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Opportunities and challenges ahead

2015 Tax Policy Outlook

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The heart of the matter

The key question for US tax policymakers is whether 2015 will be marked by compromise or gridlock. President Barack Obama and Republican leaders in the US House of Representatives and the US Senate have said they want to work together and have identified tax reform as one of the few priority issues on which agreement could be possible. For the President, the next two years are an opportunity to define his second-term legacy. House Speaker John Boehner (R-OH) and Senate Majority Leader Mitch McConnell (R-KY) have said they want to demonstrate an ability to govern ahead of the 2016 presidential election. At the same time, differences between the two political parties over immigration, healthcare, energy policy, environmental regulations, and other economic and social issues will pose challenges for the enactment of significant legislation.

Following the 2014 midterm Congressional elections, President Obama called tax reform legislation that "closes loopholes and makes it more attractive to create jobs in the United States" a key issue on which he hopes to work with the new Republican-controlled Congress. House Speaker Boehner and Senate Majority Leader McConnell also identified reform of an "insanely complex tax code that is driving jobs overseas" as a priority for the 114th Congress.

Meanwhile, in December 2014, Congress passed one-year retroactive extension of the research credit and other temporary business and individual tax provisions; thus, these provisions expired again on December 31, 2014. If, in coming months, President Obama and Congress cannot reach an agreement on tax reform legislation that would address the expired provisions, look for Congress later this year to make a strong push to make permanent the research credit and certain other business and individual tax provisions that have expired, along with temporary extensions of certain other provisions and possible elimination of some temporary provisions.

Congress this year also will need to address other issues important to businesses, including appropriations for government spending programs, an increase in the statutory federal debt limit, highway and infrastructure funding, international trade, tax treaties, and state tax issues. Legislative work on these issues will affect the amount of time that can be devoted to other issues like tax reform.

Multinational enterprises will want to watch carefully for developments related to the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan. The OECD is on track to issue the plan's final reports no later than December 2015.

Overview

President Obama will set forth his legislative goals for 2015 in his January 20 State of the Union address and in his Fiscal Year (FY) 2016 budget, which White House officials have said will be released on the first Monday in February (February 2), as specified by law. The President in late December said that the Administration soon will be putting out 'specific' tax reform proposals that build on his 2012 'framework for business tax reform,' in order to encourage action on tax reform.

Bipartisan support will be necessary to enact legislation.

Instead of that, a January 17 White House release indicates that the President's budget will include tax proposals to increase the top rates on capital gains and dividend income to 28 percent for joint filers with incomes above $500,000, and to change the estate tax carryover basis rules to limit the ability to "step-up" the basis of inherited property. In addition, the budget will include a new fee on large financial institutions. Revenue from these proposals would be used to provide a new $500 second earner tax credit for families where both spouses work, increase the child tax credit to up to $3,000 per child under five, and provide additional retirement savings incentives.

Note: The question of how to offset the cost of any new targeted tax relief proposals in a revenue-neutral tax reform bill likely will be the subject of extended debate. A number of Republican leaders have responded to the new White House proposals by noting their opposition to the proposed tax increases.

The prospects for tax reform and other tax legislation on which this outlook focuses may depend in part on the extent to which more divisive issues—such as immigration, healthcare, energy policy, environmental regulations, and foreign policy—dominate the agenda of the Republican-led Congress and President Obama.

Bipartisan support will be necessary to enact legislation. While Republicans won a majority in the Senate and increased their House majority, they do not have the 60 votes in the Senate needed to end a filibuster nor the two-thirds majority required in each chamber to override a presidential veto.

Over the past several months, President Obama has pursued what he has called a 'pen and phone' effort to issue executive actions and negotiate international agreements, citing his authority as president. Congressional Republicans have said they will attempt to reverse the President's executive action on immigration covering roughly five million undocumented immigrants. Many Republican leaders in the House and Senate also have expressed opposition to President Obama's recent agreement with China to address climate change, and actions taken to normalize diplomatic relations with Cuba.

House and Senate Republicans are expected to push bills this year to repeal the Affordable Care Act (ACA), to make significant changes to the Dodd-Frank Wall Street Reform and Consumer Protection Act, to limit federal regulations, and to revisit other legislation enacted during President Obama's first term, notwithstanding expected presidential vetoes.

Even if some sweeping efforts, like full repeal of the ACA, fall short given expected presidential vetoes, Republicans may be able to pass more limited modifications to recently enacted laws. Senate approval of such bills generally will require some Democratic support, given the Senate's 60-vote threshold to advance most legislation.

For example, Senate Majority Leader McConnell may be able to secure more than 60 votes for bills to support construction of the Keystone XL oil pipeline between Canada and the United States and to repeal the ACA's medical device excise tax. Votes on these issues often were blocked in the Senate when Democrats held majority control, but they gained significant bipartisan support. In late 2014, the Senate fell one vote short of the 60 votes required to advance Keystone XL legislation. The Senate in 2013 voted 79 to 20 to approve a non-binding budget resolution amendment calling for repeal of the medical device excise tax.

Majority Leader McConnell has said that Keystone XL will be the first bill (S. 1) put to a vote in the Senate this year. The House passed a bill (H.R. 3) on this issue earlier this month. However, President Obama has already indicated he will veto a Keystone XL bill bypassing the Administration's review process if Congress sends one to him. The House vote of 266 to 153 to pass H.R. 3—which included 28 House Democrats—fell short of the two-thirds majority that would be required to override a presidential veto.

Congress early this year also is expected to consider legislation to repeal the medical device excise tax. House and Senate bills (H.R. 160; S. 149) to repeal the tax were introduced in the first days of the new Congress. President Obama has not yet said whether he would veto these bills.

President Obama and the Congress may need to respond legislatively if the Supreme Court decides this year in *King v. Burwell* that ACA tax subsidies to purchase health insurance are not available to individuals who purchase coverage in federal exchanges, rather than from one of the state exchanges.

In an example of how some issues can have broad bipartisan support, Congress in early 2015 acted quickly to reauthorize the Terrorism Risk Reinsurance Act (TRIA), which expired on December 31, 2014. The House on January 7 voted 416 to 5 to renew TRIA for six years, and the Senate on January 8 voted 93 to 4 to clear the bill for signing by President Obama.

President Obama and Congressional Republicans have expressed a shared interest in advancing international trade agreements. President Obama is expected to seek approval of trade promotion authority—also known as 'fast track' trade negotiating authority—to expedite Congressional consideration of new trade agreements.

Fiscal policy deadlines

Last December, Congress passed a $1.1 trillion spending bill to fund most of the federal government for FY 2015, which ends September 30, 2015. However, the law funds the Department of Homeland Security (DHS), which has jurisdiction over immigration enforcement, only through February 27, 2015. This deadline is intended to allow Republicans additional time to construct a legislative response to President Obama's executive action on immigration.

Calling on Congress to respond with its own proposal for comprehensive immigration reform, President Obama has said he would veto a DHS funding bill passed by the House on January 14 that attempts to block his executive actions on immigration. In addition to the near-term DHS funding deadline, Congress and the Administration will need to agree to a FY 2016 spending bill before September 30, 2015.

Another test of how effectively Democrats and Republicans can work together next year will come when Congress considers legislation to increase the statutory federal debt limit. A temporary debt limit suspension expires March 15, 2015, but the Treasury Department can use 'extraordinary measures' to avoid immediate default. According to some projections, these extraordinary measures may not be exhausted until August or later. In the past, debt limit legislation has provided an opportunity for Congress to consider deficit reduction issues and changes to the tax law.

Senate Majority Leader McConnell has said that there will be no default on the federal debt and no government shutdowns under a Republican-controlled Congress.

Congress will need to address the May 31 expiration of federal highway program authorization legislation. In recent weeks, some policymakers have called for an increase in federal fuel excise taxes, which were last raised in 1993. While some members of Congress have expressed a willingness to consider an increase in fuel excise taxes, others remain strongly opposed to the idea.

Other fiscal deadlines in 2015 include a March 31 expiration of temporary Medicare 'doc-fix' legislation preventing scheduled reductions in physician payment rates, and the June 30 expiration of authorization for the Export-Import Bank.

One test of how effectively Democrats and Republicans can work together this year will come when Congress considers legislation to increase the statutory federal debt limit.

Business tax reform

Policy differences between President Obama and Congressional Republicans will continue to make it challenging to reach agreement on comprehensive tax reform for both businesses and individuals.

While leaders in both parties have expressed support for lowering the US corporate tax rate, President Obama has continued to call for increased revenues from upper-income individuals and corporations to be used for deficit reduction and spending priorities. In contrast, Congressional Republicans in recent years have called for lowering both corporate and individual tax rates in a revenue-neutral manner. Republicans generally have opposed tax increases to reduce the federal deficit. Instead, they have called for cuts in discretionary spending and fundamental changes in federal entitlement spending programs, such as Social Security, Medicare, and Medicaid, which Democrats have been unwilling to support.

President Obama and key Republican leaders on Capitol Hill have expressed optimism that there could be an agreement to advance a more targeted business tax reform. This effort could focus primarily on reducing the US corporate tax rate—now the highest in the world among advanced economies—and updating US international tax rules, while also addressing the tax concerns of businesses that operate as non-corporate ‘passthrough’ entities. At the same time, for individuals, Congress could consider some targeted tax relief proposals as well as relatively noncontroversial proposals to simplify and improve education and retirement savings tax incentives.

House Ways and Means Committee Chairman Paul Ryan (R-WI) has said that a ‘phase 1’ approach to tax reform focusing on business issues may be possible in 2015. Chairman Ryan on January 13 said that the Ways and Means Committee may pursue an ‘aggressive’ schedule on tax reform.

Senate Finance Committee Chairman Orrin Hatch (R-UT) last December laid out several principles for tax reform, including revenue neutrality, and remarked that “if we are ever going to make tax reform a reality, both parties will have to come together to make it happen.” Also on January 13, Chairman Hatch announced plans to establish bipartisan Finance Committee tax reform working groups.

As a practical matter, the window for tax reform in the new Congress may begin to close in late 2015, as the political parties and presidential candidates begin to stake out positions in advance of the 2016 presidential election. Ways and Means Chairman Ryan and others in Congress have commented that tax reform either will happen in 2015 or will have to wait until the next president takes office in 2017. If tax reform is delayed, the current Congress will still have an opportunity to lay the foundation for future reform legislation through tax committee hearings and the drafting of legislative proposals.

Revenue issues remain a potential sticking point

While there is general consensus that business tax reform should be revenue neutral (i.e., not result in a net revenue gain or loss), there is disagreement about how revenue neutrality is to be measured.

President Obama has said tax reform should be revenue neutral beyond the traditional 10-year budget window; that is, the cost of permanently reducing the corporate tax rate would have to be offset not only during the first 10 years but thereafter. Administration officials have said that 'one-time' revenues—such as from repatriation of foreign earnings—should not be available to pay for a permanent reduction in the corporate rate.

In another important 'scoring' issue, Ways and Means Chairman Ryan has said that the Republican-led Congress will use a more 'reality based' model for measuring the effects of tax reform legislation on the federal budget. House rules adopted earlier this year require the staffs of the Congressional Budget Office (CBO) and Joint Committee on Taxation (JCT) to incorporate 'to the extent practicable' dynamic macroeconomic analysis in budget estimates for major legislation.

In a November 17 speech, Finance Chairman Hatch said dynamic scoring of tax reform proposals should be accelerated and refined. "I believe the expanded and sensible use of dynamic analysis can, if done correctly, be an important tool to help us achieve our goals," he said. While dynamic scoring may reduce the need for some base broadening measures to offset the cost of corporate rate reduction in revenue-neutral reform legislation, Chairman Hatch has cautioned that it is "not a magic elixir."

There also is the issue of whether some revenue from tax reform might be used for other purposes. President Obama is expected to propose again that some 'one-time' revenue from tax reform be used for infrastructure spending. The President's FY 2015 budget called for $150 billion in revenue from tax reform to be set aside for spending on highway construction and other infrastructure programs. Chairman Ryan in late 2014 said that he would reserve judgment on the idea of using some revenue from tax reform for improving the country's infrastructure.

