Perspectives on Tax Reform: The Challenges of Enacting and Implementing Tax Simplification

Background Paper for the Tax Policy and Simplification Committee October 21, 2011

by

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Perspectives on Tax Reform: The Challenges of Enacting and Implementing Tax Simplification (Background Paper for the Committee on Tax Policy and Simplification Committee, October 21, 2011)

by Jonathan Barry Forman

I. OVERVIEW

A. The Program

Friday
9:30AM-11:00AM
Tax Policy and Simplification (TX)
Chair: Professor Roberta F. Mann, University of Oregon, Eugene, OR
9:30am Perspectives on Tax Reform: The challenges of enacting and implementing tax simplification. Join us as the Tax Section’s immediate past chair and former top officials from Treasury, the IRS, and the Joint Committee on Taxation offer their perspectives on tax simplification. It has been 25 years since the Tax Reform Act of 1986 was enacted, and our politicians are again close to forming a consensus in favor of tax simplification. This panel will highlight some of the Tax Section’s recent simplification recommendations and discuss what we have learned since 1986 about the challenges of enacting and implementing major tax simplification proposals.

Moderator: Professor Jonathan B. Forman, University of Oklahoma, Norman, OK
Panelists: Charles H. Egerton, Dean Mead, Orlando, FL; Lawrence B. Gibbs, Miller & Chevalier, Washington, DC; Lindy L. Paull, PricewaterhouseCoopers LLP, Washington, DC; Eric Solomon, Ernst & Young LLP, Washington, DC

B. The Speakers

1. Charles H. Egerton

Charles H. Egerton is one of the founding shareholders of Dean, Mead, Egerton, Bloodworth, Capuano & Bozarth, P.A., in Orlando, Florida. He is the immediate past chair of the ABA Section of Taxation. Mr. Egerton received his J.D. from the University of Florida, his LL.M. in Taxation from New York University, and his B.B.A. from Emory University.

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1 Alfred P. Murrah Professor of Law, University of Oklahoma; B.A. 1973, Northwestern University; M.A. (Psychology) 1975, University of Iowa; J.D. 1978, University of Michigan; M.A. (Economics) 1983, George Washington University; Professor in Residence at the Internal Revenue Service Office of Chief Counsel, Washington, D.C., for the 2009-2010 academic year.

2. Lawrence B. Gibbs
Lawrence B. Gibbs is a partner in Miller & Chevalier in Washington, D.C.\(^3\) He served as Commissioner of the Internal Revenue Service from 1986 through 1989. He also served as Assistant Commissioner from 1973-1974 and prior to that as Acting Chief Counsel and Deputy Chief Counsel. Mr. Gibbs received his LL.B. from the University of Texas and his B.A. from Yale University.

3. Lindy L Paull
Lindy L. Paull leads Pricewaterhouse Coopers’ legislative and regulatory practice in PwC’s Washington National Tax Services office.\(^4\) Ms. Paull served as Chief of Staff of the Joint Committee on Taxation for five years from 1998 through 2003 and with the Senate Committee on Finance for the previous 12 years. She received her J.D. and LL.M. in Taxation from the University of Florida and her B.B.A. from Florida International University.

4. Eric Solomon
Eric Solomon is the Director of National Tax at Ernst & Young’s Center for Tax Policy.\(^5\) Mr. Solomon was Assistant Secretary for Tax Policy from 2006 to 2009, and he was Deputy Assistant Secretary before that. Mr. Solomon was also Assistant Chief Counsel (Corporate) from 1990 to 1995. He received his J.D. from the University of Virginia, his LL.M. in Taxation from New York University, and his A.B. from Princeton University.

\[^3\] http://www.millerchevalier.com/OurPeople/LawrenceBGibbs.
II. ROLE OF THE ABA TAX SECTION

A. THE MISSION OF THE TAX SECTION

As the national representative of the legal profession, the mission of the ABA Section of Taxation is to serve our members and the public through education and leadership and to achieve an equitable, efficient, and workable tax system.

