaneous drives to be simple, be fair and be affluent can all converge as we gain a greater understanding of taxpayer behavior. Next, we will explore the possibility of this convergence between simplicity, fairness and the drive to generate wealth in greater detail under one provision of the corporate tax code, expensing, whereby corporations potentially reduce their tax liability by investing in their own growth.

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[1] *Hate Paying Taxes? 12 Quotes You'll Love* by Robert Wood. Fortune.com 12/2/2012. Retrieved 3/22/2017. https://www.forbes.com/sites/robertwood/2012/12/02/hate-paying-taxes-12-quotes-youll-love/#79782351317e.
[2] Ibid

II. A Recent History of Corporate Tax Reform

On June 24th, 2016, the National Republican Party distributed their policy paper describing reforms they were seeking in the U.S. Tax Code. Entitled *A Better Way,* the Republican policy paper criticised the increase of U.S. tax law from the equivalent of 26,000 pages, after the Tax Reform Act of 1986, to a total of 70,000 pages today.[3] The 70,000 pages includes both the Internal Revenue Code, at 2,600 pages, as well as IRS forms, instructions and publications, Treasury regulations and Federal Court decisions. This has been a dramatic expansion, as seen in Figure 1. However, it is premature to assume that substantial tax reform would result in its length returning to former lengths, In this paper, we will evaluate the complexities in the current U.S. corporate tax code along with some of the provisions put forward by the Republican Party and whether they create additional complexity and breadth to the U.S. Tax Code, such as transitioning to a territorial tax with border adjustments.

It's easy to see the consequences of the growth in the tax law. Today it takes a sole proprietorship 24 hours to complete a tax return, at an average cost nationwide of four hundred and ten dollars[4]. Furthermore, some have estimated that it takes over 52 hours to complete a return for an S-corporation, another form of business with pass-through taxation which, assuming the same hourly rate, approximates $1000 in compliance costs[5].

The cost for C Corporations is significantly higher than either of these. In a study by the Internal Revenue Service, the average cost for C Corporations that had less than $100,000 in

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[3] Retreived 3/22/2017 https://abetterway.speaker.gov/_assets/pdf/ABetterWay-Tax-PolicyPaper.pdf

[4] *IRS, 2014 Form 1040 Instructions, "Estimates of Taxpayer Burden."*", retrieved from http://www.nolo.com/legal-encyclopedia/how-much-time-do-you-spend-preparing-your-tax-return.html.

[5] See, for example, https://en.wikipedia.org/wiki/Corporate_tax_in_the_United_States. Assuming the same hourly rate is a simplification. It is likely that the hourly rates to complete a tax return for an S Corporation are significantly higher than that for a sole proprietorship

assets to comply with the tax codes ranged from $3,400 to $7,100.[6] Costs for larger C Corporations were even higher, and the cost of compliance ended up totaling from between $12.6 to $18.4 billion in 2009[7]. This study, looking at tax year 2009, was the second survey commissioned by the IRS to study the cost of compliance for business taxpayers. Low estimates on the cost used a variable monetization rate, a reflection of the different opportunity costs it takes to complete returns for firms of different sizes based on an assumption that smaller firms had proportionately lower opportunity costs. Higher estimates on the costs of compliance utilized a fixed monetization rate of $28.73 per hour. The range of estimates also reflect the use of different methodologies, from the ADL methodology first employed in 1984 by Arthur D. Little Inc. to new methodologies such as the Business Taxpayer Burden Model (BTBM). Newer models, which reflected a growth in outsourcing for recordkeeping, generally resulted in lower yet still costly results. A summary of these estimates can be seen in Table 1. However, even these costs to compliance could be underestimates if we assume that corporations are imperfectly rational.

The Republican Party argued that the complexity of the current tax code makes it too costly to comply with and encourages business to move overseas while simultaneously discourages savings and investment. It reflects a government that is bloated with waste and beholden to special interests.[8] Republicans boasted that under *A Better Way*, individual tax returns could just be submitted on a postcard instead of on multiple long forms. Their claim was

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[6] See *Taxpayer Compliance Costs for Corporations and Partnerships: A New Look* by George Contos, John Guyton, Patrick Langetieg Allen H. Lerman and Susan Nelson at https://www.irs.gov/pub/irs-soi/12rescontaxpaycompliance.pdf.. The authors also confirmed a significant non-response bias.
[7] *Ibid*
[8] *Supra* 3

soon decried for actually making taxes even more complex; the proposed postcard would've required an additional ten worksheets to complete[9].

In the push for tax reform, unnecessarily complicated individual returns haven't been the only inefficient suggestion. The potential that corporate tax reform may make the tax code become increasingly complex exists as well. The reason: politicians have developed several competing proposals that are designed to generate wealth in different ways; not to simplify the tax code. A look at three recent Republican proposals, the plan highlighted in A Better Way, the proposals recommended by the Trump Administration and the most recent plan passed by the House Ways and Means Committee, The Tax Reform Act of 2014, highlight a few of the policy objectives that may be at odds with an initiative to simplify the tax code.

The Republican Party's call to reduce complexity in the tax code echoed those of other stakeholders from previous years. Beginning in 2001, the American Institute of Certified Public Accountants, or AICPA, published a series of papers encouraging simplification of the tax code and suggesting that simplifying the tax code is actually consistent with policies promoting fairness and wealth generation[10]. Specifically, that taxpayers have an easier time complying with the tax code, and consequently can spend less time on maintaining compliance and more time engaging in strategic planning.

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[9] *Ryan's Deceptively Simple Promise of Postcard Tax Filing* by Roberton Williams, June 28th, 2016. https://www.forbes.com/sites/beltway/2016/06/28/ryans-deceptively-simple-promise-of-postcard-tax-filing/#422a0aec7442. Retrieved 3/25/2017 at 8:50 am.