Budget reconciliation and tax reform

Under Senate rules, legislation generally needs 60 votes to advance. However, a bill can pass the Senate with only a simple majority under budget reconciliation procedures. House Budget Committee Chairman Tom Price (R-GA) has indicated that Congress could choose to use the budget reconciliation process to pass tax reform legislation or a bill repealing the Affordable Care Act, but no decision has been made yet on this issue.

Any bill passed under budget reconciliation procedures still could be subject to veto by President Obama. In addition, budget reconciliation rules impose significant limitations, including a requirement that legislation enacted under reconciliation may not be permanent if it would result in a revenue loss beyond the period covered under a budget resolution. As a result, using reconciliation procedures to pass tax reform could require Congressional Republicans to address President Obama's concern that tax reform be revenue neutral beyond the traditional 10-year budget window. For more on Congressional budget rules, see Appendix A.

Temporary business and individual tax provisions

Key business provisions renewed only through December 31, 2014 include the research credit, 50 percent bonus depreciation, look-through treatment for certain payments between related controlled foreign corporations (CFCs), and Subpart F exceptions for active financing income. Congressional leaders last year had reached a bipartisan agreement on legislation that would have made permanent the research credit and several other business and individual tax provisions, while also extending for two years—2014 and 2015—more than 40 other provisions, including bonus depreciation, CFC look-through, and active financing. The agreement faltered in the face of a veto threat from President Obama.

Congress separately approved an extension of the Internet Tax Freedom Act through September 2015 as part of legislation funding the federal government for FY 2015.

> *"I believe the expanded and sensible use of dynamic analysis can, if done correctly, be an important tool to help us achieve our goals,"*
>
> *– New Senate Finance Committee Chairman Orrin Hatch (R-UT)*

International tax issues

There is some overlap in the approaches advanced by the two parties for lowering the corporate tax rate, but differences exist, particularly with respect to proposals to bring US international tax rules more in line with those of the rest of the world. The United States is the only G7 country that taxes the active foreign earnings of its companies on a worldwide basis.

Last year, President Obama and some Congressional Democrats called for action on legislation to address 'inversions' involving cross-border merger and acquisition transactions in which the combined company chose to be legally resident outside of the United States. However, no legislative action was taken in 2014, primarily because of a disagreement on whether Congress should take immediate action to address corporate inversions or address the issues during action on tax reform. Finance Chairman Hatch last year cautioned that proposals to "build walls around US corporations in order to keep them from inverting" could result in making US companies "more attractive acquisition targets for foreign corporations."

Meanwhile, G20 nations and the OECD continue to move forward with a BEPS Action Plan that has stimulated increased scrutiny of cross-border tax issues by both US and foreign tax authorities. Calls for greater transparency regarding companies' tax affairs in general are intended to advance a goal of increasing the pressure on companies to pay increased taxes in the countries where they operate. Separately, the European Commission has launched investigations of whether European Union countries are providing prohibited 'State aid' in tax agreements with certain companies.

Some countries already have begun to take unilateral actions to address perceived base erosion and profit shifting. The United Kingdom in late 2014 announced the introduction of a new 'diverted profits tax' to address companies using 'elaborate structures to avoid paying taxes.' The diverted profits tax would be applied at a rate of 25 percent—five percentage points higher than the general UK corporate tax rate. The UK government intends the new tax to be effective April 1, 2015, in advance of general elections set for May 7.

At a time when the US economy on average is recovering faster than the economies of Europe and other parts of the world, US companies, particularly in the technology and pharmaceutical sectors, have appeared to be targets of heightened tax scrutiny by policymakers abroad and public campaigns by non-governmental organizations. US officials have expressed concern that US companies should not be the target of protectionist measures implemented through foreign tax laws or 'revenue grabs' by foreign tax authorities. In June 2014, Chairman Hatch and former House Ways and Means Chairman Dave Camp (R-MI) raised a concern that "when foreign governments—either unilaterally or under the guise of a multilateral framework—abandon long-standing principles that determine taxing jurisdiction in a quest for more revenue, Americans are threatened with an un-level playing field."

A by-product of the current international tax policy environment—in which specific US companies may be identified as targets of new proposals aimed at tax avoidance—is a need for businesses to assess reputational risks associated with tax planning. The risks have increased even as companies continue to comply with long-standing laws and rulings by tax authorities, and can be especially high for companies with a significant international presence.

An in-depth discussion

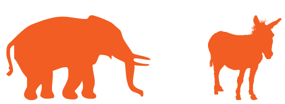
Balance of power

As a result of last November's midterm Congressional elections, House Republicans increased their previous 233-seat majority with a net gain of 13 seats, resulting in the largest House GOP edge since 1928. Currently, there are 246 Republicans and 188 Democrats in the House of Representatives, with one vacancy resulting from the recent resignation of Rep. Michael Grimm (R-NY).

Republicans also gained a majority in the Senate following the 2014 elections. In the Senate, there are now 54 Republicans and 46 Democrats (including the two Independents who caucus with Senate Democrats).

In 2013, Senate Democrats adopted a change in rules that generally require 60 votes to limit debate and end a filibuster. Under the change, executive branch and non-Supreme Court judicial nominations could be approved by a simple majority; the change did not apply to legislation. (Some Senate Democrats had called for extending the rule change to allow all legislation, including tax and spending bills, to pass with a simple majority.) Senate Majority Leader McConnell has said that Republicans, who opposed the Democrats' rules change at the time, have not yet decided whether to reverse the rules change in this Congress.

Figure 1: Current composition of the 113th Congress



	Republicans	Democrats	Vacancies
House	246	188	1
Senate	54	46*	

*Includes two Independents: Senators Bernie Sanders (I-VT) and Angus King (I-ME).

President Obama can veto legislation he opposes, with a two-thirds majority of both the House and Senate required for a veto override. President Obama has vetoed only two bills during his first six years in office, because the previous Democratic-led Senate generally blocked bills passed by the Republican-controlled House that he opposed. With Republicans now in control of both the House and the Senate, the presidential veto could come into play more often.

House and Senate tax committees

The House Ways and Means Committee now is led by Chairman Ryan, with Rep. Sander Levin (D-MI) continuing as the Ranking Democratic Member. Chairman Ryan, who previously led the House Budget Committee, takes over Ways and Means from Rep. Camp, who did not seek re-election in 2014. To reflect their increased House majority, Republicans added a new GOP seat to Ways and Means; there are now 24 Republicans and 15 Democrats on the committee.

Following the change to Republican control of the Senate, the Senate Finance Committee is led by Chairman Hatch. Former Chairman Ron Wyden (D-OR) is now serving as Ranking Democratic Member. The Finance Committee expanded its total membership by two, with Democrats losing one seat and Republicans gaining three, resulting in 14 Republicans and 12 Democrats on the panel.

A listing of House and Senate tax committee members and other key tax policymakers is provided in Appendix B.

As a result of last November's midterm Congressional elections, House Republicans increased their previous 233-seat majority with a net gain of 13 seats, resulting in the largest House GOP edge since 1928.

Looking ahead to the 2016 elections

Speculation about the 2016 presidential election is well under way, with several potential candidates exploring a run for president. If no tax reform legislation is enacted in this Congress, a new president in the White House would influence the prospects for future tax reform.

All 435 seats in the House are up for election every two years. With Republicans increasing their majority after the 2014 elections, Democrats would need to achieve a net gain of 30 seats in 2016 to gain control of the House.

Figure 2: 2015 Congressional schedule

House and Senate convene	January 6
President's State of the Union address	January 20
Presidents' Day recess (House, Senate)	February 16–20
Constituent work week (House)	March 9–13
Spring recess (House, Senate)	March 30–April 10
Constituent work week (House)	May 4–8
Memorial Day recess (House, Senate)	May 25–29
Independence Day recess (House, Senate)	June 29–July 6
Labor Day recess (House)	August 3–September 7
Labor Day recess (Senate)	August 10–September 7
Constituent work week (House)	September 21–25
Constituent work week (House, Senate)	October 12–16
Constituent work week (House)	November 9–13
Veterans Day	November 11
Thanksgiving recess (House, Senate)	November 23–27
Target adjournment	December 18

Roughly one-third of all Senate seats are subject to election every two years. In the upcoming 2016 election cycle, 10 seats currently held by Democrats and 24 seats currently held by Republicans are up for election. Of these, all 10 seats now held by Democrats and seven seats now held by Republicans are in states that President Obama won in the past two presidential elections. Two additional seats held by Republicans are in states that President Obama won in 2008. This history suggests that control of the Senate could swing back to the Democrats in two years, but that possibility would likely depend on the outcome of the 2016 presidential race and specific factors within individual campaigns and states. Democrats would need a net gain of five seats to win a 51-seat majority in the Senate.

A listing of all Senators whose seats are subject to election in 2016 is provided in Appendix C. Senate Finance Committee members up for election are Michael Bennet (D-CO), Richard Burr (R-NC), Daniel Coats (R-IN), Mike Crapo (R-ID), Charles Grassley (R-IA), Johnny Isakson (R-GA), Rob Portman (R-OH), Tim Scott (R-SC), Charles Schumer (D-NY), John Thune (R-SD), Pat Toomey (R-PA), and Ranking Member Wyden.

Economic outlook

As 2014 came to a close, the US economy exhibited relatively strong and stable growth. Gross domestic product (GDP) in the second and third quarters averaged 4.8 percent, and the economy was creating a monthly average of 264,000 jobs over the final six months of the year. The unemployment rate in December was 5.6 percent, down from 6.7 percent in December 2013.

Declining oil prices continue to provide a benefit to consumers, with prices for February delivery of West Texas Intermediate falling below $50 per barrel in early January from over $100 last summer.

At the same time, the US economy continues to face challenges. Wage growth has been slow, with little growth in inflation-adjusted income for most Americans. Also, continued slow growth in other countries will be a drag on US growth in 2015: Japan has experienced two consecutive quarters of negative GDP growth, and Eurozone GDP has grown by just 0.8 percent over the past year.

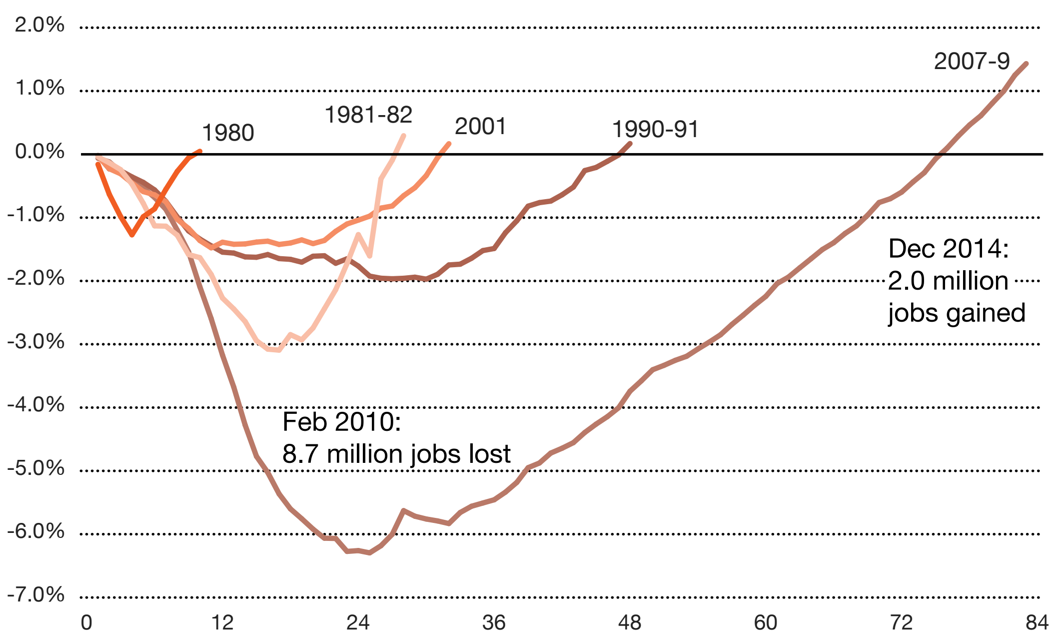
Continued growth in 2015

The economic situation in the United States strengthened in 2014, and, despite certain challenges, the outlook for 2015 is for continued growth. Third quarter real GDP increased at a 5 percent annual rate, following second-quarter growth of 4.6 percent. These were the strongest back-to-back quarters since 2003. Blue Chip economists in January forecast GDP growth at 2.8 percent for the fourth quarter, and at 2.9 to 3.0 percent in 2015.

