



U.S. SENATE COMMITTEE ON

Finance

SENATOR CHUCK GRASSLEY, OF IOWA - CHAIRMAN

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Remarks of Sen. Chuck Grassley
Tax Executives Institute's 55th Midyear Conference
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Thank you for inviting me to be with you. While I'm not a tax counsel like most of you, we still have a lot in common. Your job is to make sure your company pays only the taxes it owes, not a penny more or less. My job is to help make sure the U.S. government collects the taxes it's owed, not a penny more or less. At the same time, I need to promote tax policy that keeps U.S. companies competitive and Americans well-employed. Some people might think tax collection and tax relief are contradictory priorities. But consider the biblical expression, "To whom much is given, much is required." Since 2001, Congress and President Bush have enacted \$1.8 trillion over 10 years in tax relief. That doesn't even count the American Jobs Creation Act of 2004. The cost of the comprehensive business tax relief and reform in that law is fully offset with tax abuse loophole closers, and the law is considered revenue-neutral. That \$1.8 trillion is the biggest amount of tax relief in a generation. At the same time, we've enacted some of the toughest crackdowns on abusive tax shelters in decades. The message is, if you play by the rules, you'll get well-earned tax relief. If you don't play by the rules, you'll get caught and pay the price. Those who abuse the system won't be able to make chumps out of those who pay what they owe. It's only fair.

If I were you, I'd want to know what's next. Is Congress likely to give more tax relief to businesses, shut down more tax loopholes, or both? I can't speak for the House, or what will get final passage, but I'll tell you my priorities. First, on more tax relief for businesses.

Tax Relief, Reform

The JOBS Act last October cuts the tax rate for U.S.-based manufacturing from 35 percent to 32 percent. If you make it here, you get a tax cut here. The law is designed to end trade sanctions hitting U.S. exporters. Those steps, plus the international tax reforms, will help to keep our companies competitive. But we in Washington can't rest on our laurels. The tax code is still much too complicated for businesses and individuals alike. You shouldn't need a Ph.D or an army of experts to fill out your taxes. That last part might get me in trouble with this crowd. Believe me, I want to see Americans gainfully employed, and that includes you. Seriously, there have been a lot of headlines about U.S. taxpayers skirting their fair share. I've helped to make some of those headlines. Non-payment is a serious problem. The IRS just estimated that between \$312 billion and \$353 billion in U.S. taxes went uncollected in 2001. That's at least 15 percent of the amount due. That was just for individuals, not businesses.

The IRS commissioner attributes some of the tax gap to complexity, and some to plain old cheating. Policymakers have an obligation to fix both. It's wrong if the tax code is so complex, and regulations are so dense, that honest taxpayers can't figure out what they owe. And it's wrong if tax enforcement is holier than Swiss cheese and lets lots of people get off scot-free. On the reform side,

I give the President a lot of credit for convening a tax reform panel. He has the greatest bully pulpit in the country. He can do more to build a national consensus on tax reform than anyone else. I look forward to his panel's work. The panel plans to make recommendations to the Treasury Department at the end of July. I'll be glad to have the Finance Committee receive and consider those recommendations. In the meantime, I have my staff looking at the best ways to simplify the tax code so it just makes more sense.

That review is from the "bottom up" – meaning, the easier reforms should be on the table with the most difficult ones. I expect the Finance Committee to conduct some hearings on tax reform and simplification this year. I hope the Committee will produce a bipartisan package of simplification and other reform measures. Congress has made some progress here. Last fall, we enacted the uniform definition of a child for five different tax functions. That was just common sense, and it makes filing easier for millions of taxpayers. There are many more simplification measures where that came from. The Joint Committee on Taxation gave Congress a list of specific simplification steps in a comprehensive study in 2001. Congress needs to continue making progress to enact the recommendations.

What might be even more valuable is the Joint Committee's identification of sources of complexity. These include statutory language that's sometimes too technical and other times too vague; the use of temporary provisions; broad grants of regulatory authority; and the effects of the congressional budget process. For example, Congress phased out the estate tax – effectively repealing it for one year in 2010. It'll come back in full force in 2011 unless Congress gets rid of it. Ideally, we would have been able to abolish it outright, permanently. That would have been much easier on taxpayers and estate planners. The Alternative Minimum Tax was intended to ensure that the very wealthy wouldn't escape all taxes. But the tax isn't tied to inflation, so it hits more and more middle-income taxpayers each year, contrary to congressional intent. The problem has mushroomed; Congress lately has offered some temporary relief. Cleaning up the mess for good will cost billions of dollars.