[10] AICPA's modern efforts to redesign the tax code began in 1992 when it developed *The Blueprint for Tax Simplification*, which sought to foster tax simplification, ironically as a special interest group might push for their agenda, by calling for a base to advocate for tax simplification as well as developing a method to evaluate proposed tax legislation. AICPA's work encouraging tax simplification follows a series of publications starting in 1977, *Blueprints for Basic Tax Reform*, by David F. Bradford, formerly Deputy Assistant Secretary of the Treasury for Tax Policy, as well as hearings on tax simplification that took place in the U.S. Senate starting in 1979 (see, e.g. Hearing Before the Subcommittee on Taxation and Debt Management Generally of the Committee on Finance, United States Senate, Ninety-sixth Congress, First Session, on S. 1062, S. 1063, June 22, 1979).

In 2002, AICPA published seven *Guiding Principles for Tax Simplification*.[11] As one core principle, AICPA noted that government entities should make simplification a priority. Too often, AICPA suggests, Congress and the Treasury Department seek short-term corrections for current problems, overlooking the additional complications these corrections could cause. This results in further problems, creating a perceived need for even more short-term corrections. In other words, the high frequency of tax law changes, while often called tax reform, creates a vicious cycle where ever more changes are necessary. AICPA indicated that amending the code to benefit a limited number of taxpayers as well as extensively using phase-in and sunset provisions within the code exacerbate these complications.

Ultimately, legislators and regulators should seek the simplest approaches in reshaping the tax code. They should first their policy objectives and/or their revenue, then determine the simplest ways to achieve their objectives. Describing their methods in plain language would obviate the need for long lists of definitions and exceptions, while paying a relatively small price in the code's precision. This AICPA suggests, would reduce the amount of strain on both the government and the taxpayer, significantly reducing the costs of compliance[12]. Economists concur that for taxes to be fair and be efficient, they should employ low rates across a wide tax base and keep the structure simple[13].

Now, some economists have argued that including complexity in the tax code could actually be helpful for two reasons. One, by making applications for programs that are based on tax returns more efficient, like the Temporary Assistance for Needy Families program, and two,

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[11] *Seven Guiding Principles for Tax Simplification* by the Tax Division of the American Institute of Certified Public Accountants. This policy statement builds upon an earlier policy statement that the AICPA had submitted, *Guiding Principles of Good Tax Policy, A Framework for Evaluating Tax Proposals*. Available at https://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/TPCS%202%20-%20principles%20for%20tax%20simplification.pdf.

[12] Ibid

[13] In William Congdon, Jeffrey R. Kling and Sendhil Mullainathan's *Working Paper, Behavioral Economics and Tax Policy*, found at 15328 http://www.nber.org/papers/w15328,

by encouraging social goals such as promoting savings for retirement[14]. While looking at relevant provisions in individuals' tax returns as well as certain excise taxes, these authors did not explore how society may benefit by increasing complexity in the corporate tax code as well.

Instead, the consequence of recent tax reform's focus on making short-term corrections that are applied narrowly and only for a short timeframe is evident in a number of ways. from a curvilinear tax rate structure, to extensive tax expenditures, to a haphazard tax treatment of expensing. We will look at each of these complexities in turn before taking a close look on how a simplified consistent treatment of capital expenses could help in tax planning and become an example to other elements of the code.

III. Corporate Statutory Tax Rates

A good place to start understanding how the tax treatment of corporations has become increasingly complex is to reflect on the changes in the marginal corporate tax rates in the past thirty years. The Revenue Act of 1978 had replaced the previous tax structure that had included surtaxes with a simple five-bracket graduated tax. The first steps towards increasing complexity came with The Deficit Reduction Act of 1984, which charged an additional five percent tax on corporations earning over $1 million to phase out the benefits of having lower tax rates for the first $1 million in income. In a sense, after eliminating a surcharge in favor of a graduated tax rate, the government reintroduced a surcharge on top of the graduated tax rate just six years later.

This pattern of using both a graduated rate structure and a surcharge tax would continue. With the Tax Reform Act of 1986, Congress soon eliminated the Investment Tax Credit along with several corporate tax shelters. By closing these loopholes and instituting the Alternative Minimum Tax, Congress was able to substantially reduce tax rates across the board. However,

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[14] Ibid

one significant wrinkle remained. The surcharge which had previously raised the tax rate on the first $1 million of income became a surcharge on the first $100,000. The consequences of first including, then changing, the surcharge would become important as the Omnibus Budget Reconciliation Act of 1993 had not only included a new tax bracket of 35% for corporations earning over $10 million, it introduced a second surcharge of an additional 3% tax on corporations earning between $15 million and $118.3 million[15]. A summary of these changes can be seen in Table 2. Today, as a result of utilizing both the surtaxes with the graduated tax rate structure that was intended to replace them, the corporate tax rate structure that the United States, seen on Table 3, ends up looking increasingly curvilinear and convoluted.

IV. Tax Expenditures

Yet the complexity of statutory corporate tax rates is only the proverbial "tip of the iceberg" when it comes to byzantine nature of the corporate tax code. Ideally a simple tax code would be transparent. The statutory rates discussed above would provide a close estimate of what corporations could expect to pay. However, the statutory rates are not the rates corporations pay. Corporations pay what is called the effective rate. The question is then what is the effective rate; what do corporations actually pay? Answers from the experts vary.

While the U.S. corporate tax code today has one of the highest statutory rates in the industrialized world, it is unclear what corporations actually pay. Estimates have ranged from 36.2% , in a study by Andrew Lyon, formerly the Deputy Assistant Secretary of the Treasury for Tax Analysis[16], for PricewaterhouseCoopers, to 22.7% by the United States Government

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[15] Pub.L. 103–66, 107 Stat. 312, enacted August 10, 1993

[16] *Another Look at Corporate Effective Tax Rates*, by Andrew B. Lyon. The rate cited by the author was higher than the statutory rate in part because it included the effect of taxation by states. Found at http://actontaxreform.com/wp-content/uploads/2013/10/Lyon-Effective-Tax-Rates-Tax-Notes-Oct-21-2013.pdf.

Accountability Office.[17] Other independent analyses put the effective corporate tax rate at falling between the mid to upper 20 percentiles when not during a recessionary period. [18] In Table 4, we can see just how the effective tax rate for corporations has changed, erratically, over time[19]. While different studies employed different methodologies and included different years, another reason why estimates vary is because different industries and different-sized firms pay different average effective rates. Yet the biggest reason for the a wide range in estimates for the effective tax rane rested on how they included or excluded certain items called tax expenditures.