Over the past year, payroll jobs have increased by 3 million, with total payrolls now 2 million greater than at the previous peak employment level in January 2008. At the same time, the current recovery took more than twice as long to reach pre-recession peak employment compared to the past four recoveries (Figure 3).

The December 2014 unemployment rate of 5.6 percent was the lowest since June 2008. A broader measure of unemployment and underemployment for December is at 11.2 percent, down from 13.1 percent in December 2013. This broader measure includes part-time workers seeking full-time employment and individuals who have looked for work in the past year but not in the past four weeks.

Figure 3: Percent change in payroll employment from peak employment, recent recessions



Source: Bureau of Labor Statistics, Current Employment Survey; PwC calculations.

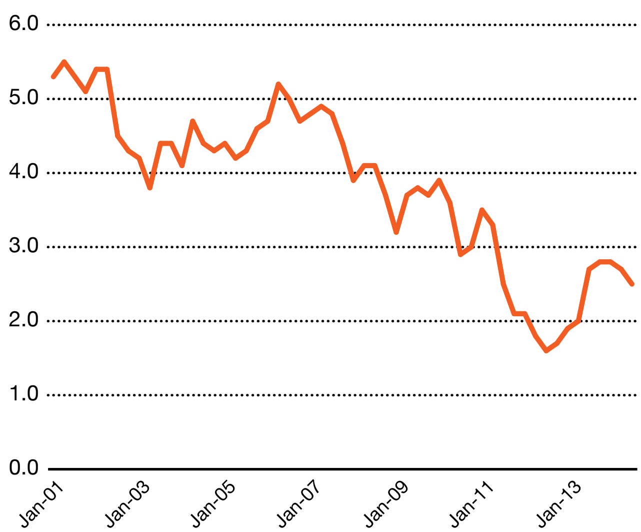
Other economic indicators show the favorable conditions that promoted growth in the second half of 2014 (see Figure 4):

- Interest rates remained low by historical standards. While the Federal Reserve is expected to begin raising rates in 2015, rates are expected to remain relatively low throughout the year.
- Home prices, a key variable in promoting household confidence, continued to rise.
- Equity market valuations continued to increase, reinforcing confidence and incentives to boost investments by businesses.
- Gas prices and overall energy costs dropped significantly, boosting cash available to households and businesses.

Figure 4: Selected indicators for US economy, 2001-2014

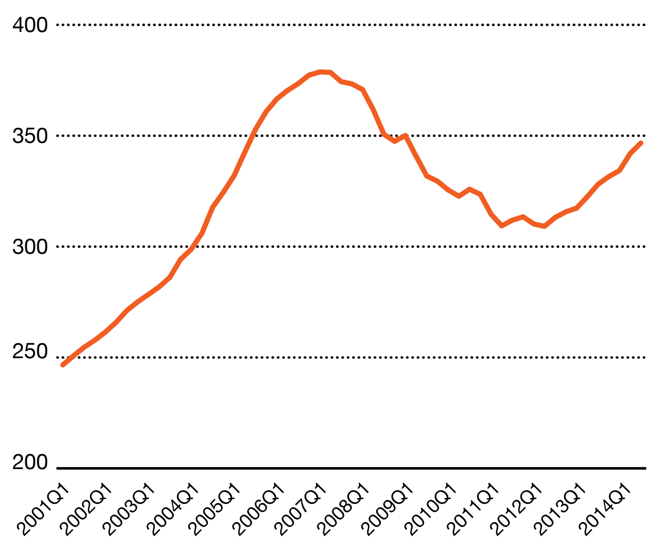
10-Year Treasury Yield

10-Year Treasury Constant Maturity Rate (Percent, Weekly)



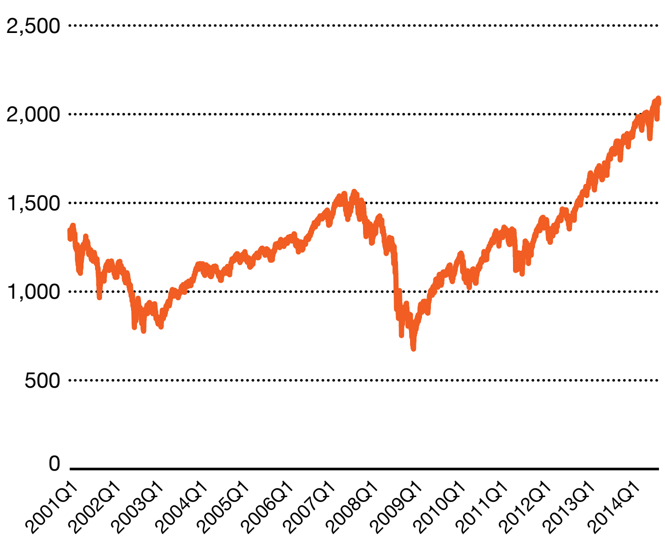
Home Price Index

All-Transactions House Price Index for the United States, Index (1980 Q1=100)



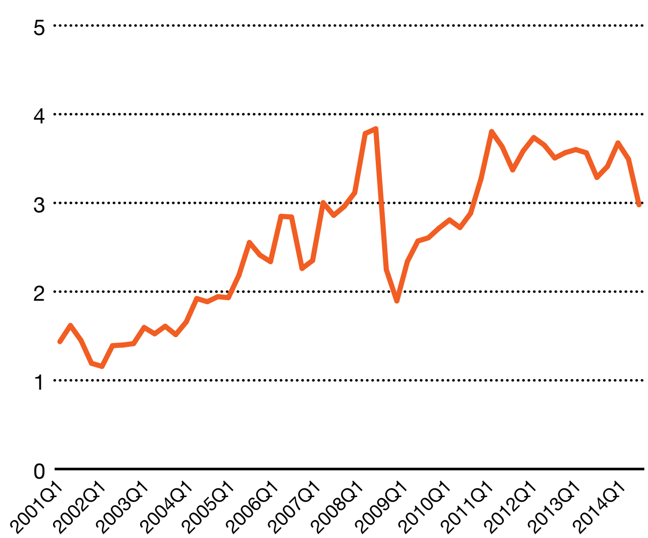
S&P 500 Index

S&P 500 Index (Daily)



Price per Gallon of Gas

US Regular All Formulations Gas Price, Dollars per Gallon (Weekly)



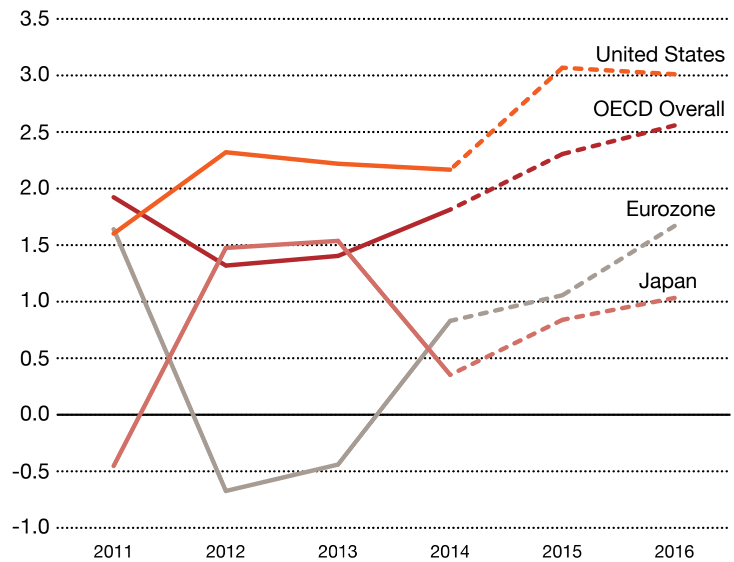
Source: Federal Reserve Board, FRED system and CCAR.

Contrary to the positive developments in the US economy, other developed economies continue to struggle. Economic projections from the OECD show growth increasing in many countries but remaining below average relative to historical trends. Real GDP in the Eurozone remains below the pre-2008 peak, and Japan continues to see slow growth as its government deals with accumulated government debt.

Income growth issues

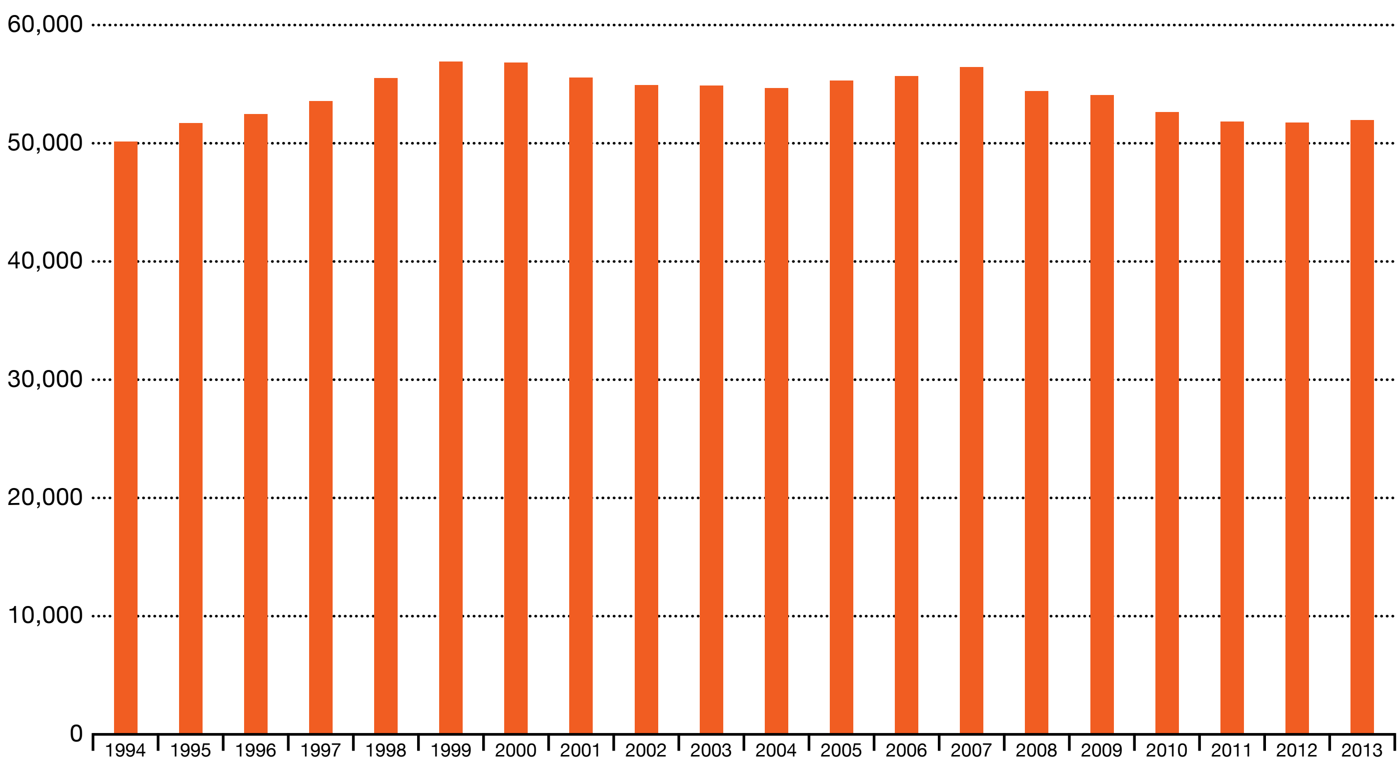
The slow growth in US wages and overall household income have become a greater focus of attention among policymakers. Over the prior 12 months, real (inflation-adjusted) average hourly earnings of all workers, including part-time employees, increased by only 0.8 percent (November 2013 to November 2014). Since the beginning of 2007, real hourly earnings have increased by less than three percent cumulatively. Median household income in 2013 was still below pre-recession levels in real terms and was less than four percent higher than in 1994 (see Figure 6).