The lessons for those of us making tax policy are numerous: (1) First, do no harm. We need to look at whether the policy creates winners and losers, or whether it treats all taxpayers fairly. (2) Second, try to anticipate as many future consequences as possible. We don't make tax policy in a vacuum. One provision can interact badly with another one. We might encourage economic growth in one sector, such as consumption, but discourage it in another, such as investment. We need the full picture before we act. (3) Third, look for ways to make things easier for taxpayers. Every time we enact a savings incentive, we create a different set of paperwork for taxpayers. One set is for Individual Retirement Accounts, another one is for educational incentives, etc. We need to find ways to simplify and consolidate the methods that get the same result. Taxpayers will be more likely to take advantage of provisions that don't cause headaches. (4) Give the IRS good guidance. The IRS is responsible for enforcing tax law; Congress is responsible for writing it. We have to be clear on what we intend. Otherwise the IRS and the courts might interpret our intentions for us. That causes complexity for everyone involved. (5) Adhere to these principles in a highly partisan environment. Members of Congress who compromise with the other side face criticism, even as they get good results for taxpayers. My view is, if we focus on good policy, the politics take care of themselves.

I intend to keep these lessons in mind as Congress and President debate tax simplification and reform options. Our nation has nearly 100 years of history with the tax code. Regardless of the

model in mind – a flat tax, a national sales tax, or a value-added tax – we need to let experience be our guide. Simplification and reform require sophistication and finesse. On specific tax relief for businesses, a lot of that is unknown until we get tax numbers through the budget. The Senate voted to increase its five-year tax cut target to \$134 billion. The House included room for \$106 billion in tax cuts, with only \$45 billion of them offered the procedural protection of reconciliation. The negotiations to get to a final number will be tough. Depending on how much room there is, I'd like to see continued relief on capital gains and dividends. The current 15 percent capital gains rate will expire at the end of 2008. That would cause the rate to bounce back up to its historical 20 percent. That would be a 33 percent increase. The Senate budget would extend the 15 percent rate for another two years to 2010. The Senate number is also meant to give enough room for extensions of the college tuition deduction, small business expensing, and savers' credit. I hope to enact these extensions this year and keep current levels of tax relief. People need certainty in these areas. Our economy needs that certainty, too.

Also the Finance Committee has started what I hope is a thoughtful look at tax provisions expiring at the end of 2005. Often Congress is forced to make an all-or-nothing decision on whether to extend such provisions with no changes. During the 108th Congress, the Senate was able to pass much-needed changes to the research and development tax credit and the work opportunity tax credit. Unfortunately, those improved provisions didn't make it out of conference – the House believed they lacked a basis for change. This time, I want members to examine the merits of expiring provisions. Some provisions might need to become permanent. Others might need to lapse. And others might need reforms to be easier to administer. Efficiency should be a key consideration. For each expiring provision extended or made permanent, we need to be sure tax dollars aren't being wasted. Sometimes, we enact short-term provisions to provide temporary economic stimulus – for example, the temporary tax incentives to aid the New York Liberty Zone after 9/11.

The Joint Committee on Taxation has given us recommendations for all of the extender provisions. The Finance Committee is requesting public comment by April 15, so I encourage you to weigh in if you haven't already.

Enforcement

I've given what you might consider the good news first. Now I'll give you what might seem like the bad news – what's in store on enforcement. But before I get into specifics, I hope you don't see enforcement as bad news. Those who cheat on their taxes make chumps out of everyone who pays. Better enforcement should lead to fairness for all. As I mentioned, last fall's JOBS Act contains the most significant crackdown on corporate abuses and tax dodges in a generation. We went after general tax shelters, leasing tax shelters, corporate expatriation, and more. You might be wondering what's next – for example, will we embrace a general anti-abuse approach like codifying the economic substance doctrine?