Tax expenditures represent the biggest challenges to simplifying the tax code. Beginning with the Congressional Budget Act of 1974, the government has been required to track tax expenditures, defining them as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.''[20] Many of these tax expenditures have become known colloquially as subsidies, tax breaks and tax loopholes[21]. These tax expenditures have a dramatic impact on the corporate tax code. Based on

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[17] *Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate*. By the United States Government Accountability Office. Report to Congressional Requesters. Found at http://www.gao.gov/products/GAO-13-520.

[18] *Behind the GAO's 12.6 Percent Effective Corporate Rate*, by Martin A. Sullivan Tax Analysis, July 15, 2013. Found at http://taxprof.typepad.com/files/140tn0197.pdf. The 12.6% rate referred to in the title does not include the effect of state taxation on the effective rate calculated in the Government Accountability Office's report.

[19] *Federal Government: Tax Receipts on Corporate Income/(Corporate Profits After Tax (without IVA and CCAdj)+Federal Government: Tax Receipts on Corporate Income).* A customizable chart indicating a recent increase in the effective corporate rate may be found at the Federal Reserve Bank of St. Louis's website at https://fred.stlouisfed.org/graph/?g=aWA. IVA represents inventory valuation adjustments, the increase in value of a corporation's inventory and CCAdj represents capital consumption adjustments due to depreciation. State income tax on corporations are also excluded from this graph.

[20] Pub.L. 93–344, 88 Stat. 297, 2 U.S.C. §§ 601–688. Fully known as the Congressional Budget and Impoundment Control Act, the section known as the the Congressional Budget Act refers to Title I through Title IX of the Act. In addition to tracking the tax expenditures, the Congressional Budget Act established the Congressional Budget office and provided for expedited budget reconciliations. The Impoundment Act refers to Title X of the Act and it allows the President to request that Congress rescind appropriated funds. Attempts to strengthen this provision have led to efforts for a Presidential line item veto.

[21] *Tax Expenditures: What They Are and Who Benefits* by Christopher Howard at http://www.scholarsstrategynetwork.org/brief/tax-expenditures-what-they-are-and-who-benefits.

Congressional Budget Office estimates, the U.S. will collect $5.6 trillion in corporate taxes from 2016 to 2025[22]. Table 5 indicates the Congressional Budget Office's revenue projections on corporate income tax through 2025, along with other elements of the tax code. During this same time, based on estimates by the Treasury Department, corporate tax expenditures will total $2 trillion in today's dollars.[23] In short, the credits deductions, and exclusions that reduce tax liability equals more than one-third of the total revenue that will be collected over the next ten years.

The U.S Treasury has reported that there are 94 different tax expenditures in the corporate tax code. In itemizing the tax expenditures, the Treasury identifies the corporate tax expenditures by where the item is allocated in the budget, i.e under national defense, international affairs, energy, etc. These expenditures cover everything, from exceptions in inventory sales source rules that allow exporters to assign a larger portion of earnings than than they could based on their economic activity in order to claim more foreign tax credits to the deferral of taxes corporations owe on the interest from U.S. savings bonds until they redeem the bonds[24]. These two tax expenditures have been among some of the biggest tax expenditures between 2010 and 2014. The inventory sales source rules exemption was worth $38 trillion dollars during those years while the government bond interest deduction was valued at over $45 trillion.

Other notable corporate tax expenditures include a deduction for domestic production activities, special provisions for Last-In-First-Out (LIFO) inventory methods and tax credits for

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[22] Congressional Budget Ofice 2015-2016 Reports, found at https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51129-chapter4.pdf.

[23] The Tax Foundation's summary of the U.S. Treasury's report , ***Fiscal Fact 521: Corporate and Individual Tax Expenditures 2016***, can be found at https://files.taxfoundation.org/legacy/docs/TaxFoundation-FF521.pdf.

[24] The most recent report on tax expenditures by the.US Department of Treasury's Resource Center can be found at https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2016.pdf.

the development of low income housing. The code even has a tax expenditure allowing for lower tax rates on the first $10 million of income that corporations have earned. That is correct, Congress enacted a tax expenditure to counteract the surcharges imposed on statutory rates mentioned earlier instead of changing the underlying rates. Table 6 lists the ten biggest tax expenditures from 2010 to 2014.

One dollar uncollected due to an expenditure such as a credit or a deduction does not necessarily mean that the ending the expenditure will result in that dollar end up being collected as revenue. Taxpayers' behaviors will change with the tax laws. For instance, the loss of the itemized deduction for mortgage interest payments will result in fewer people buying homes, and therefore less money will be collected from individuals who could have claimed the deduction than was lost with the deduction in the first place. Still, the effect of these expenditures can not be understated. The tax expenditures mentioned above make it difficult to implement a low, broadly applied statutory rate that closely approximates the effective rate corporations actually pay. And these expenditures also create considerable complexity in the tax code.

Take, for example, the largest tax expenditure listed in above, the deferral of income earned by foreign subsidiaries. As we have seen with the inventory sales source rules exemption, U.S. corporations pay taxes on their income worldwide, receiving a credit on the taxes they pay to foreign governments. In addition, the part of the tax code known as Subpart F rules were intended, in part, to help American corporations be more competitive overseas as well, where other countries' use of territorial and value added taxation might otherwise put the American businesses at a competitive disadvantage.

In general, Subpart F rules foreign subsidiaries of U.S. companies can defer their taxes until they make a dividend payment to the domestic parent corporation.[25] It allows U.S. taxpayers, primarily corporations, that are holding 10 percent or more of the voting shares in a Controlled Foreign Corporation (CFC) to defer the tax owed on that income until the income is distributed in the U.S., if the foreign corporation has not been a CFC for 30 continuous days or if the income is derived from the purchase and sale of property that is manufactured, extracted, grown or used in the CFC's country. Subpart F even allows the deferral of income derived from illegal bribes, boycotts and blacklisted countries. Shareholders can take an unlimited number of loans from these CFCs. As long as the money received is not declared or determined to be a dividend or sale of stock, those funds would be tax-free[26].