B. EXAMPLES OF RECENT LEGISLATIVE SUBMISSIONS

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<td>Joint Statement on Tax Issues in Health Care Reform</td>
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<td>House/Senate Subcommittee on Financial Services and General Government</td>
<td>04/21/09</td>
<td>Statement of Policy Favoring Reform of Federal Civil Tax Penalties</td>
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C. EXAMPLES OF RECENT REGULATORY COMMENTS SUBMITTED TO THE U.S. TREASURY § IRS

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<td>501</td>
<td>1/20/2011</td>
<td>Requirements for Tax-exempt</td>
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6 http://www.americanbar.org/groups/taxation/policy.html.
III. SOME RECENT THOUGHTS ON THE TAX REFORM ACT OF 1986

Many who lived through the Tax Reform Act of 1986 believe that tax reform requires “the total commitment of the President and sustained leadership from the White House.”7 In particular, the President needs to establish clear, concise goals, e.g., fairness, growth, and simplification. It could also help to try to focus on tax rates and to try to keep individual and corporate tax rates at comparable levels. It’s just “not worth going through the political pain of cutting popular tax breaks if tax rates are not reduced substantially.”8

IV. BUDGET DEFICITS AND TAX REFORM

A. THE BUDGET BASELINE

Under current law, the Congressional Budget Office (CBO) now projects that budget deficits will drop markedly over the next few years to 6.2 percent of gross domestic product (GDP) next year and 3.2 percent in 2013, and budget deficits will average just 1.2 percent of GDP from 2014 to 2021.9 Those projections incorporate the effects of the deficit reduction measures in the recently enacted Budget Control Act of 2011, and they also reflect the sharp

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8 Thompson & Trinca, supra note 7, at 930. “Incremental reform dies from a thousand little cuts; bold reform that offers significantly lower income rates could help deliver historic reform during this Congress.” Id.
increases in revenues that will occur when provisions of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 expire. In CBO’s baseline, cumulative deficits will total $3.5 trillion between 2012 and 2021, and by the end of 2021, debt held by the public will equal 61 percent of GDP.

**B. Unrealistic Assumptions**

But those baseline projections understate the budgetary challenges facing the federal government in the coming years because changes in policy that are scheduled to take effect under current law will produce a federal tax system and spending for some federal programs and activities that differ noticeably from what people have been accustomed to. In particular, the Congressional Budget Office’s baseline projections incorporate the assumption that current laws governing taxes and spending will remain unchanged, including assumptions that:

- The two-year extension of provisions designed to limit the reach of the alternative minimum tax, extensions of emergency unemployment compensation, and the one-year reduction in the payroll tax all expire at the end of 2011;
- Sharp reductions in Medicare’s payment rates for physicians’ services take effect at the end of 2011;
- Funding for discretionary spending declines over time in real terms, in accordance with the caps established under the Budget Control Act; and
- Additional deficit reduction totaling $1.2 trillion over the 2012–2021 period will be implemented as required under the Budget Control Act.\(^{10}\)

\(^{10}\) Id. at x.
C. CONGRESSIONAL BUDGET OFFICE FIGURES ILLUSTRATE THESE POINTS:

Summary Figure 2.
Federal Debt Held by the Public—Historically, in CBO's Baseline, and with a Continuation of Certain Policies


Total Deficits or Surpluses (Percentage of GDP)

V. RECENT TAX REFORM PROPOSALS

A. FALL 2011

1. President Barack Obama

   a. The American Jobs Act

      (1) Cutting the payroll tax in half on the first $5 million in payroll, targeting the benefit to the 98 percent of firms with payroll below this threshold.

      (2) A complete payroll tax holiday for added workers or increased wages up to $50 million

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(3) Extending 100 percent expensing into 2012

(4) A “Returning Heroes” hiring tax credit for veterans

(5) A $4,000 tax credit to employers for hiring the long-term unemployed

(6) Cutting payroll taxes in half for 160 million workers next year

b. Deficit Reduction Recommendations to the Joint Committee

(1) The President calls on the Committee to undertake comprehensive tax reform, and lays out five principles for it to follow:

(a) lower tax rates;

(b) cut wasteful loopholes and tax breaks;

(c) reduce the deficit by $1.5 trillion;

(d) boost job creation and growth; and

(e) comport with the “Buffett Rule” that people making more than $1 million a year should not pay a smaller share of their income in taxes than middle-class families pay.

