President's tax plan offers lower corporate tax rates in exchange for funding job creation –July 29, 2013

President Obama has unveiled a tax reform plan that aims to simplify the tax code for businesses, eliminate loopholes, and lower the top corporate tax rate to 28%, then use the "one-time revenues" generated to improve infrastructure, manufacturing incentives, and job training. The Administration is emphasizing that the plan reflects a departure from the President's earlier insistence that corporate and individual tax reform be done in tandem, but opponents to the plan characterize it as a mere tax hike that breaks campaign promises for revenue-neutral corporate tax reform.

Background on corporate income tax. The income of a C corporation is subject to double taxation since it is taxed once at the corporate level, then again at the shareholder level. "Pass-through entities," such as partnerships and S corporations, are only taxed at the partner level.

The general procedure for computing corporate tax is basically the same as the procedure for computing the tax of any other taxpayer. It involves computation of taxable income, application of rates (nominal top rate of 35%), and subtraction of credits. But, specific rates are provided for corporations, special rules apply to certain special corporations, and special deductions are also authorized.

There are many deductions and credits available to corporate taxpayers. Some of these provisions can be categorized as intending to encourage taxpayer spending and revive the economy, such as the accelerated write-off of business equipment and machinery. Others support other policy considerations, such as Code Sec. 174's deduction for research and experimental expenditures, or various deductions and credits designed to promote "green" technology. Some claim that other provisions are simply a result of lobbying efforts by influential industries. The cumulative result of these provisions is a complex Code that allows certain corporate taxpayers to pay an effective tax far below the nominal 35% top rate.

U.S. corporations are generally taxable on income from outside the U.S. just as they are on income from inside the U.S. However, a foreign corporation with U.S. owners can often earn and accumulate certain types of income at tax rates below the U.S. rate because, subject to certain limitations, the foreign-source income is insulated from U.S. tax until it is actually brought back to the U.S. (i.e., repatriated and distributed to the U.S. owners).

The President's "Pro-Growth Tax Reform and Jobs Package." President Obama's new plan, which he described in a July 30th speech in Tennessee, is essentially a jobs creation plan that also puts corporate tax reform on the table.

The tax aspects of the plan include:

- **Lowering the top corporate rate.** The plan calls for lowering the top rate to "no higher than 28%."

Observation: This is the same rate that has been proposed by President Obama on prior occasions. A number of Republican proposals have suggested a 25% rate. The extent to which the corporate tax rate can be reduced in a revenue-neutral way via the elimination of corporate tax breaks was a hot topic in the 2012 Presidential race

Eliminating loopholes. Although the plan lacked specifics at this point (presumably to leave room for negotiation), popular targets include eliminating and/or modifying the following: the last-in, first-out (LIFO) accounting method, interest expense deduction rules, and quick depreciation for corporate jets.

- **Simplifying tax filing.** Presumably, this refers largely to streamlining the filing process and lowering overall lower rates.
- **Increasing expensing for small businesses.** The plan would allow small businesses to annually expense up to $1 million in investments (for 2013, maximum expensing amount is $500,000 with a $2,000,000 phaseout threshold; for later years, $25,000 and $200,000, respectively).
- **Establishing a new manufacturing tax rate.** The plan would set a manufacturing tax rate at no higher than 25%.
- **Clean energy incentives; R&D.** The plan would also encourage research and development (presumably, by permanently extending the R&D credit) and the production of clean energy.
- **Removing incentives to locate overseas.** Again, the President's new plan didn't set out many specifics. However, earlier proposals, such as those in the President's 2014 budget, include creating a new general business credit for “insourcing,” and disallowing deductions for expenses associated with outsourcing, a U.S. trade or business (see Weekly Alert ¶ 8 04/18/2013 for more details).

Revenue neutral with a windfall? The fact sheet on the President's plan vaguely refers to using the “one-time revenue raised in the transition to a new business tax system” to fund his job creation and infrastructure plans. An Administration representative indicated that the revenue could be generated by a transition fee on unrepatriated foreign earnings, a minimum tax on foreign earnings, or slower depreciation for various business equipment.

The plan, and this revenue raiser in particular, has been characterized by opponents as a tax hike and a violation of the President's commitment during the campaign to reform corporate taxes in a revenue-neutral way.

Political response. The White House is characterizing the President's so-called “grand bargain” as reaching across the aisle—showing a willingness to make concessions (i.e., by putting corporate tax reform on the table without individual tax reform) in order to move forward.

However, Republicans were quick to note that, in previous proposals, the President supported all of the ideas included in the plan—including lower corporate tax rates.

Senator Orrin Hatch (R-UT), Ranking Member of the Senate Finance Committee, called the plan “curious, contradictory, and unserious.” He said that it merely reflected “more of the same tax-and-spend proposals” and that it would leave “small businesses out in the cold” (i.e., because many small businesses would receive no benefit from corporate tax reform).

Senator Mitch McConnell (R-KY) said that the President's plan “lacks meaningful bipartisan input” and includes a tax hike that would “dampen any boost businesses might otherwise get.” He also called the plan a “rebuke” to Senate Finance Committee Chairman Max Baucus (D-MT), who, with House Ways and Means Committee Chairman Dave Camp (R-MI), has been leading an effort for bipartisan tax reform.

Senator Baucus and Rep. Camp themselves issued a joint statement on the President's proposal in which they “welcome the President's recognition that our broken, outdated tax code is making it harder for U.S. companies to compete and American families to get ahead” and “look forward to continuing to work with the Administration... to simplify the tax code and lower rates for all families and businesses.” They neither endorsed nor criticized the plan.