Unfortunately, what's outlined above is a gross simplification of the Subpart F rules. In a 16 page practice unit for the Large Business & International (LB&I) Division, the IRS admitted to its own experienced employees working with multinational corporations that the "provisions of Subpart F are exceedingly intricate and contain numerous general rules, special rules, definitions, exceptions, exclusions and limitations, which require careful consideration[27]." The Subpart F rules are a perfect example of the complexities in the corporate tax code that challenge both the taxpayer and the IRS alike, raising the costs of compliance. As just one example Companies may have to choose to elect the inventory sales source rules exemption or create a subsidiary and defer the income they make under Subpart F, if that's possible under the multiple exclusions. The fact that it Subpart F had been retroactively extended two years at a time

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[25] *A Proposal to Reform the Taxation of Corporate Income*, by Eric Todor and Alan D. Viard, Tax Policy Center, June 2016.

[26] *Subpart F Income*, by Andrew Mitchel. Available at International Tax Blog, November, 14, 2011. http://intltax.typepad.com/intltax_blog/2011/11/subpart-f-income.html.

[27] *LB&I International Practice Service Concept Unit, Volume 2: Deferral Planning*, page 3. Available at https://www.irs.gov/pub/int_practice_units/DPLCUV_2_01.PDF. Practice units are training aids for IRS employees and are not considered a source of tax law. For further information, please see https://www.irs.gov/businesses/corporations/international-practice-units.

multiple times, meaning it may not have been the law when the decision was made, but could have been possible in hindsight, presents even more challenges to tax planning.

Tax expenditures provide a challenge to tax planning for domestic corporations as well. This is most clearly evident with the depreciation of capital expenses. Two models exist for how to treat capital expenses. One model is called expensing. Under expensing, businesses deduct the full cost of capital expenses the year they are purchased. Expensing is popular because it reduces the tax burden of younger companies' investments. In addition, it provides a greater net present value (NPV) of the deduction. Alternatively, under economic cost recovery. Businesses deduct the cost of capital assets over time, as the value of the asset declines. Economic cost recovery is popular as it helps reduce the tax burden over a period of several years it helps encourage new investment when businesses focus on the statutory tax rate instead of the effective rate. Furthermore, it can raise $1.8 trillion more in tax revenue over ten years than expensing, which if being revenue neutral instead could fund a 3 to 4 percent reduction in the statutory tax rates. As a baseline, the IRS has adopted a compromise between expensing and economic cost recovery, called the Modified Accelerated Cost Recovery System, or MACRS[28].

Utilizing MACRS creates complexity in the tax code even without the use of tax expenditures. MACRS actually incorporates two different cost recovery systems, the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). The two systems have different depreciation methods and different cost recovery periods. And just selecting which depreciation method may pose challenges as, in the IRS's own words to taxpayers "you generally must use GDS unless you are specifically required by law to use ADS or you elect to

[28] Publication 946: How to Depreciate Property. Available at https://www.irs.gov/uac/about-publication-946.

use ADS[29]." With instructions like this in the IRS publications, it's no surprise that Wolters Kluwer's 2015 Master Depreciation Guide exceeded 1,000 pages[30]

Then, including tax expenditures in the analyses of corporate tax deductions, there are elements introduced into the tax code such as bonus depreciation, which provides additional depreciation early on if available, the amount of depreciation available changing with each tax expenditure for bonus depreciation[31]. The code also includes §179 expensing for different properties. The type of property eligible for §179 expensing depends on the nature of the tax expenditure which, if valid that year, allows expensing for the first $510,000 in equipment purchases (or more, if in a qualified enterprise zone in some years) that begins to phase out after the equipment exceeds $2,030,000 in costs. Both provisions for bonus depreciation and §179 expensing expired and were recently retroactively reapplied[32].

V. Retroactive Tax Provisions

One might think that the example of retroactively applying a tax provision mentioned above would be rare for all of the confusion that it causes; and that it only happens for esoteric part of the tax code like Subpart F. However, in a report examining the constitutionality of retroactive tax provisions, the Congressional Research Service pointed out that the practice is actually "quite common."[33] The Supreme Court considered it a "customary congressional practice" to enact necessary legislation as well[34].

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[29] Ibid. Retrieved on 5/11/2017

[30]https://www.cchgroup.com/media/wk/taa/pdfs/landing-pages/national-accounts/us_master_dep_guide_2015-product-brochure.pdf.

[31] *Supra 28*

[32] *Ibid*

[33] *Constitutionality of Retroactive Tax Legislation*, October 25, 2012, by the Congressional Research Service's Erik,a K. Lunder, Robert Meltz and Kenneth R. Thomas. Available at https://fas.org/sgp/crs/misc/R42791.pdf.

[34] *United States v. Carlton*, 512 U.S. 26 (1994) at 33; *United States v. Darusmont*, 449 U.S. 292 (1981) at 291.

One recent example that became widely acknowledged was the restructuring of corporations to become foreign subsidiaries in a process known as inversion. In a letter that Treasury Secretary Jacob Lew sent to the House Ways and Means Chairman David Camp, on July 15th, 2014, the Treasury Secretary urged the passing of a retroactive provision to the tax code even when noting that the best way to handle the situation would be "through business tax reform that lowers the corporate tax rate, broadens the tax base, closes loopholes and *simplifies the tax system.*[35] (emphasis added). The reason then to pass the retroactive provision was to handle the tax treatment of inversions expeditiously.

It's interesting to note that anti-inversion provisions had been retroactively applied before in the American Jobs Creation Act of 2004. It's worthwhile to consider whether the retroactive provisions considered ten years previously became necessary in 2014 and therefore likely sanctioned by the Court, as in *Carlton*, not because of lack of foresight, but because of an abrupt change in public policy after the media storm that had developed when corporations like Walgreens had been considering inversions in 2014. When Congress has had a decade to change the tax code, but hadn't, would the Supreme Court evaluate the constitutionality of retroactive tax provisions differently than it had in *Carlton*?