(2) The President offered a detailed set of specific tax loophole closers and measures to broaden the tax base that, together with the expiration of the high-income tax cuts, would be more than sufficient to hit the $1.5 trillion target, including:

(a) Allowing the 2001 and 2003 tax cuts for upper income earners to expire ($866 billion)

(b) Limiting deductions and exclusions for those making more than $250,000 a year ($410 billion)

(c) Closing loopholes and eliminating special interest tax breaks (approximately $300 billion)
2. **Jon Huntsman**<sup>12</sup>

   a. **Individual Income Taxes**
      
      (1) Simplify the personal income tax and lower rates: A revenue-neutral tax plan that eliminates all deductions and credits in favor of three drastically lower rates of 8%, 14% and 23%
      
      (2) Eliminate the Alternative Minimum Tax

   b. **Corporate Taxes**
      
      (1) Reduce the corporate tax rate from 35% to 25%
      
      (2) Shift from a worldwide system of taxation to a territorial system
      
      (3) Implement a tax holiday for repatriation of corporate profits

   c. **Capital Gains and Dividends**
      
      (1) Eliminate the taxes on capital gains and dividends

**B. OTHER RECENT PROPOSALS**

1. **Senators Ron Wyden & Dan Coats, Bipartisan Tax Fairness and Simplification Act of 2011 (2011).**<sup>13</sup>

2. **House Committee on Budget, The Path to Prosperity: Restoring America’s Promise (2011).**<sup>14</sup>

3. **The National Commission on Fiscal Responsibility and Reform, The Moment of Truth (December 2010).**<sup>15</sup>

4. **The Bipartisan Policy Center Debt Reduction Task Force, Restoring America’s Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple, Pro-Growth Tax System (November 2010).**<sup>16</sup>

5. **The President’s Economic Recovery Advisory Board, The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation (August 2010).**<sup>17</sup>

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C. OLDER PROPOSALS


VI. WHAT CAN WE LEARN ABOUT TAX REFORM FROM AUSTRALIA? 24

Australia has long been concerned about having a sensible tax system. For example, in 2006, the Australian Treasury commissioned a study into how the Australian tax system compared with other developed economies. 25 Also, in 1998, the Australian Treasury commissioned a comprehensive review of business taxation. 26 Pertinent here, the Australian

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19 http://govinfo.library.unt.edu/taxreformpanel.
22 Id.
23 See id. for the original version.
24 It was my privilege to spend a month this past summer learning about the Australian tax system as a Professorial Visiting Fellow and Winner of the 2011 Abe Greenbaum Research Fellowship at the Australian School of Taxation and Business Law, University of New South Wales, Sydney, Australia.
Government is currently in the midst of a comprehensive review of its tax and transfer system,\textsuperscript{27} and major changes might soon be enacted in coming years.

\textit{A. Recent Reform Efforts}

1. Australia’s Future Tax System Review (Henry Report)

The current tax reform effort had an almost accidental birth. Tax reform was not on the agenda when the Labor Government was elected in 2008; however, at the so-called 2020 Summit on Australia’s Future, business leaders nominated tax reform as a priority area.\textsuperscript{28} Soon thereafter, the Australian Government established Australia’s Future Tax System Review panel to examine Australia’s tax and transfer system and make recommendations to position Australia to deal with its demographic, social, economic and environmental challenges.\textsuperscript{29} The Review Panel prepared detailed background reports,\textsuperscript{30} received more than 1,500 formal submissions,\textsuperscript{31}

\begin{thebibliography}{99}
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and held a two-day conference in June 2009.\textsuperscript{32} In December 2009, the Review Panel delivered its final report to the Australian Government.\textsuperscript{33} The \textit{Final Report} is also known as the \textit{Henry Review} because the review panel was chaired by Dr. Ken Henry, then the Australian Secretary to the Treasury.\textsuperscript{34}