As you may know, the Senate passed codification of economic substance doctrine several times over the past two years. Each time, the House rejected the provision in conference. The Finance Committee passed a tax shelters bill in May 2002 that did not contain economic substance codification. The origins of codification trace back to July 2002, when it was proposed by Chairman Thomas in his FSC-ETI repeal bill. Since its House introduction, this measure received increasing support in the Senate – largely because of the Enron investigation conducted by the Joint Committee, at the Finance Committee's request. The Enron Report, released in February 2003, was filled with descriptions of Enron tax shelters having no business purpose or economic substance.

From the very beginning, I've had concerns about certainty in applying this doctrine. If taxpayers are going to be subjected to substantial penalties for violating it, they need to know with certainty when those penalties will apply. Nonetheless, recent cases have again caused us concern about the court's willingness to apply this doctrine consistently. One court even declined to apply the doctrine because Congress has not enacted codification. This ruling is troubling because we thought application of this doctrine was better left to the courts. This issue won't go away anytime soon. In fact, in its recent tax gap report, the Joint Committee on Taxation has, for the first time, taken a position advocating a limited codification of the economic substance doctrine. I anticipate that any future legislation won't be the same as what we've seen in the past because the prior proposals have been repeatedly rejected by the House in conference. We've received numerous comments on this issue, most of them negative, but have also received several suggestions on alternative ways to approach this problem. Our work in this area continues.

Also, Senator Baucus and I are conducting an extensive review of the Advanced Pricing Agreement program. Our interest came because of the increasing number of APA's in recent years, the billions of dollars worth of transactions covered, and the IRS' discretion in these matters. We're looking at whether taxpayers are treated consistently and how the IRS is managing its backlog, among other issues. It's too early to tell what might come out of our review. The program has value – it keeps taxpayers and the IRS out of court in endless arguments over complicated business facts. But it's fair to predict that if we find significant problems that raise questions about whether the APA is meeting congressional intent -- of effectively solving potential tax problems prior to filing and also protecting the public fisc -- then we'll have to look at real reform. I mentioned the problem with the tax gap – meaning the difference between what taxpayers should pay and what they actually pay on time. The committee has been looking at this problem since last year. On April 14, we're having a hearing to hear from the IRS commissioner on further ideas for closing the gap.

Remember, the findings so far are only for individuals, not corporations. Next we need to look at corporations and pass-through entities. We need a complete picture of the tax gap. Non-profit reform also continues to be a high priority. This morning, the committee is having a hearing to look at the waterfront of charitable abuses and solutions. This is probably our last hearing before Senator Baucus and I propose our legislative reform package. As Finance Committee leaders, we have a duty to make sure charitable donations actually help those in need. There are problems with charities and companies enriching each other at the expense of the needy and taxpayers. For example, some charities purchase insurance policies on donors' lives, and then those policies provide significant benefits to companies. Today I'm releasing a new letter from the IRS commissioner. He says almost half of the 31 transactions identified as listed transactions involve the use of a tax-indifferent party including charities. He adds that this type of abuse -- using tax exempts as accommodation parties -- is on the rise. We'll put an end to that.

Donor advised funds – often run by mutual fund companies – allow donors to contribute and take an immediate deduction but then direct the distribution of the donation to charities over time. You can expect a crackdown on all of these arrangements.

Conclusion

I hope you'll see my enforcement comments in the spirit in which they were given. I'm pro-business and pro-taxpayer. I believe American companies show more work ethic and more innovation than any in the world. Policy out of Washington should capitalize on that value. It should make companies more competitive with their global counterparts, and more competitive with

one another. I can't compete in farming if I get \$5 a bushel for my soybeans and my neighbor gets \$10 a bushel because he cheats. Those who play by the rules should get rewarded for it, and the rules should make sense. Now I'm not coming up with all of my good ideas on my own. I want to hear from you. Representative democracy is a two-way street, and for it work, I need your thoughts. Working together, we'll harness our nation's top resources to thrive well into the 21st Century. We'll take the blessings we've been given as Americans, and we'll continue to prove ourselves worthy of living, working, and doing business in the greatest nation on Earth. Now I'll take your questions. As Yogi Berra said, if you ask me anything I don't know, I won't answer. But I'll do my best.