Retroactive tax provisions have been enacted multiple times to preventive the exploitation of unintended loopholes. For example, the Taxpayer Relief Act of 1997 closed a loophole that would have allowed Seagrams to avoid paying taxes on its sale of DuPont in 1995 if the Act had not been retroactively applied.[36] In addition the Community Renewal Tax Relief

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[35] Available at https://www.treasury.gov/connect/blog/Documents/7-15-2014%20Final%20Camp%20Letter.pdf.
[36] *Retroactive Tax Provisions, a "Quite Common" Practice* by: Mark J. Mazur 7/24/2014. In Treasury Notes (a U.S. Treasury blog), available at: https://www.treasury.gov/connect/blog/Pages/Retroactive-Tax-Provisions.aspx.

Act that had passed at the end of 2000 prevented the acceleration of losses caused by assuming certain liabilities going back to October 19, 1999.[37]

Yet retroactive provisions have been used for more than closing loopholes. They have been employed to provide a short-term economic stimulus, or implemented because the tax provision had expired and Congress had failed to extend it it time. They also have been ostensibly used after conducting cost-benefit analyses of temporary provisions. In fact, retroactive tax provisions are commonly associated with elements of the tax code that are just temporary, also called sunset provisions, another element complicating the tax code. Provisions of the tax code expire and Congress renews them retroactively after the provision had already expired.

This occurred with the American Taxpayer Relief Act of 2012, with the retroactive tax credits for research and development (R&D) as well as for low income housing of non-federally subsidized buildings[38]. This happened again with the Tax Increase Prevention Act of 2012, which retroactively extended the R&D credit for one more year along with various employment credits as well as the Subpart F rules for active financing income, or income from banking, insurance and other financing activities.[39] And, most recently, the Protecting Americans from Tax Hikes Act of 2015, also known as the PATH Act, retroactively extended 52 tax provisions that had expired at the end of 2014[40]. Remarkably, the PATH Act was one of the few times that Congress made several temporary provisions permanent as some of these provisions had been

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[37] Ibid

[38] *The American Taxpayer Relief Act of 2012: Some Tax Certainty in an Uncertain World* by Baker Donelson, https://www.bakerdonelson.com/The-American-Taxpayer-Relief-Act-of-2012-Some-Tax-Certainty-in-an-Uncertain-World-01-08-2013. July 8. 2013

[39] *RIA Special Study: Business Tax Provisions Retroactively Extended by the Tax Increase Prevention Act of 2014*. Thomson Reuters Tax & Accounting News. 12/17/2014. Available at: https://tax.thomsonreuters.com/media-resources/news-media-resources/checkpoint-news/daily-newsstand/ria-special-study-business-tax-provisions-retroactively-extended-tax-increase-prevention-act-2014/.

[40] *Tax Provisions Expiring in 2016 ("Tax Extenders")*, Available at https://www.everycrsreport.com/reports/R44677.html#_Toc466277211.

temporary for ten years or more. Notably, this includes the Subpart F rules for active financing income that had just been retroactively applied two years before[41]. Yet not all of the provisions were made permanent. For example, another Subpart F rule, the look-through treatment of payments between related CFCs under foreign personal holding company rules, were retroactively reset to expire at the end of 2019 instead becoming permanent[42]. In addition, the R&D credit was submitted for a retroactive extension for a third time[43]. Other provisions just expired.

VI. Temporary Tax Provisions

Looking forward, the Joint Committee on Taxation prepared reports on temporary tax provisions ever since 1999, looking as far ahead as 2025 in the latest reports[44]. Looking at these reports, a few patterns emerge. One, temporary tax provisions continue to be very popular. While not at the height they were during the 'Great Recession' of 2008-2009, temporary tax provisions were already becoming increasingly popular before the recession began and continue to twice as prevalent as they were in the early 2000's. Two, a majority of the temporary provisions expire within the first few years after the Joint Committee publishes its report, indicating that Congress has preference for passing short-term provisions and waiting until they are about to expire, or have expired, to reenact them. Longer lasting provisions such as the

[41] Ibid
[42] Ibid
[43] Committee on Ways and Means' Section by Section Summary of the Proposed "Protecting Americans from Tax Hikes Act of 2015" by Kevin Brady. Available at:http://www.section179.org/summary-of-the-path-act-of-2015.pdf.
[44] *Joint Committee on Taxation, List of Expiring Federal Tax Provisions 2016-2026* (JCX-1-17), January 4, 2017. This report and others published as far back as 07/09/1998 are available on the Joint Committee on Taxation's website at https://www.jct.gov/publications.html?func=select&id=10. Please note that while excise taxes and elements of the tax code for individuals are included in this paper's analysis due to their importance for both C corporations and pass-through entities, temporary tax provisions targeting emergency disaster relief are not included.

Subpart F exclusions of active financing income mentioned earlier being the exception, not the rule. Consequently, three, most years have had vastly different numbers of expiring provisions, depending on the date of the report. For example only five tax provisions were scheduled to expire in 2016 for several years. In 2013, that number increased to 11 temporary provisions in 2013 and then jumped to 47 in 2016, the same year that they were scheduled to expire. Three, many expiring tax provisions seem to be clustered around the time that presidential election cycles begin. The start of the next presidential campaign season in 2019, for example, had a higher than expected number of expiring tax provisions in 2016 than most years three years or more from the date of the report. And four, looking closely at the reports, the most common expiring provisions tend to be tax expenditures regarding empowerment zones, domestic energy production and, in particular, the treatment of capital expenses. Table 7 summarizes these reports.

VII: Conclusion

A closer look at the congressional record as well as a comparison with earmarks in discretionary spending might help determine how frequently temporary provisions are not being included in the tax code to provide a short-term stimulus or to give Congress a chance to evaluate how they work, but instead are being passed for political purposes. This is, in fact, a conclusion that some economists have drawn. Taxpayers have a tendency to believe that measures that complicate the tax code tend to be included for political instead of economic reasons[45]. And taxpayers then perceive that these complex tax laws are unfair[46].

It had been the purpose of the paper to explore how well *A Better Way* and the recent one page summary of the proposal by the Trump Administration may go in simplifying the tax code.