Figure 5: Real GDP growth



Source: OECD Economic Outlook, November 2014. Dotted lines denote projections.

Figure 6: Median household income, 1994-2013



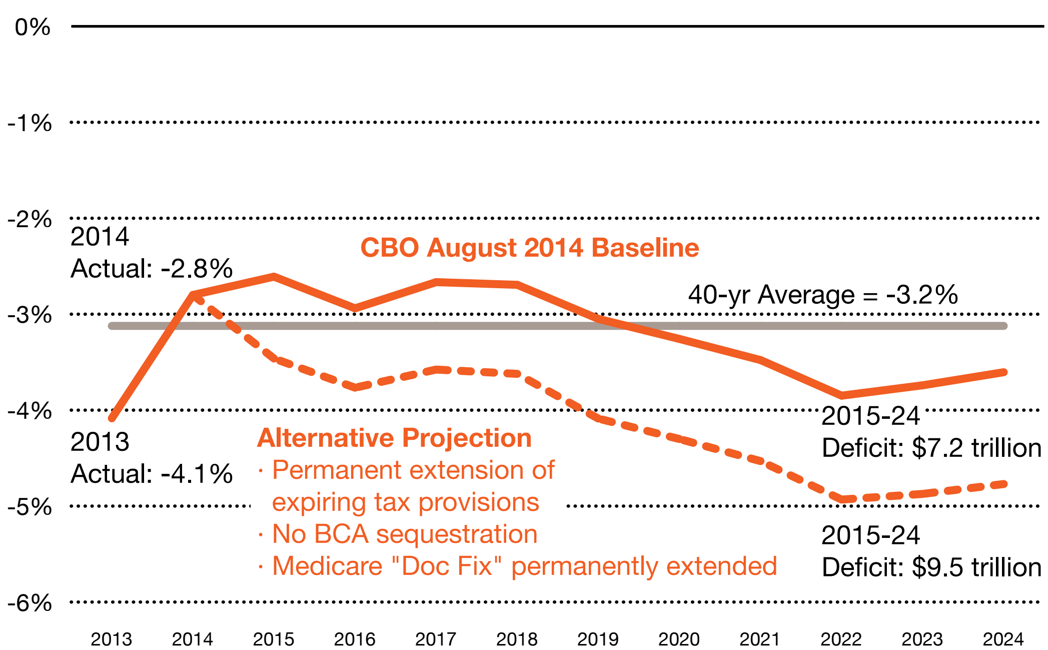
Source: Federal Reserve Board, FRED system and CCAR.

Federal budget outlook

The federal budget deficit for FY 2014 was $483 billion (2.8 percent of GDP); by comparison, the deficit reached a peak of $1.4 trillion in FY 2009 (9.8 percent of GDP). In FY 2014, government revenues reached $3 trillion, the second consecutive year of record revenues in dollar terms, and represented 17.5 percent of GDP, exceeding the 40-year average of 17.3 percent. Spending was 20.3 percent of GDP, just below the 40-year average of 20.5 percent.

CBO's budget projections from August 2014 for fiscal years 2015-2024, projecting a 10-year budget deficit of $7.2 trillion, are shown in Figure 7. Revenue as a percent of GDP is forecast to exceed the 40-year historical average in all years. However, as spending grows, particularly in the last five years of the budget period, deficits are projected to exceed the 40-year average of 3.2 percent beginning in 2020.

Figure 7: Federal budget projections



Source: FY 2013 and 2014 from CBO, November 2014. Projections for FY2015-2024 from CBO, August 2014.

The CBO August 2014 baseline projections above assume the expiration of certain tax and spending policies that typically have been extended by Congress:

- Certain expiring tax provisions, such as the research tax credit, have long been part of the tax code and consistently extended. More recent additions to the list of 'tax extenders,' such as bonus depreciation, also have been extended. Most recently, the 113th Congress extended these at the end of the session retroactively through 2014.
- The 'Sustainable Growth Rate' formula under the Medicare program is scheduled to cut payments to physicians by approximately 24 percent beginning April 1, 2015. Congress consistently has delayed these cuts through 'doc fix' measures since 2003.
- As a result of the Budget Control Act of 2011, discretionary and certain mandatory spending programs were subjected to across-the-board spending cuts, or sequestration, through 2021. In 2013, Congress and the Administration relaxed the required sequestration in 2014 and 2015. If discretionary spending grew only with inflation after 2021, it would decline to 5.2 percent of GDP by 2024, well below the historical average of 8.3 percent.

If Congress continues these policies, deficits would be significantly higher over the period, as indicated by the CBO 'Alternative Projections' in Figure 7. Under the Alternative Projections baseline, expired tax provisions would be made permanent, as would the Medicare 'doc fix,' and limits on future discretionary spending would not apply.

Importance of budget baselines for tax reform

The budget impact of proposed legislation, such as tax reform, depends on the baseline spending and revenue collections assumed in the absence of the new legislation.

Congress typically uses a current law baseline, which generally assumes that provisions with expiration dates expire as scheduled. However, Congress could choose to adopt an alternative baseline, such as a current policy baseline. A current policy baseline assumes that provisions that generally are understood to be part of current policy, such as the research tax credit, would be included in the baseline projection as if these provisions had been permanently extended by legislation. In past budget presentations, both the Administration and House Budget Committees have adopted such an approach.

Use of a current policy baseline could facilitate the extension of expiring tax provisions because there would not be a revenue cost to offset. More broadly, comprehensive tax reform could face a lower hurdle to reach revenue neutrality if a current policy baseline is adopted in lieu of a current law baseline, as the former assumes permanent extension of revenue-losing temporary provisions. That is, if extension of such provisions is assumed, then making some temporary provisions permanent in tax reform legislation would not have to be paid for with revenue-raising provisions, and fewer base broadening provisions would be required to make tax reform revenue neutral.

*The federal budget deficit for FY 2014 was **$483 billion** (2.8 percent of GDP); by comparison, the deficit reached a peak of $1.4 trillion in FY 2009 (9.8 percent of GDP)*

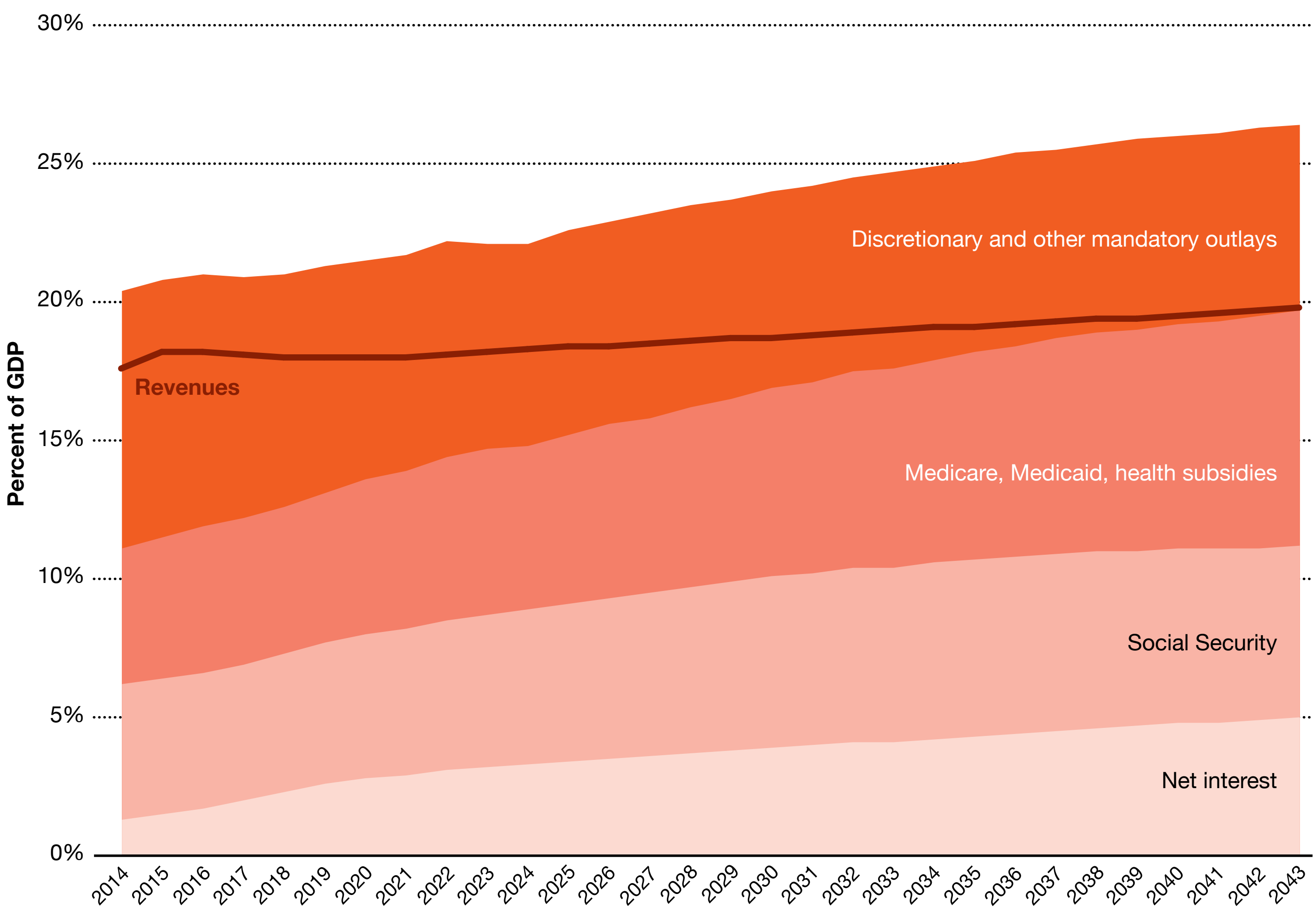
Long-term budget challenges

Beyond 2024, the federal budget will face unprecedented pressure associated with entitlement programs such as Social Security, Medicare, and Medicaid, as shown in Figure 8. Unless addressed, federal health entitlement spending alone will represent 8.6 percent of GDP by 2044, a 75 percent increase over the current level of 4.9 percent.

High debt levels in the future would limit the ability of the economy to grow because:

- Growing debt can crowd out private investment since federal borrowing would compete with private borrowers for capital.
- Increased levels of federal debt can cause investors to lose confidence in the federal government's ability to cover its debt service costs. If such a loss of confidence were sudden, it could result in a rapid rise in interest rates and a decline in the value of the dollar, creating a risk of a financial market crisis and severe recession.
- A high level of debt can constrain the federal government's ability to respond to future economic downturns. In the most recent recession, the federal government was able to implement a significant fiscal stimulus, cutting taxes and increasing spending to address the economic downturn. At current levels of US debt, it is uncertain whether markets would be as willing to absorb a similar expansion of US government debt in response to another recession.

Figure 8: Long-term budget projections, 2014-2043



Source: CBO Long Term Budget Outlook, July 2014.

