



<http://finance.senate.gov>
Press_Office@finance-rep.senate.gov

Floor Speech of Sen. Chuck Grassley
Economic Substance Offset in the Tax Title to Farm Bill
Delivered Tuesday, Nov. 6, 2007

I'd like to take time today to comment on a revenue raiser in the farm bill. The revenue raiser is a proposal to clarify a judicial doctrine in the tax law known as the economic substance doctrine. Now, for a lot of folks, this proposal may sound like an esoteric tax policy matter and they might wonder why I'm focusing on it today. The reason, Mr. President, is that the White House has indicated that the President will veto the farm bill if this proposal is included in a bill sent to the President's desk. I ask unanimous consent that a copy of an article from this morning's Washington Post entitled "Bush vows to veto Senate farm bill" be printed in the record.

Before I discuss the specifics of the economic substance doctrine, I'd like to put this revenue raiser in context. We've heard a lot about pay-go this year. Of course, pay-go was in place for many years before the current one. The difference is that the old version of pay-go applied it as a backstop to the budget resolution. So, if a proposal spent more than the budget permitted and added to the deficit, a pay-go point of order was possible. Likewise, if a proposal cut taxes more than the amount of revenue the budget assumed would come in, pay-go could apply.

This year Congress is struggling because a rigid notion of pay-go has ham-strung the committees that process revenue and spending policy. The rubber has hit the road with pay-go in the end of session business. It has been a bumpy road. And it is only going to get bumpier.

As everyone knows, Congress has a lot of unfinished business. I'm going to focus on the unfinished tax business. I've got a chart here. This chart shows the unfinished tax business. It accounts for all the bills we've passed out of the Finance Committee. It also accounts for the expiring provisions, known as "tax extenders." The biggest item on the revenue loss chart is the alternative minimum tax ("AMT") patch. It runs at a revenue loss of \$55 billion for this year to prevent 19 million middle income families from paying the AMT. Since we are in the 2008 fiscal year, I've included the 2008 tax extenders and the 2008 AMT patch. This chart accounts for the revenue loss from the farm bill package that is before us today. It is a \$13 billion revenue loss. It's right there. My chart shows the revenue loss side as demands on the well. It is at the top of the well in the bucket. There are a lot of thirsty bills. Those thirsty bills carry a revenue loss of \$170 billion over 5 years. I've accounted for revenue offsets. This figure includes all revenue raisers proposed by Senate Democrats that are specified and scored by the non-partisan Joint Committee on Taxation.

That figure includes \$32 billion from Finance Committee-approved proposals and \$29 billion in other proposals. That totals \$61 billion. This offset figure is calculated from the vantage point of the Senate Democratic leadership. In this total are proposals that House Democrats have opposed, like shutting off the foreign subway leasing tax shelter known as "SILOS." In this total are proposals that most Senate Republicans have opposed, like a re-imposition of the Superfund taxes. In this total are many proposals that the Bush Administration opposes.

With this favorable assumption to them, the pay-go advocates in the Senate need to know that, as we stand today, they cannot meet pay-go. In other words, the demands on the revenue well are \$170 billion and the available raisers are \$61 billion. That's a shortfall of \$109 billion. In other words, Mr. President, the revenue well is dry to the tune of \$109 billion. One hundred and nine billion is a lot of money. Even in Washington, D.C.

If the proposals are scored over 10 years, the shortfall narrows slightly to \$76 billion. And it is possible that some of the revenue raisers in the Chairman Rangel's bill may be pursued by the Senate Democratic Leadership. But, as it stands now, for unfinished tax business alone, by this accounting, we cannot meet pay-go. Mr. President, I point this out because everybody is missing the big picture on how we wrap up our overdue legislative business.

On the farm bill alone, my chart treats the farm bill as fully offset. My chart is created from the perspective of the Senate Democratic Leadership and so, it shows the farm bill as offset. The problem is President Bush's opposition to the key revenue raiser is not accounted for in this chart. President Bush's position matters. His opposition to this revenue raiser would have to be overcome with a veto override. As my friends in the Democratic Leadership know, that's a tough hurdle.

So, my point is that it is time to get practical around here. This well chart shows that, as we sit here today, looking at it from a Senate Democratic Leadership perspective, the revenue well is dry. To insist on pay-go, without a sense of realistically available offsets, is to go up a blind alley.

I say to my Democratic friends, at this late point in the legislative year, let's focus on the practical. Let's apply the offsets we can agree on in a manner we can agree on. We need to get to a posture of what can be agreed to by the House, Senate Republicans, and the White House.

