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Despite “Super-Committee’s” Failure, Tax Reform Continues to Move through Congress

Efforts to reform the federal income tax code are showing no signs of slowing as the U.S. Congress turns to its agenda for 2012. While the Joint Select Committee on Deficit Reduction (Committee) represented a missed opportunity to put tax reform on a fast track, it is also true that the factors driving interest in tax reform remain despite the committee’s failure to reach a deal. Certainly, the congressional tax-writing committees and supporters of tax reform are diligently continuing their work.

There has been a growing interest in the last year in reforming the U.S. Internal Revenue Code (Code). Reasons to reform the code include increased simplicity, certainty, and fairness. There also is a hope that a reformed code will increase economic efficiency by decreasing its interference in investment and business decisions and, as a result, increase the competitiveness of U.S. businesses. There appears to be consensus around the idea of reducing or eliminating a number of tax preferences, incentives, credits and deductions to offset the cost of a general reduction in marginal tax rates for both individuals and businesses. More than two dozen hearings addressing tax reform’s potential effect on everything from energy policy to homeownership were held by the House and Senate tax-writing committees in 2011, and more are planned.

For those currently benefiting from relatively few tax preferences, *i.e.*, for those paying a high effective tax rate, tax reform represents an opportunity to reduce their tax burden. Conversely, those tending to benefit from such items and, as a result paying a lower effective tax rate, are at real risk of paying higher taxes.

The committee’s failure appears to mitigate these risks and opportunities in the very near term. However, over the longer term—and in key respects still in the short term—those risks and opportunities remain.

First, there remains an interest in simplifying the code to reduce economic

inefficiencies and to lower rates to reduce such inefficiencies and increase global competitiveness for U.S. business. For example, U.S. Senate Finance Committee Chairman Max Baucus continues his work on tax reform, including inquiries into modifying federal energy tax incentives to become more “technology neutral.” Meanwhile, business leaders at various hearings this year have said they would willingly give up tax breaks of direct benefit to their companies if the U.S. marginal corporate tax rate were lowered to roughly 25 percent.

Second, in the next 12 months Congress must decide the fate of expiring tax provisions worth \$4.7 trillion over the next 10 years, or roughly 12 percent of all federal revenues during the period. The bulk of these provisions stem from the 2001 and 2003 tax acts, which are set to expire at the end of 2012. But dozens of other temporary tax provisions of benefit to businesses and individuals, colloquially known as “extenders,” expired at the end of 2011. These include 15-year depreciation for leasehold and restaurant improvements, the research and development tax credit, the active financing exception for subpart F income and others. Pressure to more permanently decide the fate of these expiring provisions could provide the impetus for a broader reform of the code.

Finally, it is true that enacting a comprehensive tax reform will be an extraordinarily difficult task because of the political power of the interests behind tax provisions that would be reformed or eliminated: if reforming the code

were easy, it would have been done long ago. As a result, it appears more likely than not that tax reform will not be signed into law until after the upcoming presidential election.

However, one should not focus on when exactly tax reform will be enacted, because the shape of the legislation will be decided long before then. For example, House Ways and Means Committee Chairman David Camp (R-MI) released on October 26, 2011 a discussion draft plan for international tax reform [see next article], and Senator Rob Portman (R-OH) plans soon to release a tax reform plan based on a proposal offered while he was a member of the Committee. These and similar drafts likely will be used in whole, or in part, as the baseline for future negotiations.

Almost daily, lawmakers and congressional staff are meeting with constituents and interest groups, holding hearings, and negotiating among themselves about how to craft tax reform. And once policymakers set pen to paper, every decision made will be hard to “unmake.” As a result, those with an interest in tax reform should be actively engaged in the debate.

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