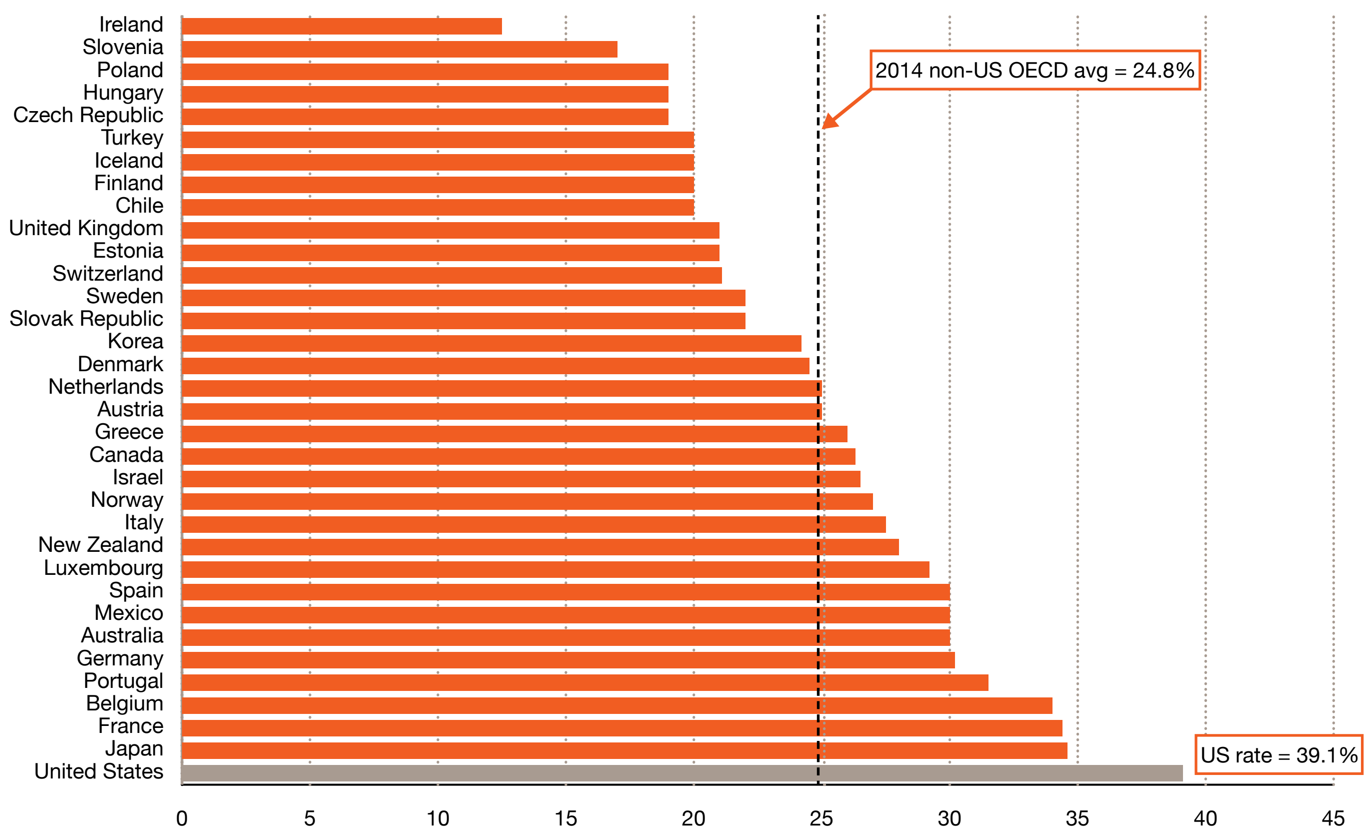
A more competitive US tax system

In recent years, President Obama and many in Congress have expressed support for lowering the US corporate tax rate as a way to promote economic growth and better-paying jobs.

Including state taxes, the US combined statutory tax rate of 39.1 percent is more than 50 percent higher than the 24.8 percent average corporate tax rate of other OECD countries in 2014.

The latter rate is set to fall even lower in 2015, when the United Kingdom implements a scheduled reduction in its corporate tax rate from 21 percent to 20 percent and Japan reduces its combined national and local corporate tax rate from 34.62 percent to 32.11 percent in April (a further reduction in Japan's combined corporate rate is planned for 2016). Portugal and Spain also are scheduled to reduce their corporate tax rates, while only Chile is moving to increase its rate.

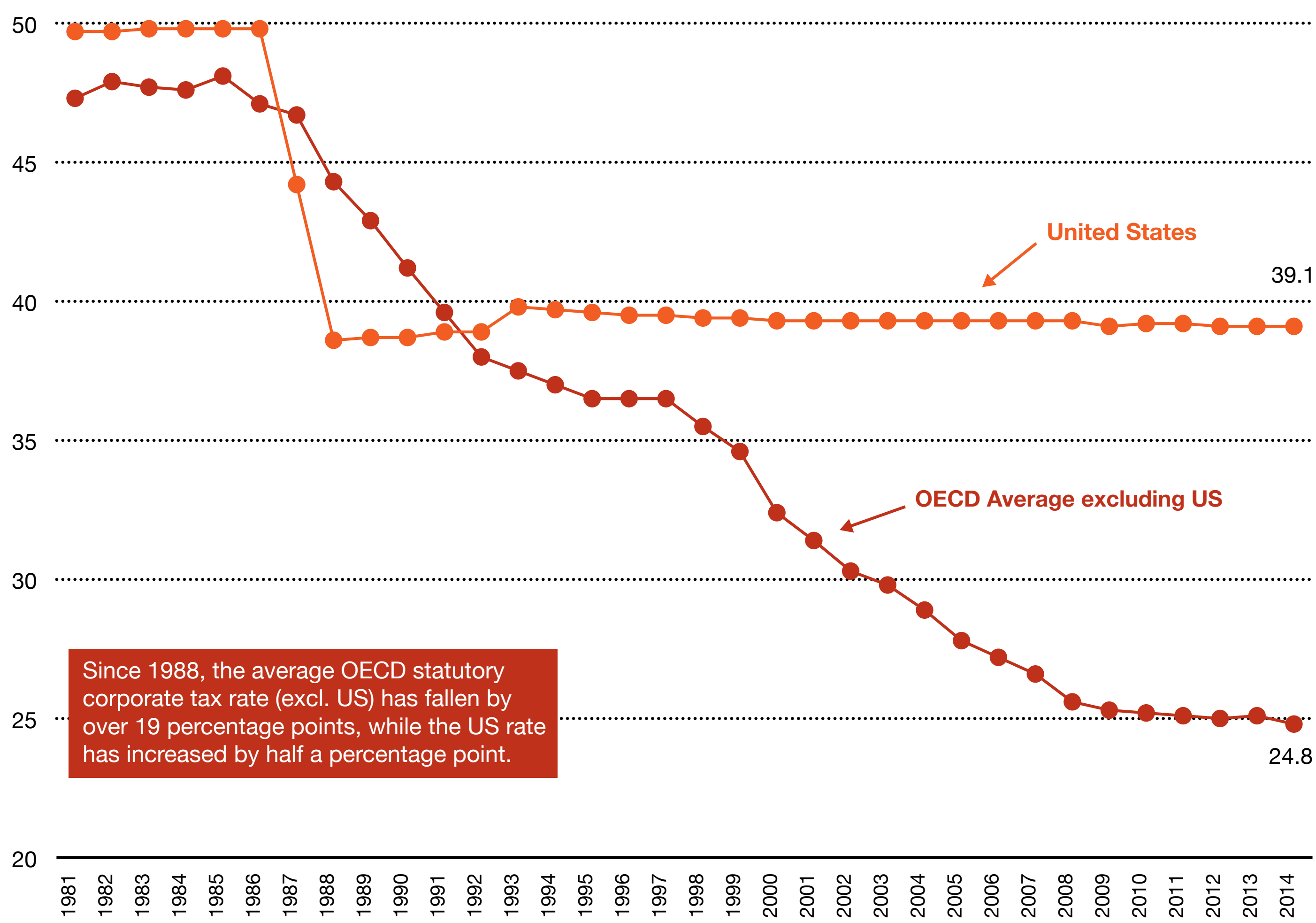
Figure 9: Combined corporate tax rates for OECD countries, 2014



Source: OECD Tax Database and PwC Worldwide Tax Summaries, http://www.pwc.com/gx/en/worldwide-tax-summaries/index.jhtml.

President Obama has called for lowering the US corporate tax rate to 28 percent, while Congressional Republicans have proposed a 25 percent top corporate tax rate. A 25 percent federal corporate rate would result in a combined federal and state rate of just under 30 percent. This would result in the United States moving from the highest tax rate among OECD nations to the seventh highest.

Figure 10: Top statutory (Federal and State) corporate tax rates, 1981 - 2014



Source: OECD Tax Database and PwC Calculations

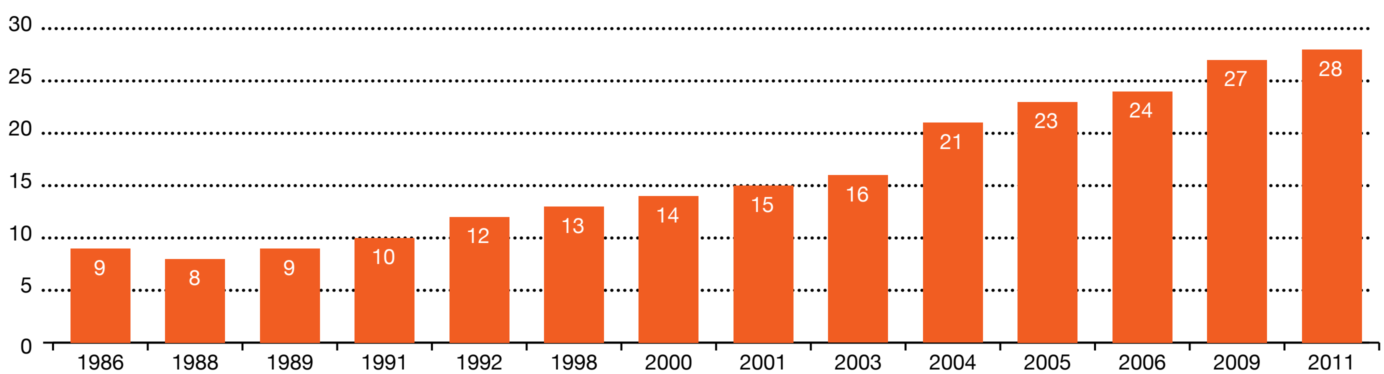
There is some overlap in the approaches advanced by the two parties for lowering the corporate tax rate, but differences exist with respect to proposals to bring US international tax rules more in line with those of the rest of the world.

President Obama has proposed modifying the current US worldwide tax system, by imposing a minimum tax on foreign earnings and stricter rules for cross-border transactions. House Ways and Means Chairman Ryan and Senate Finance Chairman Hatch—along with many other Congressional Republicans—support adopting a territorial-style system to encourage US companies to repatriate their foreign earnings. Former Ways and Means Chairman Camp coupled a territorial-style international tax system with a minimum tax on certain 'intangible' income in his 2014 tax reform proposal (outlined below) to address concerns about US corporations shifting profits to low-tax jurisdictions.

Currently, the United States is the only G7 country that taxes the active foreign earnings of its companies on a worldwide basis. The number of OECD countries have worldwide tax systems (as shown in Figure 11 below). As Figure 11 also reflects, the number of OECD countries moving to dividend exemption tax systems has increased significantly since the last time the United States reformed its tax law in 1986.

All G7 countries except the United States follow territorial tax systems.