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[45] Supra 12
[46] Ibid

We know that, under this proposal, the United States would tax corporate profits at a flat 15%[47]. Unfortunately, just knowing the statutory tax rate is not enough. Neither proposal adequately address current complications in the corporate tax code, including tax expenditures, cumbersome rules for depreciation, along with the overuse of retroactive and temporary tax provisions. Moving to a territorial system for example, even with a border adjustment, it is difficult to speculate the fate of Subpart F. Would profits from foreign subsidiaries no longer be tax-deferred?[48]

As these proposals take form, it would be best if Congress and the White House can identify and address these limitations in the current code throughout the process.

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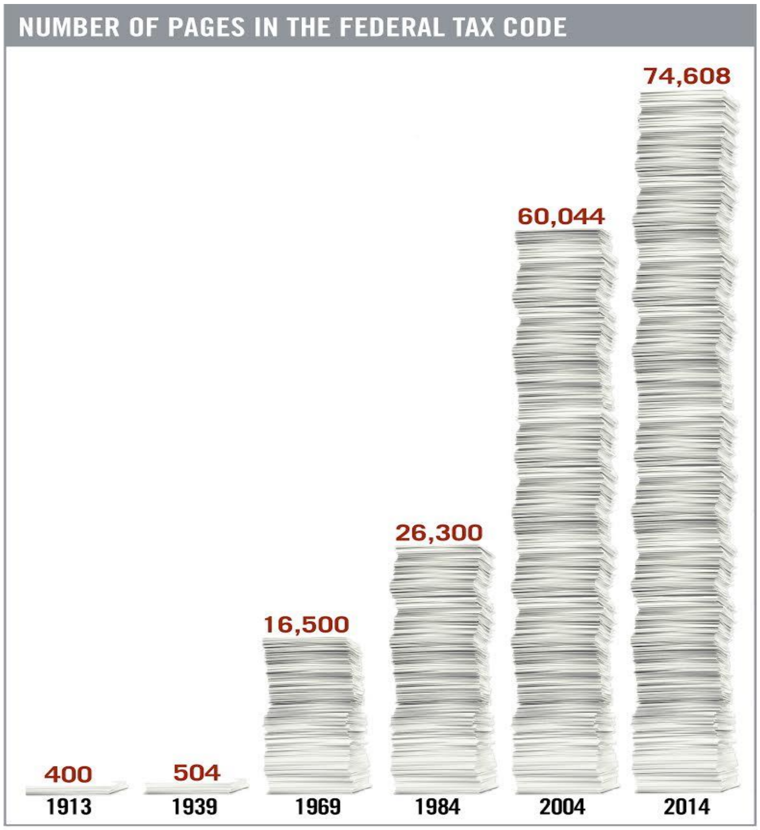
[47] *Comparison of Tax Reform Proposals*, Covington & Burling, LLP, February 24, 2017.

[48] It remains unclear whether taxes would be able to be deferred for foreign subsidiaries of U.S. corporations under the Trump plan. Deferrals were not mentioned when his campaign released an outline of their plan to reform corporate taxes. Many analysts concluded that the ability to defer taxes would therefore be eliminated. For more discussion on this topic, please see: *Deferral a Question Mark in Trump's Final Tax Plan*, by Alex M. Parker, Bloomberg BNA Transfer Pricing Report, October 24th, 2016 at https://www.bna.com/deferral-question-mark-n57982079032/. Accessed on April 15, 2017.

APPENDIX

Figure 1: Pages of Federal Tax Law



Sources: Washington Examiner 4/12/2016, *Look How Many Pages Are in the Federal Tax Code* by Jason Russell; Wolters Kluwer

Table 1: Estimates of the Costs for Corporate Income Tax Compliance

	ADL Methodology	**BTBM Methodology**
Panel A: Average Compliance Costs (in $)		
Variable Rate Monetization (range $8.00/hr to $90.00/hr)	$6,500	$11,600
Constant Rate Monetization ($28.73 per hour)	$5,800	$10,300
Panel B: Total Compliance Costs ($ in Billions)		
Variable Rate Monetization (range $8.00/hr to $90.00/hr)	$58.3	$104.1
Constant Rate Monetization ($28.73 per hour)	$51.8	$92.2

TABLE 2; A Brief History of Corporate Tax Rates

Statutory Marginal Tax Rate (%)

Income ($)	1979 - 1981	1985 - 1986	1987 - 1993	1994 - Present
0 - 25,000	17	15	15	15
25,000 - 50,000	20	18	15	15
50,000 - 75,000	30	30	25	25
75,000 - 100,000	40	40	34	34
100,000 - 335,000	46	46	39	39
335,000 - 1,000,000	46	46	34	34
1,000,000 - 1,405,000	46	51	34	34
1,405,000 - 10,000,000	46	46	34	34
10,000,000 - 15,000,000	46	46	34	35
15,000,000 - 18,333,000	46	46	34	38
18,333,000 +	46	46	34	35