The AMT patch is the 800-pound gorilla in this discussion. It is \$55 billion. It affects 23 million families and could adversely affect another 27 million families. The AMT patch is long-overdue. It needs to be completed expeditiously. To address this important matter solely from a pay-go perspective is to ignore the reality that it needs to get done. Republicans are ready, willing and able to help get the patch done, but for many reasons I've discussed all year, not at the price of offsets.

Mr. President, I will now go into the reasons why clarification of the economic substance doctrine is an appropriate revenue raiser. The provision made the Finance Committee package revenue neutral, raising \$10 billion over 10 years. But I support codification of economic substance not just to raise money. As Ranking Member of the Finance Committee, and as Chairman in the last two Congresses, I've supported it because it's the right policy. This provision is an improved version of a provision that passed the Finance Committee and the full Senate in the last two Congresses.

The prior version was included in two bills passed by the full Senate in the 109th Congress twice in the tax reconciliation bill, once in 2005 by a vote of 64-33 and again in 2006 by a vote of 66-31. It also passed the full Senate two times in the 108th Congress, once in the 2003 tax cut bill by a vote of 51-49 and again in the 2004 JOBS bill by a vote of 92-5.

Codifying the economic substance doctrine will clarify the test is a conjunctive test requiring both a meaningful change in economic position and a business purpose independent of Federal taxes.

The courts are split on whether a transaction must have both economic substance and business purpose. This will give courts a uniform doctrine to apply to non-economic transactions that are inappropriately motivated solely to avoid Federal taxes.

It will also ensure that a court will not overturn the doctrine, as the trial judge in the Coltec case tried to do, saying that “the use of the economic substance doctrine to trump the mere compliance with the Code would violate the separation of powers.”

Although the court of appeals reversed that decision, I am still concerned that another strict constructionist judge might reach a similar conclusion.

Most importantly, codifying the economic substance doctrine will provide an additional deterrent against taxpayers entering into transactions solely for tax purposes in ways that are inconsistent with congressional intent.

As I said earlier, this provision is an improved version of what has already passed the Finance Committee and the full Senate. Modifications were made in response to concerns of taxpayers that codification would throw legitimate tax planning into question and allow the IRS to substitute its business judgment for that of the taxpayer.

The strict liability nature of the penalty has been retained in order to effectively deter taxpayers from entering into tax-motivated transactions in unintended ways. Indeed, according to the Joint Committee on Taxation, the bulk of the revenue score is attributable to the strict liability penalty. Not because the IRS will collect the penalty, but because the penalty will alter taxpayer behavior and cause them to forgo entering into non-economic tax-motivated transactions that Congress didn't intend. We have heard complaints that a strict liability penalty will cause IRS field agents to overreach and courts to be reluctant to apply the doctrine.

These are serious concerns, and we've addressed those concerns by requiring the IRS to nationally coordinate through the Chief Counsel's office when the penalty is asserted and when it is compromised. This procedure is similar to a process currently used by the IRS to designate cases for litigation. As a protective measure, taxpayers will be permitted to make their case to the IRS at the national level before the penalty is asserted.

Of course, cases involving the economic substance doctrine should be going through Chief Counsel already, and taxpayers currently have the ability to persuade the IRS not to assert a penalty. But because of the strict liability nature of this penalty, it is important to formalize this process and move

it to a higher level of review. Getting the Chief Counsel's office involved earlier in the controversy should help taxpayers and the IRS resolve or make litigation decisions regarding tax shelters earlier. We have also lowered the penalty for undisclosed transactions from 40 percent to 30 percent, to bring it in line with the penalty on undisclosed listed transactions.

The proposal to codify economic substance has been controversial, even though it has passed the Finance Committee and the full Senate in the last two Congresses. Taxpayers and practitioners expressed legitimate concerns about it. We've addressed those concerns, maybe not in the way everybody wants, but certainly in a responsible way. As a general matter, in my tenure as Chairman of the Finance Committee, I'm proud to have kept taxes down. During my tenure, we enacted bipartisan tax relief bills that totaled about \$2 trillion over 10 years.

For the critics of this revenue raiser, I'd refer them to that record. By the way for those on the liberal side of the political spectrum, I'd point out that, as a percentage of GDP, the Federal Treasury is taking in a percentage that is above the Post World War II average.

So, Mr. President, codifying the economic substance doctrine should be considered on its merits. It should not be dismissed because it scores as a revenue raiser. It should not be endorsed because it scores as a revenue raiser. In my view, it should be enacted because it's the right tax policy. Folks need to take off the bean-counting green eye-shades and look at the tax policy. The same goes for the long-overdue AMT patch. It's not about maximizing Federal revenues. It's about fair taxation of 19 million middle income families.