Figure 11: Number of OECD countries with dividend exemption systems



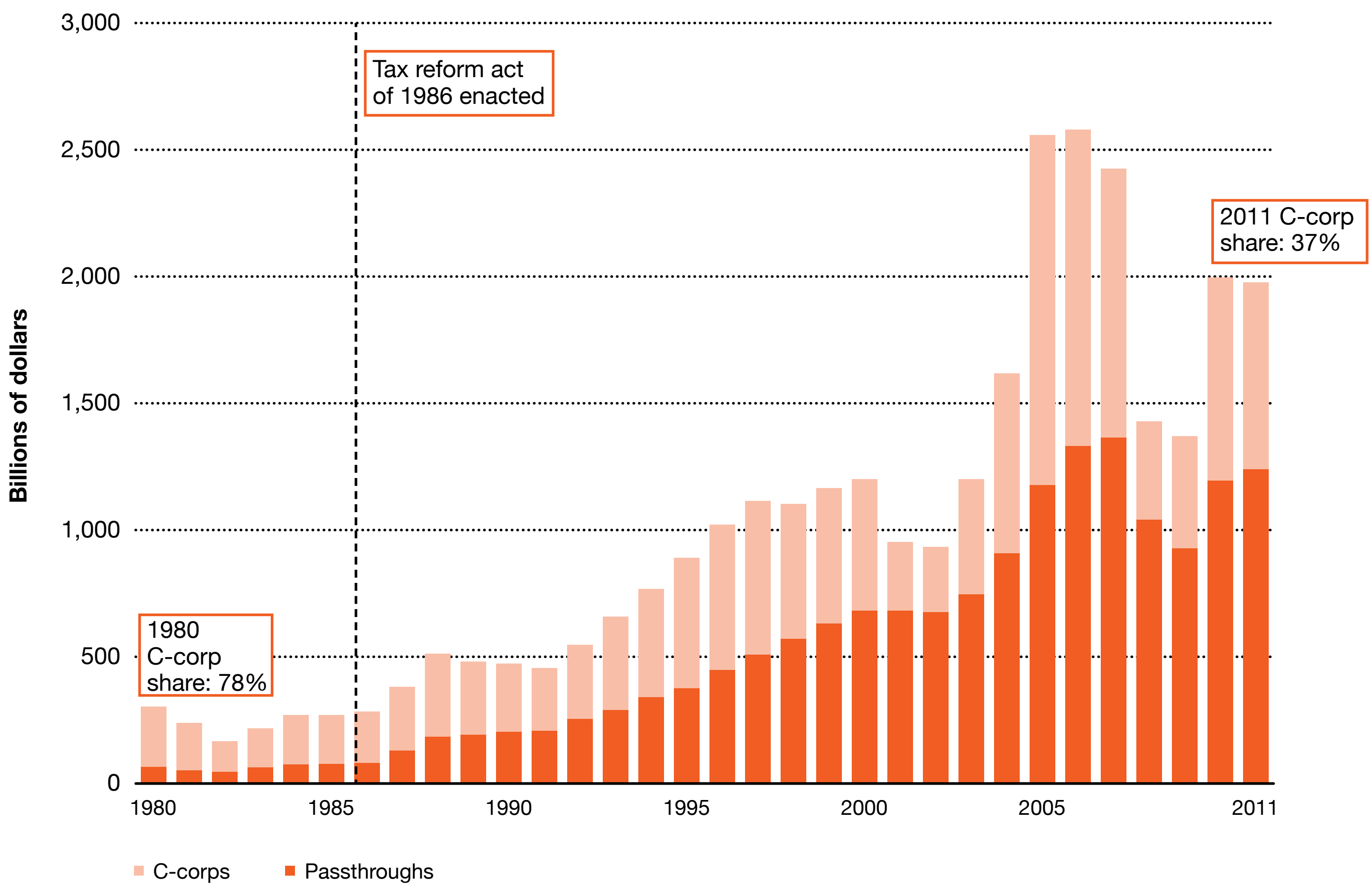
Source: PwC report, Evolution of Territorial Tax Systems in the OECD, prepared for the Technology CEO Council, April 2, 2013.

Non-corporate businesses

If tax burdens are to be reduced to make US businesses more competitive in the global marketplace, Congress would have to consider the treatment of businesses that do not pay corporate tax on their earnings and instead are taxed at the individual level. The share of business income from passthrough businesses has increased significantly since US tax laws were last overhauled in 1986 (see Figure 12). In 2011, more than 60 percent of business net income was attributable to passthrough entities.

Most policymakers believe that business tax reform should address all business income, both because of the percentage of business income earned by passthrough entities and because proposals to broaden the tax base to offset the cost of a rate reduction would affect both corporate and non-corporate businesses.

Figure 12: Net income of C corporations and passthroughs



Excludes net income of regulated investment companies and real estate investment trusts.
Source: Internal Revenue Service, Statistics of Income.

Individual tax issues

Efforts to enact comprehensive individual tax reform face a number of challenges. Potential base broadeners to offset the cost of individual rate reductions could include repeal or limitation of many popular tax expenditures, including deductions for home mortgages, State and local income, sales, and property taxes, and charitable donations. Proponents of comprehensive reform face another challenge if their proposals seek to achieve 'distributional neutrality,' i.e., the reform proposals should not result in a re-distribution of tax burdens from one income level to another. Finally, President Obama continues to call for increased taxes on upper-income individuals to reduce federal budget deficits, a position that is strongly opposed by Congressional Republicans.

As an alternative to comprehensive tax reform, a business tax reform bill might be expanded to include relatively noncontroversial individual income tax changes, such as simplification of certain tax provisions, while leaving the current individual income tax rate structure generally unchanged. For example, there has been bipartisan interest in a proposal to consolidate individual education tax provisions offered by Ways and Means Committee members Diane Black (R-TN) and Danny Davis (D-IL).

Congress also could consider changes to retirement savings incentives as part of business tax reform legislation. Senate Finance Chairman Hatch has said that he will pursue legislation to encourage employers without retirement plans to establish them, and also to enable small employers to pool their assets in a single plan to achieve better investment outcomes, lower costs, and easier administration. Chairman Hatch also has expressed support for legislation encouraging lifetime annuity income options in 401(k) plans, as well as a measure to help state and local governments control their pension liabilities. Separately, Congress in late 2014 approved changes to multiemployer pension plans at risk of insolvency, as part of the FY 2015 funding legislation.

Tax expenditures

Policymakers generally propose that the cost of business tax reform would be offset by broadening the tax base to reduce or eliminate certain 'tax expenditures.' JCT staff define tax expenditures as 'revenue losses attributable to the provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.' For a listing of selected tax expenditures, see Appendix D.

Some recent tax reform proposals also include measures that would modify or limit current federal tax deductions that are not defined as 'tax expenditures,' such as deductions for advertising.

Recent tax reform proposals

White House tax reform proposals

President Obama has not provided a detailed tax reform plan, but his 'framework for business tax reform' released in early 2012, which proposed lowering the corporate tax rate to 28 percent, identified several options for offsetting the cost of reducing the rate. Some of these options—such as limiting depreciation deductions—are similar in concept to proposals included in former House Ways and Means Chairman Camp's tax reform bill.

A January 17 White House release indicates that the President's budget will include proposals to increase the top rates on capital gains and dividend income to 28 percent for joint filers with incomes above $500,000, and to change the estate tax carryover basis rules to limit the ability to "step -up" the basis of inherited property. In addition, the budget will include a new fee on large financial institutions. Revenue from these proposals would be used to provide a new $500 second earner tax credit for families where both spouses work, increase the child tax credit to up to $3,000 per child under five, and provide additional retirement savings incentives.

Examples of previously proposed domestic and international business revenue raisers that could offset part of the cost of business tax relief include proposals that would:

- Repeal last-in, first-out (LIFO) inventory method
- Modify like-kind exchange rules for real property
- Restrict deductions for 'excessive' interest of members of a financial reporting group
- Prevent avoidance of foreign base company sales income through manufacturing services arrangements
- Create a new category of Subpart F income for transactions involving digital goods or services.

The Administration also is expected to propose again that some 'one-time' revenue from tax reform be used for infrastructure spending. The President's FY 2015 budget called for $150 billion in revenue from tax reform to be set aside for spending on highway construction and other infrastructure programs.

The President's FY 2015 budget proposed to make certain provisions permanent as part of tax reform, including a modified research credit, certain renewable energy tax provisions, and several temporary individual and small business tax provisions. Similar proposals are expected to be included in his FY 2016 budget.

Ryan tax reform proposals

Chairman Ryan has said that tax reform is a critical centerpiece of the Republican agenda to promote economic growth. In late 2014, he also described the current US international tax system as a 20th century 'jalopy,' and said its replacement is a matter of economic survival.

Chairman Ryan on January 13 said that he and other Ways and Means Committee Republicans would be discussing an 'aggressive' schedule for advancing tax reform. Ways and Means Republicans will hold a policy retreat in late January.

As previous Chairman of the House Budget Committee, Rep. Ryan proposed a series of annual budget resolutions calling for comprehensive tax reform.

Key goals for tax reform listed in the most recent House budget resolution included proposals to:

- Simplify the tax code
- Consolidate the current six individual tax brackets into two brackets of 10 and 25 percent
- Repeal the alternative minimum tax (AMT)
- Reduce the corporate tax rate to 25 percent
- Shift from a worldwide system of taxation to a territorial tax system
- Broaden the tax base to maintain revenue growth at a level consistent with current tax policy and recent average revenue levels of between 18 and 19 percent of GDP.

Hatch tax reform proposals

Finance Chairman Hatch and Ranking Member Wyden on January 15 established five Finance Committee member working groups to examine key tax reform issues. The five policy areas to be discussed are: individual income tax, business income tax, savings and investment, international tax, and community development and infrastructure. The working group's recommendations will be included in a report to be completed by the end of May, and 'will serve as a foundation for the development of bipartisan tax reform legislation.'

Last December, Chairman Hatch released a 340-page Finance Republican staff paper ('Comprehensive Tax Reform for 2015 and Beyond') providing background on recent reform proposals and 'some possible direction on where our reform efforts should go in the future.' The report discusses various tax reform options for lowering the corporate and individual income tax rates, integrating the corporate and individual income tax systems, moving to a territorial tax system, repealing the AMT, making the research credit permanent, and adopting a patent or innovation box.

In a December 16, 2014 floor statement, Chairman Hatch outlined seven principles for comprehensive tax reform legislation, with the first three principles following ones set out by President Ronald Reagan in advance of the last major reform of US tax laws. Chairman Hatch said that tax reform legislation should promote:

- Economic growth by eliminating 'economic distortions' and the 'anticompetitive nature of the current tax system, such as the high US corporate tax rate, which stifles job growth.'
- Fairness, through a 'broader tax base coupled with significantly lower tax rates.'
- Simplicity, to greatly reduce compliance costs.
- Permanence, to provide certainty for businesses and individuals planning future activities.
- Competitiveness, through a reduction in 'high tax rates on businesses' and a 'competitive international tax system.'
- Savings and investment, by addressing 'aspects of the current US income tax system' that discourage savings and investment by individuals.
- Revenue neutrality, since 'any effort to use tax reform as a revenue-raising exercise is a needless distraction.'

Camp tax reform proposal

Former House Ways and Means Chairman Camp on February 26, 2014 released a 979-page tax reform discussion draft that would lower corporate and individual tax rates, reform US international tax rules, and broaden the tax base by repealing or limiting business and individual tax deductions, credits, and income exclusions. Shortly before the last Congress adjourned, he introduced his proposal as H.R. 1, the Tax Reform Act of 2014.

Note: Current Ways and Means Chairman Ryan last December referred to the Camp tax reform bill as a 'marker' for future reform efforts.

Under Camp's bill, the current 35 percent top corporate rate would have been reduced by two percentage points each year over five years to 25 percent.

The Camp bill was designed to be revenue neutral over the traditional 10-year budget window under conventional revenue estimates.

Some of the key proposals to broaden the tax base by limiting deductions, credits, and income exclusions affecting businesses would have:

- Eliminated the modified accelerated cost recovery system (MACRS), resulting in longer deduction periods for the cost of certain property
- Required, after a phase-in period, five-year amortization of research and experimental expenditures
- Required, after a phase-in period, 10-year amortization for 50 percent of certain advertising expenses
- Phased out and repealed the domestic manufacturing deduction (section 199)
- Repealed LIFO and lower-of-cost-or-market (LCM) inventory accounting methods
- Limited use of the cash accounting method for certain large passthrough entities
- Repealed special net operating loss (NOL) carryback rules
- Repealed deferral of gain on like-kind exchanges
- Imposed an excise tax on systemically important financial institutions (SIFI).

Building on Camp's 2011 international tax reform discussion draft, the 2014 Camp bill proposed to move from the current US worldwide system of taxation to a 'territorial' tax system in which 95 percent of qualified foreign-source dividends received by US corporations from foreign subsidiaries would not be subject to US tax (through a dividend received deduction).

