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Highlights

Highlights of [GAO-06-1113T](#), a Testimony to the Committee on Finance, U.S. Senate

Why GAO Did This Study

Business income taxes, both corporate and noncorporate, are a significant portion of federal tax revenue. Businesses also play a crucial role in collecting taxes from individuals, through withholding and information reporting. However, the design of the current system of business taxation is widely seen as flawed. It distorts investment decisions, hurting the performance of the economy. Its complexity imposes planning and record keeping costs, facilitates tax shelters, and provides potential cover for those who want to cheat.

Not surprisingly, business tax reform is part of the debate about overall tax reform. The debate is occurring at a time when long-range projections show that, without a policy change, the gap between spending and revenues will widen.

This testimony reviews the nation's long term fiscal imbalance and what is wrong with the current system of business taxation and provides some principles that ought to guide the debate about business tax reform.

This statement is based on previously published GAO work and reviews of relevant literature.

www.gao.gov/cgi-bin/getrpt?GAO-06-1113T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact James White at (202) 512-9110 or whitej@gao.gov.

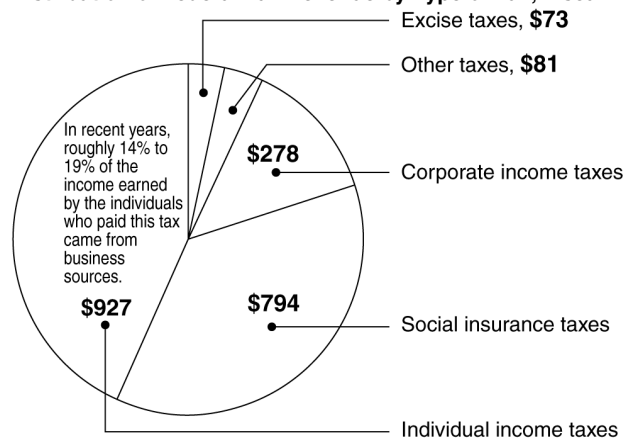
BUSINESS TAX REFORM

Simplification and Increased Uniformity of Taxation Would Yield Benefits

What GAO Found

The size of business tax revenues makes them very relevant to any plan for addressing the nation's long-term fiscal imbalance. Reexamining both federal spending and revenues, including business tax policy and compliance must be part of a multipronged approach to address the imbalance.

Distribution of Federal Tax Revenue by Type of Tax, Fiscal Year 2005 (\$ billions)



Source: GAO analysis of data from the Office of Management and Budget and from Internal Revenue Service (IRS).

Some features of current business taxes channel investments into tax-favored activities and away from more productive activities and, thereby, reduce the economic well-being of all Americans. Complexity in business tax laws imposes costs of its own, facilitates tax shelters, and provides potential cover for those who want to cheat. IRS's latest estimates show a business tax gap of at least \$141 billion for 2001. This in turn undermines confidence in the fairness of our tax system—citizens' confidence that their friends, neighbors, and business competitors pay their fair share of taxes.

Principles that should guide the business tax reform debate include:

- The proposed system should raise sufficient revenue over time to fund our current and future expected expenditures.
- The tax base should be as broad as possible, which helps to minimize overall tax rates.
- The proposed system should improve compliance rates by reducing tax preferences and complexity and increasing transparency.
- To the extent other goals, such as equity and simplicity, allow, the tax system should aim for neutrality by not favoring some business activities over others. More neutral tax policy has the potential to enhance economic growth, increase productivity and improve the competitiveness of the U.S. economy in terms of standard of living.
- The consideration of transition rules must be an integral part of any reform proposal.