\textit{2. Stronger Fairer Simpler: a tax plan for our future (The Government’s Initial Response)}

In May 2010, the Government released the \textit{Henry Review}, along with an initial response.\textsuperscript{35} The government’s initial response called for adoption of a number of the \textit{Henry Review}’s proposed tax and transfer reforms. Of note, the government’s support of the \textit{Henry Review}’s controversial proposal for a major tax increase on mining companies almost certainly played a role in the 2010 resignation of Prime Minister Kevin Rudd of the Labor party and in his

\begin{footnotesize}
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  \item \textsuperscript{31} Australian Treasury, \textit{Australia’s future tax system}, Submissions web page (2010),
  \item \textsuperscript{32} Australian Treasury, \textit{Australia’s future tax system}, Conference web page (2010),
  \item \textsuperscript{33} AUSTRALIAN TREASURY, \textit{AUSTRALIA’S FUTURE TAX SYSTEM, REPORT TO THE TREASURER} (December 2009), \textit{Part One: Overview},
  \textit{Part Two: Detailed Analysis},
  \item \textsuperscript{34} See, e.g., Australian Treasury, \textit{Australia’s future tax system The Review Panel web page},
  \item \textsuperscript{35} Australian Government, \textit{Stronger Fairer Simpler: A tax plan for our future web page} (2010) (includes links to various fact sheets and measures),
\end{itemize}
\end{footnotesize}
Labor party successor, Prime Minister Julia Gillard, barely being able to form a government after the subsequent 2010 national election.\textsuperscript{36}

3. More Recent Events

On May 10, 2011, the Gillard Government released its 2011-12 Budget.\textsuperscript{37} The Budget included a few of the tax reform proposals from the \textit{Henry Review}.\textsuperscript{38} These include proposals to better target tax incentives, to increase and reform support for families, and to improve tax system governance by committing to a principles-based approach to tax law design. In addition, the Budget has proposals to reduce income splitting by high-income earners and by improving the reporting of taxable payments made to some contractors. The Australian government is also holding a National Tax Forum to discuss its recent tax reform proposals.\textsuperscript{39} That Forum will bring together some 150 representatives of community groups, businesses, unions, and

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governments, as well as academics and tax practitioners, to discuss ways to build on the Labor
Party Government’s tax reform agenda.40

4. A Carbon Tax

The Australia government has also introduced—and looks likely to enact—a carbon tax.
The government will start pricing one ton of carbon at AUS$23 (about US$24) starting in mid-
2012.41 To offset the burden of the new tax, more than half of the revenue raised will go toward
tax cuts, pension increases, and other payments that are largely targeted to help low-income
households.

B. LESSONS WE CAN LEARN FROM AUSTRALIA

This part highlights a few aspects of the Australian tax system that U.S. policymakers
should consider. In particular, Australia has:

1. A Balanced Budget

Unlike the United States, Australia tends to balance its budget and has a relatively little
public debt. For example, while the United States ran a deficit of 10.7 percent of GDP in 2010
and had a public debt of 65.2 percent of GDP, Australia ran a deficit of just 3.5 percent of GDP
in 2010 and actually had no public debt (-1.3 percent).42

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41 See generally Australian Government, Working Together for a Clean Energy Future web page,

42 Simon Rogers posting to Datablog, National debt and deficit date for every OECD country (May 27, 2010),
http://www.guardian.co.uk/news/datablog/2010/may/27/debt-deficit-oecd-countries-data#data. See also Google
docs, OECD country debts and deficits,
https://spreadsheets.google.com/ccc?key=0AonYzs4MziZbdDZsU2k2VEQ2elkwenNDOTNHS3ZwRkE&hl=en&gid=0; International Monetary Fund, Data and Statistics,
More specifically, the government is going to try to keep taxation (and spending) at around 23.5 percent of GDP. This aim-for-a-surplus approach stands in sharp contrast to the United States, where for the last 40 years, revenues have historically averaged around 18 percent of GDP while spending has averaged almost 21 percent of GDP.43