Note: S corporations and US partnerships (and their respective owners) would not have been eligible for this territorial tax treatment under the Camp bill.

Former Chairman Camp proposed to address concerns about US corporations shifting profits to low-tax jurisdictions by taxing certain 'intangible' income of foreign subsidiaries (defined as income earned on sales to customers outside the US in excess of a 10 percent return on depreciable assets), at a reduced rate of 15 percent when the income is earned. Similarly defined 'intangible' income of foreign subsidiaries earned on sales to the US would be taxed at the 25 percent corporate tax rate when the income is earned. The proposal also would have limited certain interest deductions.

A one-time transition tax would have applied to all previously untaxed earnings and profits (E&P) of foreign subsidiaries of US corporations. The cash portion of previously untaxed E&P would have been subject to an 8.75 percent rate, and the remainder would have been subject to a 3.5 percent rate.

Former Chairman Camp also proposed that some of the revenue from his tax reform bill could be allocated to federal transportation trust funds. However, this transfer did not impact the revenues raised under the tax reform plan, and therefore did not reduce the revenues available to offset the cost of rate reduction and other favorable changes in the legislation.

For individuals, the Camp bill would have replaced the current seven individual income tax brackets—ranging from 10 to 39.6 percent—with two tax brackets of 10 percent and 25 percent. A new 10 percent surtax would have applied to a broad range of 'modified' adjusted gross income above $450,000 for joint filers and above $400,000 for single filers. The standard deduction would have been increased, but personal exemptions would have been repealed. The bill would have repealed both the individual and corporate alternative minimum tax.

In an example of how a future tax reform bill may address the concerns of passthrough business taxpayers, former Chairman Camp proposed to provide non-corporate taxpayers a 'qualified domestic manufacturing income' exemption from a 10 percent surtax that would have applied to certain upper-income individuals. At the same time, his bill would have phased out the current section 199 domestic manufacturing deduction for corporate and non-corporate taxpayers.

Dynamic macroeconomic analysis of tax reform proposals

When the Camp tax reform proposal was released as a discussion draft in early 2014, JCT staff provided both a conventional revenue estimate and also a report on projected macroeconomic effects of the proposed tax reform package under two different dynamic economic models.

Under the conventional scoring methodology, JCT staff estimated that the cost of lower corporate and individual tax rates would be fully offset and that the overall proposal would raise $3 billion over the 10-year period 2014-2023.

Under one dynamic economic model, JCT staff projected that the Camp tax reform proposal could increase US GDP by as much as 1.6 percent over the 2014-2023 period and increase federal government revenues by $700 billion more than under the traditional revenue estimate. A separate dynamic model used by JCT staff showed a lower 0.1 percent increase in GDP, and tax revenues of $50 billion more than the traditional revenue estimate over the same period.

House rules since 2003 have required nonpartisan JCT staff to provide separate macroeconomic analysis for major tax bills reported by the Ways and Means Committee. The House on January 6, 2015 approved a rule change requiring JCT staff to 'incorporate' macroeconomic analysis 'to the extent practicable' in revenue estimates for major tax legislation, which is defined as having a 'gross budgetary effect' greater than 0.25 percent of GDP in any year covered by a budget resolution. In addition, CBO staff would be required to provide macroeconomic analysis for major legislation changing federal spending levels. It is unclear how the JCT staff will apply the new House rule requiring the incorporation of macroeconomic analysis into revenue estimates for tax reform legislation.

Wyden tax reform proposals

Senator Wyden did not introduce any new tax reform proposals in 2014 while chairman of the Senate Finance Committee. In 2010 and 2011, he introduced comprehensive tax reform bills with, respectively, former Senator Judd Gregg (R-NH) and Senator Dan Coats (R-IN), who joined the Senate Finance Committee in the 114th Congress.

While a strong advocate of the need to reform both the domestic and international tax regimes, Senator Wyden has proposed taxing the income of foreign subsidiaries of US multinationals on a current basis (i.e., he proposed repealing deferral) rather than switching to a territorial tax system.

Senator Wyden's 2011 tax reform bill proposed to lower the corporate tax rate to 24 percent and substantially broaden the tax base. Major business base broadeners included current taxation of all foreign income without benefit of deferral and adoption of a per-country foreign tax credit limitation; repeal of the section 199 domestic manufacturing deduction; replacement of MACRS depreciation with the slower alternative depreciation system (ADS); and reduction of corporate interest expense deductions.

Baucus tax reform staff discussion drafts

Prior to leaving the Senate, former Finance Committee Chairman Max Baucus (D-MT) in late 2013 released a series of tax reform discussion drafts prepared by committee staff. Potentially serving as a reference for future tax reform legislation, these drafts include:

- An international reform discussion draft that proposed to repeal or modify the current deferral system. In its place, the discussion draft provided statutory language for two differing regimes—one that would have imposed a current minimum tax on CFC income and another that would have taxed 60 percent of active business income of CFCs on a current basis.
- A tax administration discussion draft that proposed to improve tax return filings, expand information reporting and IRS collection tools, and combat tax-related identity theft.
- A cost recovery and tax accounting discussion draft that proposed to replace MACRS with a new system that approximates economic depreciation based on estimates provided by CBO. This draft also proposed to repeal LIFO and limit the use of cash accounting by large passthrough entities.
- An energy tax reform discussion draft that focused on simplifying approximately 40 current energy tax incentives into two basic categories of activity: clean electricity production and clean transportation fuel production.

Note: Former Chairman Baucus expressed support for reducing the corporate rate below 30 percent, but his Finance staff discussion drafts did not propose a specific corporate tax rate reduction.

Other tax reform proposals

- On April 19, 2013, Erskine Bowles and Alan Simpson, the co-chairs of President Obama's 2010 fiscal commission, issued *A Bipartisan Path Forward to Securing America's Future*, outlining $2.5 trillion in comprehensive deficit reduction. Bowles, a former White House chief of staff during the Clinton Administration, and Simpson, a former Republican Senator from Wyoming, led the 18-member National Commission on Fiscal Responsibility and Reform in 2010, which was tasked with developing a deficit reduction proposal to be sent to Congress. The bipartisan co-chairs developed a plan that failed to win the required super-majority support of the commission to proceed. However, for some policymakers, that plan has served as a benchmark for subsequent deficit reduction efforts.

  The 2013 Bowles-Simpson plan proposed comprehensive tax reform that would have eliminated or scaled back most tax expenditures. Almost $600 billion of the revenue raised from those reforms would have been used for deficit reduction, with the rest used for corporate and individual rate reductions. The plan would have achieved additional savings from healthcare reform, cuts in mandatory spending, and stronger limitations on discretionary spending.

- On February 11, 2013, former Senator Carl Levin (D-MI) introduced the Cutting Unjustified Tax (CUT) Loopholes Act. In the international area, this bill (S. 268) included new proposals for eliminating CFC look-through and 'check-the-box' rules. In addition, it treated CFC loans to US shareholders as dividends to the extent of aggregate CFC earnings. The bill included proposals drawn from previous bills on deferral of interest expenses allocable to untaxed foreign earnings, pooling of foreign tax credits, limits on outbound transfers of intangible property, and further limits on earnings-stripping by inverted companies. The bill also treated certain foreign companies managed and controlled in the United States as US companies.

- Senator Bernie Sanders (I-VT) on February 7, 2013, introduced the Corporate Tax Fairness Act (S. 250), which would have repealed deferral for active income of CFCs, enact a per-country FTC limitation, limited FTCs for integrated oil companies that are dual-capacity taxpayers, and treated foreign companies as US tax residents if managed and controlled in the United States. Rep. Janice Schakowsky (D-IL) introduced a companion House bill (H. 694) on February 13, 2013.

- On December 10, 2014, Senate Finance Committee member Benjamin Cardin (D-MD) introduced a bill (S. 3005, the Progressive Consumption Tax Act) to impose a 10 percent 'credit invoice' consumption tax on the purchase of goods and services and to use the resulting revenue for individual and corporate income tax relief. The bill would have exempted most households from the individual income tax through a family allowance ($100,000 for joint filers and $50,000 for single filers) and provided individual income tax rates of 15 percent, 25 percent, and 28 percent. The bill also would have reduced the corporate income tax rate to 17 percent. A so-called 'circuit breaker' provision would have limited consumption tax revenue to 10 percent of GDP, with excess revenue returned to individual income tax filers through a rebate. Senator Cardin said that he plans to re-introduce his bill in the 114th Congress, "after considering comments and analyzing its revenue impacts."

- House Ways and Means Committee member Devin Nunes (R-CA) has developed a business tax reform discussion draft (the American Business Competitiveness Act) that would provide a 25 percent maximum rate for net business income. This rate, to be phased in over 10 years, would apply to both corporate and non-corporate business income. The draft bill would allow full expensing (in lieu of MACRS and other cost accounting rules) and would repeal business tax credits and deductions. Interest expense deductions would be limited to qualified residential interest expenses. Income from a trade or business outside the United States would be generally exempted from tax, but a 5 percent toll tax would apply to certain pre-enactment undistributed foreign earnings.

- On January 13, 2015, House Ways and Means Committee member Lloyd Doggett (D-TX) and Senator Sheldon Whitehouse (D-RI) introduced the Stop Tax Haven Abuse Act (H.R. 297; S. 174), an updated version of legislation that previously sponsored by Rep. Doggett and former Senator Levin. The new House and Senate bills would require country-by-country reporting and include other international tax provisions that are similar to former Senator Levin's CUT legislation.

- On January 13, 2015, Senator Jerry Moran (R-KS) introduced a 'FairTax' bill (S. 155) to replace the current US income tax with a flat national consumption tax. The FairTax would repeal all federal personal income taxes, corporate income taxes, payroll taxes, self-employment taxes, capital gains taxes and gift and estate taxes, and replace those with a revenue-neutral, personal consumption tax on all retail sales of new goods and services. Rep. Bob Woodall (R-Ga.) has introduced the companion bill (H.R. 25) in the House.

Global tax scrutiny

Tax planning by multinational enterprises (MNEs) remains in the spotlight as uneven economic recovery abroad from the 2007-2009 global fiscal crisis continues to put pressure on foreign governments to control budget deficits through reduced spending on social programs. In light of this fiscal austerity, allegations of 'unfair' tax avoidance and 'aggressive' tax planning have been the focal point of greatly increased attention from the press and government officials around the world.

Meanwhile, many of these same countries continue to pursue tax competition policies that seek to attract and retain business investments, in an effort to promote economic growth and increased employment. Promises that a country is 'open for business' increasingly are followed by warnings that companies must pay a yet-to-be defined 'fair share' of taxes. The result has been a significant increase in tax uncertainty for companies making long-term investment decisions.

OECD BEPS Action Plan

Since 2012, G20 countries and the OECD have pursued an initiative to reform international tax regimes by addressing opportunities for base erosion and profit shifting. A 15-point BEPS 'Action Plan' was issued in July 2013, and the OECD is on track to issue the plan's final reports no later than December 2015. See Appendix F for an OECD BEPS Action Plan timeline.

A consistent theme of the OECD BEPS initiative is that international tax rules have not kept pace with an increasingly globalized economy. Policymakers have expressed concern about a perceived lack of clarity over the line between acceptable tax planning and aggressive tax avoidance. They have proposed greater transparency regarding companies' tax affairs in response, with the goal of increasing the pressure on MNEs to pay a 'fair share' of tax in the countries where they operate.

For example, under new 'country-by-country' reporting requirements, MNEs would have to disclose to tax authorities detailed information for their business globally and in each country where they have a presence. There may be an increasing need to explain clearly to tax authorities the operational purpose of business arrangements that include tax advantages. In this environment, companies no longer can focus solely on technical compliance with tax rules, but instead need to be prepared to provide explanations in situations where profit allocations diverge from the location of employees, tangible assets, and sales.