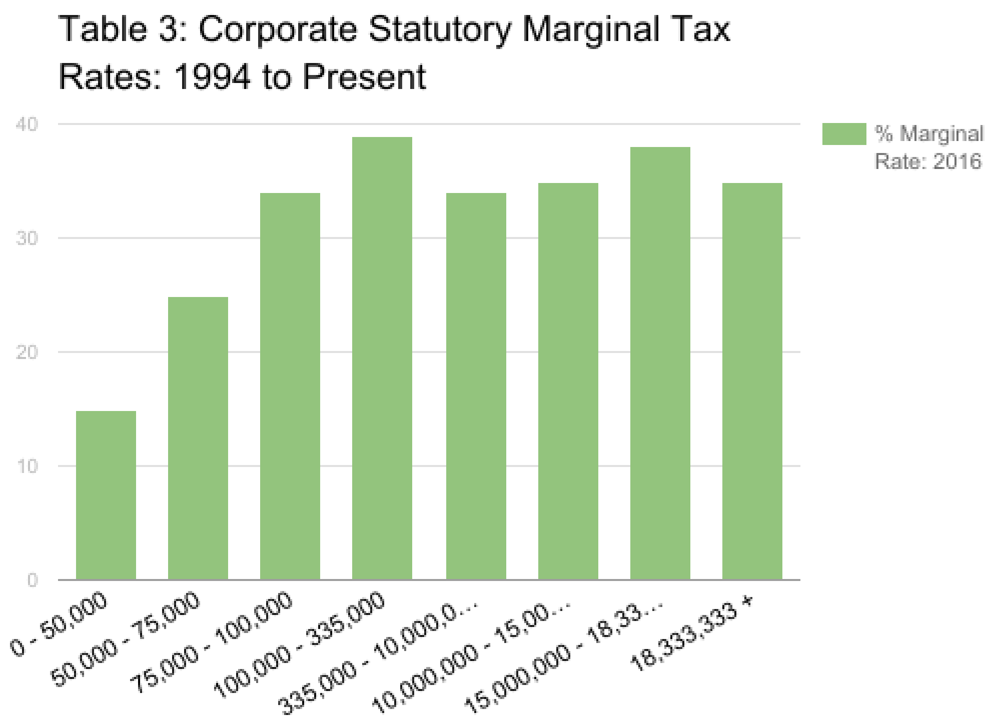


Table 3: Corporate Statutory Marginal Tax Rates: 1994 to Present
40
30
20
10
0
% Marginal Rate: 2016
0 - 50,000
50,000 - 75,000
75,000 - 100,000
100,000 - 335,000
335,000 - 10,000,0...
10,000,000 - 15,00...
15,000,000 - 18,33...
18,333,333 +

Table 4

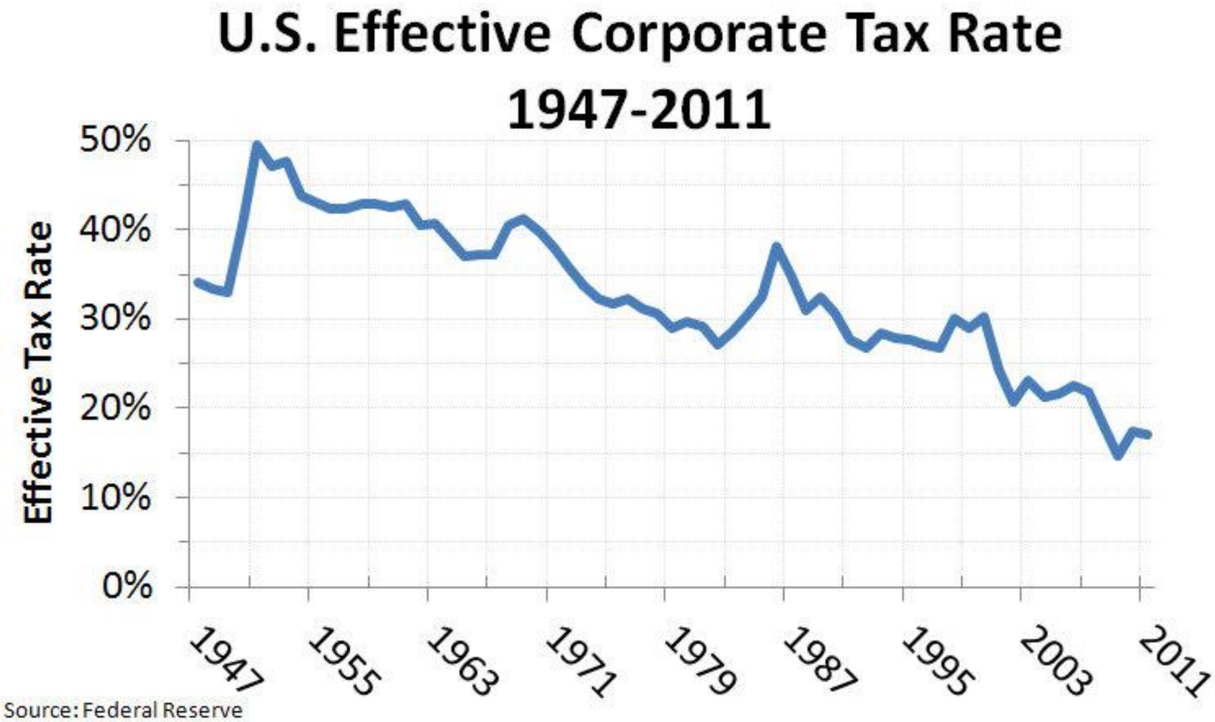

U.S. Effective Corporate Tax Rate
1947-2011
Effective Tax Rate
50%
40%
30%
20%
10%
0%
1947
1955
1963
1971
1979
1987
1995
2003
2011
Source: Federal Reserve