2. A Goods and Services Tax (GST)
As part of Australia’s efforts to transform itself into a modern economy, in the late 1990s, then-Prime Minister John Howard (of the Liberal party) pushed the Parliament to enact a broad-based consumption tax, the goods and services tax (GST).44 Since 2000, the GST has been collecting a 10 percent tax on most goods and services. The politics of enactment were tricky, but, in the end, business groups and social welfare groups coalesced in support of the GST. The states and territories were also supportive, as the reform included an agreement that transferred all GST revenue to the states in exchange for their repeal of certain taxes and in lieu of previously extended Commonwealth financial support.45

3. A Universal Pension System
The Australian pension system evolved from a noncontributory public pension and limited private pensions into a system consisting of a means-tested Age Pension and a mandatory universal pension system which since 2002/2003 has been collecting 9 percent of pay from virtually every employee for individual retirement accounts.46

43 Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2011 to 2021 (January 2011), at xv (Summary Figure 1), http://www.cbo.gov/ftpdocs/120xx/doc12039/01-26_FY2011Outlook.pdf.
45 Id. at 311.
4. Corporate Tax Integration

Australia has an imputation system that is intended to avoid double taxation of corporate earnings. Under that imputation system, Australian shareholders receive credit for the tax previously paid on the income underlying dividends that they receive from Australian corporations.47

5. Resource Rent Taxes

A 40 percent petroleum resource rent tax is levied on the taxable profit of most offshore petroleum projects. The tax is deductible from a company’s taxable income when determining its company tax liability. The Australian Government has also proposed a Minerals Resource Rent Tax (MRRT) on the profits of iron ore and coal.

6. A Fringe Benefits Tax

Australia also has a fringe benefits tax. Employers are also required to pay a fringe benefits tax on the value of certain non-cash benefits that have generally been provided to their employees. Designed to ensure that the income tax cannot be avoided by paying employees in benefits rather than cash, the fringe benefits tax is levied at the top marginal tax rate (46.5 percent (45 percent top income tax rate plus 1.5 percent Medicare levy) on the grossed-up taxable value of certain fringe benefits, such as free or discounted use of motor vehicles (including petrol and parking) and payment for items such as housing, meals, entertainment, health insurance, child care and education.

47 More precisely, dividends are “franked” to identify the amount of tax paid with respect to the underlying income funding the dividend. The shareholder then reports the dividend, grossed-up by the amount of the tax paid, and claims a tax credit in the “franked” amount. The net effect is that the corporation’s profits are effectively taxed only at the shareholder’s marginal rate, and there is no double taxation of corporate profits. Joint Committee on Taxation, Background and Selected Issues Related to the U.S. International Tax System and Systems that Exempt Foreign Business Income 14 (JCX-33-11, May 20, 2011), www.jct.gov.
7. A Board of Taxation

Australia has a permanent Board of Taxation that advises the Treasurer on ways to improve the tax system.\textsuperscript{48} The Board has ten members, including seven appointed from the private sector and three ex-officio members – the Secretary to the Australian Treasury, the Commissioner of Taxation and the First Parliamentary Counsel. The Board’s mission is to contribute a business and broader community perspective to improving the design of taxation laws and their operation. The Board advises the Treasurer on ways to improve the general integrity and functioning of the taxation system, and, when appropriate, the Board commissions research and other studies on tax matters approved or referred to it by the Treasurer. Over the years, the Board has issued reports on the tax arrangements applying to managed investment trusts,\textsuperscript{49} on international taxation,\textsuperscript{50} on the goods and services tax,\textsuperscript{51} and on the definition of a

The Treasury considers and often follows those recommendations. Of note, Australia’s 2011-12 Budget calls for allowing the Board of Taxation to initiate its own reviews of how tax policies and laws are operating and for establishing a new Tax System Advisory Board.


54 See, e.g., Swan, supra 38.