Table 5

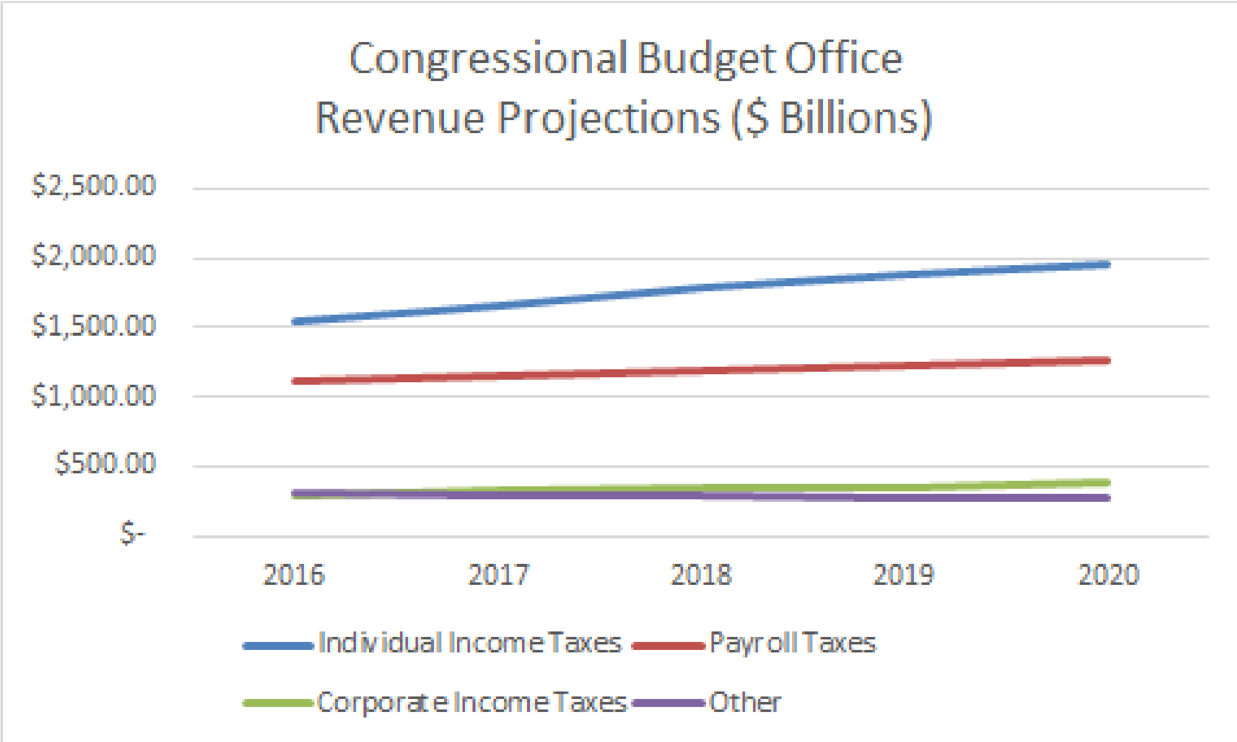
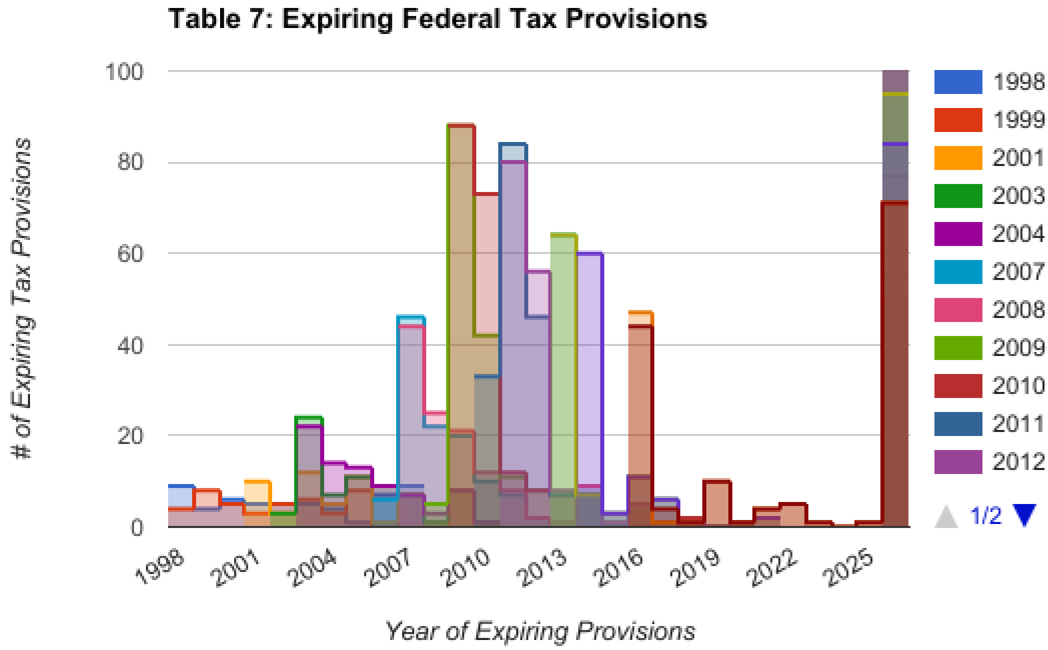

Congressional Budget Office
Revenue Projections ($ Billions)
$2,500.00
$2,000.00
$1,500.00
$1,000.00
$500.00
$-
2016
2017
2018
2019
2020
Individual Income Taxes
Payroll Taxes
Corporate Income Taxes
Other

Table 6: Ten Largest Corporate Tax Expenditures: 2010-2014 ($ Billions)

Tax Expenditure	2010	2011	2012	2013	2014	Total (2010-2014)
Deferral of Income: Foreign Subsidiary	12.5	13.3	14.1	14.9	15.8	70.6
State & Muni Bond Interest Deduction	7.5	8.5	9.0	9.9	10.4	45.3
Domestic Production Deduction	7.0	8.4	8.8	9.2	9.8	43.2
Inventory Sales Source Rule Exception	7.2	7.4	7.6	7.8	8.0	38.0
Depreciation Excess of ADS	24.1	6.5	(5.0)	0.8	10.7	37.1
Income due to debt discharge w/ new debt	21.1	6.9	0.5	0.3	< 0.05	28.8
Low Income Housing Credit	4.9	5.1	5.3	5.6	6.1	27.0
Expensing for research	4.3	4.2	4.4	5.8	6.9	25.6
LIFO Inventory	3.6	3.8	4.0	4.2	4.4	20.0
Reduced rates on first $10 million of income	3.2	3.2	3.2	3.1	3.1	15.9



Year of Joint Committee on Taxation's Report: # of Provisions Expiring

Year of Expiration	1998	1999	2001	2003	2004	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
1998	9	4														
1999	4	8														
2000	6	5														
2001	5	3	10													
2002	5	5	3	3												
2003	5	6	12	24	22											
2004	4	3	5	7	14											
2005	1	8	11	11	13											
2006	7	0	1	9	9	6										

2007	9	7	7	7	7	46	44									
2008		1	0	1	3	22	25	5								
2009			8	8	8	20	21	88	88							
2010			1	1	1	10	12	42	73	33						
2011						7	8	11	12	84	80					
2012						2	2	8	8	46	56					
2013						1	1	7	7	7	8	64	64			
2014						9	9	7	7	7	7	7	7	60		
2015						1	1	0	0	0	0	3	3	3		
2016						0	0	5	5	5	5	11	11	11	47	44
2017						0	0	1	1	1	1	6	6	6	1	4
2018						0	0	1	2	1	1	1	1	1	1	1
2019						0	0	0	0	0	0	0	0	0	10	10
2020						1	1	1	1	1	1	1	1	1	1	1
2021												2	2	2	4	4
2022															5	5
2023															1	1
2024															0	0
2025															1	1
Total	55	50	58	71	77	125	124	176	204	185	159	95	95	84	71	71