Increased risk of double taxation

Historically, the goal of the OECD has been to promote global economic growth and development through the unfettered exchange of goods and services, and the movement of capital, technology, and persons across borders. To that end, the OECD's focus has been on eliminating impediments to cross-border flows, such as double taxation, by expanding income tax treaty networks, by establishing clear rules for governments to tax companies with a limited presence in their jurisdictions, and by reducing gross basis withholding taxes.

The OECD BEPS project, by contrast, has been focused on eliminating so-called 'double non-taxation.' In its quest to address double non-taxation, the OECD also has sought to coordinate action among participating governments in order to avoid increasing the risk of unrelieved double taxation. It is unclear, however, whether the OECD will succeed in its coordination efforts. As a consequence, there are serious concerns that one outcome of the BEPS project could be a dramatic surge in instances of double taxation and tax disputes worldwide.

Departing from consensus-building OECD model

The rapid pace of the BEPS project, with discussion drafts being released and finalized quickly (sometimes with less than 30 days allowed for public comments) conflicts with the traditional approach of OECD consensus building. True consensus around a single solution chosen from an array of options can be difficult to achieve under such short deadlines. The difficulty of harmonizing the divergent views of source and residence countries, and of the developed OECD economies and the developing non-OECD G20 economies, has proven challenging.

Instead of setting forth a consensus on key issues, the OECD in several reports has presented a 'menu' of options to address base erosion concerns, in order to meet prescribed deadlines. For example, access to treaties likely will become more uncertain for MNEs, as competing subjective general anti-avoidance rules and main-purpose tests are proposed to prevent treaty shopping. Also of concern, proposals intended to prevent 'artificial avoidance' of permanent establishment (PE) status consist primarily of options for lowering the PE threshold.

Moving away from arm's-length transfer pricing standards

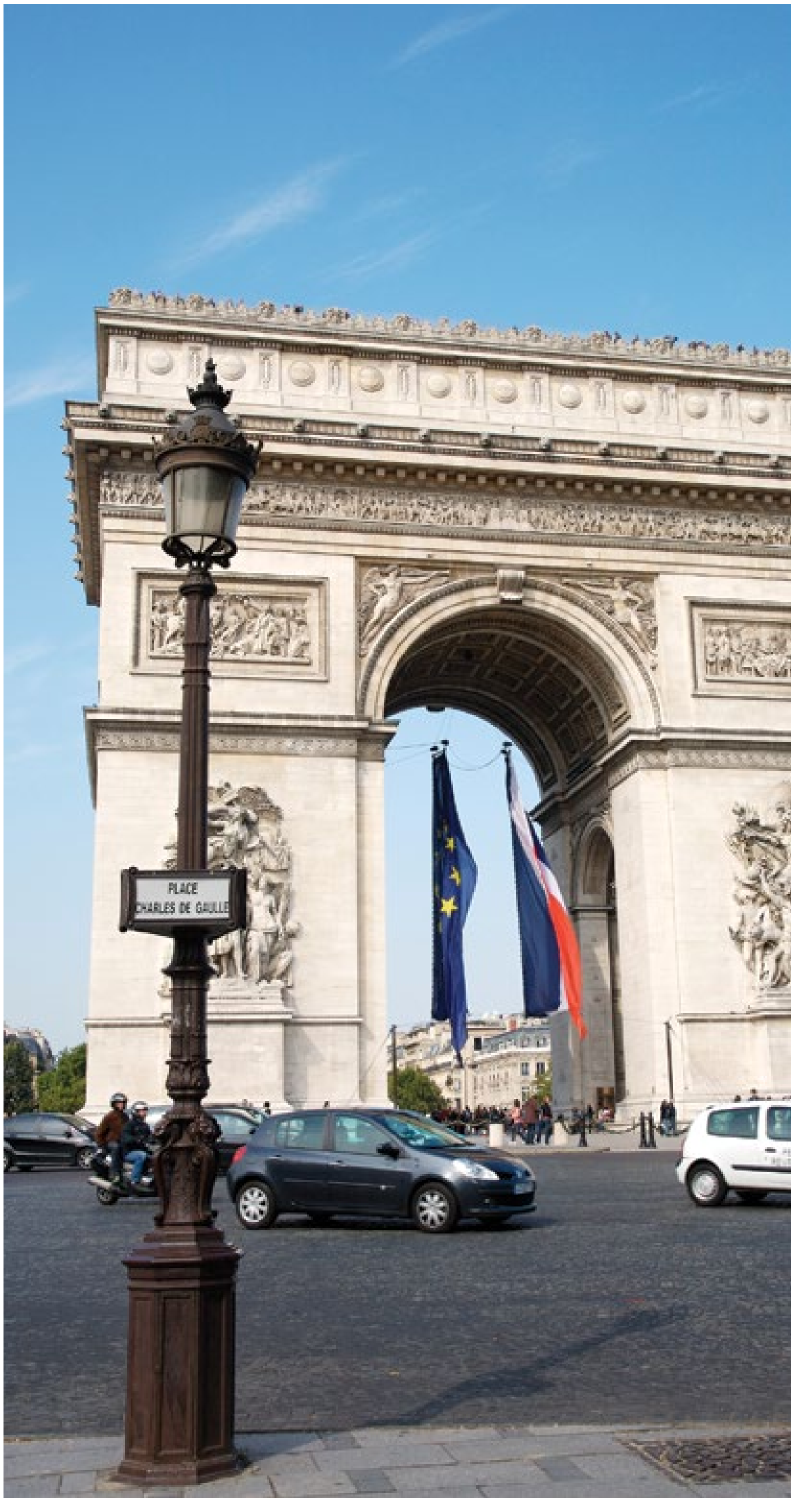
As concerns grow with separate-entity accounting and the ability of MNEs to transfer functions, assets, and risks across borders, international tax policy may be at risk of moving away from traditional arm's-length transfer pricing models to a more formulaic allocation of income and deductions, similar to models used by many US state governments. The experience of US states should stand as a warning, because historically states have had difficulty achieving consensus on formulas for allocating income and deductions across jurisdictions, with double taxation possible as a result of non-uniform formulas.

Dispute resolution difficulties

Strains in resolving cross-border tax disputes—evident even before the BEPS Action Plan was initiated and reflected in the annual OECD report on mutual agreement procedure (MAP) statistics—are likely to increase as the BEPS project moves forward. The inventory of MAP cases around the world has risen steadily, with OECD statistics for 2013 reflecting a 12.1 percent increase in the number of open MAP cases as compared to the 2012 reporting period, and a 94.1 percent increase as compared to 2006 (although MAP cases involving two OECD member countries are double counted in that total).

Potential uncoordinated, unilateral actions by some countries, spurred by the BEPS project, combined with increasing information available to tax authorities suggest that MAP statistics could worsen in coming years, unless improved dispute resolution procedures are implemented.

The 'gold standard' for dispute resolution procedures has been mandatory, binding, 'baseball-style' arbitration, which has been remarkably successful in resolving cross-border tax controversies governed by US tax treaties. In this type of arbitration, each party in a dispute submits a proposal, and an arbitrator choses one of the proposed settlement offers without modification. In response to opposition from some countries that have characterized binding arbitration as an infringement on their sovereignty, the initial OECD discussion draft on improving dispute resolution mechanisms does not include a recommendation for use of baseball-style arbitration as a tool to resolve issues that are preventing agreement in a MAP case.



Increased risk of unilateral actions

Questions have been raised as to whether the BEPS project is encouraging some countries to take unilateral actions in advance of the project's completion. Rather than waiting for the BEPS process to play out and consensus rules to emerge, some governments are using the BEPS project to advance their domestic tax agendas and to claim their 'fair share' of corporate tax revenues.

The risk inherent in this trend is that as soon as one country moves ahead of the OECD consensus process, others are spurred to action, not wanting to be left behind. For example, the recent action by the United Kingdom to propose a 'diverted profits tax' may encourage other countries to propose similar policies affecting companies operating in their jurisdictions. As a result, the danger of 'global tax chaos marked by the massive re-emergence of double taxation,' of which the OECD Action Plan itself warned, may have markedly increased.

European Commission state aid challenges

In addition to complying with tax rules and regulations of individual countries, MNEs must be aware of, and ensure compliance with, multilateral, non-tax agreements possibly impinging on tax rules.

At the beginning of 2014, the European Commission (EC) announced that it was focusing on 'fiscal State aid' in the context of the European Union (EU) program to prevent aggressive tax planning, tax avoidance, and tax evasion by MNEs. There followed a series of investigations into specific tax rulings and tax regimes involving Ireland, the Netherlands, and Luxembourg. On December 17, the EC announced that it was expanding its fiscal State aid inquiry into tax rulings to cover all 28 EU member states. Member states will be asked to provide information about their tax ruling practices, as well as provide a list of all companies that have received a tax ruling from 2010 through 2013.

In general, European competition law prohibits EU member States from providing certain forms of State aid to 'undertakings' (activities carried on by partnerships and companies) without prior authorization of the EC. This essentially is an anti-subsidy prohibition, designed to safeguard fair competition. The most straightforward example of State aid is a subsidy provided directly to an undertaking. (These rules also apply in the three countries of the European Economic Area (EEA)—Iceland, Liechtenstein and Norway.)

State aid also can consist of a reduction of taxes otherwise due when it is 'selective,' i.e., provides an advantage to certain undertakings. In that case, it is referred to as 'fiscal State aid.' Fiscal State aid can be either a tax measure or regime that provides a selective advantage or an individual concession granted to a taxpayer (e.g., via a tax ruling or a settlement).

Currently, the EC has indicated that a tax approach that potentially differs from the arm's-length standard could prove problematic from a State aid perspective. While the application of transfer pricing rules and focus on substance may play an important role in the EC's current investigations, State aid rules also are relevant outside the transfer pricing context, and special tax regimes in member States have been at the heart of previous investigations.

If a conclusion is reached that unlawful State aid has been granted, the remedy can be quite draconian. The EC may order a country's government to recover the tax benefit it deems unlawful from the taxpayer, with compound interest, for the 10 years prior to the opening of the investigation. The amount of the recovery is determined by comparing the tax that would have been paid without application of the selective tax measure with the tax that in fact has been paid. State aid is not always prohibited; it is allowable where it is compatible with EU law, and where aid schemes and individual aid were put into effect before, and are still applicable after, the entry into force in a new member State of the EU/EEA treaties.

For US MNEs, State aid issues are important because of the potentially large recovery if the EC concludes that unlawful State aid has been granted, and the recovery ruling is upheld by EU courts. If a US MNE is required to pay additional tax to a EU country as a result of mandatory State aid 'clawbacks,' potential foreign tax creditability issues could arise. As an initial matter, the additional tax payment must be specifically characterized as an income tax payment in order to qualify for US credits. US MNEs claiming foreign tax credits for clawback tax payments may need to ensure that they (or their EU subsidiaries) have taken all legal recourse possible (e.g., EU judicial action) to challenge the additional assessments. Failure to seek recourse may raise questions of 'voluntary' tax payments that would not be eligible for a foreign tax credit.

In addition, financial accounting issues may arise in the context of EC State aid challenges to tax rulings granted by EU/EEA countries.

Existing tax arrangements should be reviewed, bearing in mind that State aid issues become relevant whenever it is apparent that a tax ruling, a tax settlement, or even a tax regime is the subject of investigation or fact finding by the EC, or is similar to a situation in another State that is subject to EC investigation or fact finding.

Focus on cross-border M&A activity

Taxation is an important factor affecting the ability of US MNEs to compete in foreign markets. In recent years, there has been a growing recognition that the US tax system deviates in important respects from those of other major industrial countries, often adversely affecting the competitiveness of US MNEs in foreign markets.

In 2014, cross-border business combinations involving US companies that elected a foreign tax domicile for the new parent company attracted attention in the Congress and in the media. These redomiciliations involve the acquisition of a foreign company whose share value is at least 25 percent of the US company's share value. The transactions are referred to as 'inversions,' the name given pre-2004 transactions in which a US parent company created a foreign subsidiary and then merged into it, literally 'inverting' the corporate structure and becoming a foreign-parented company. Recent cross-border mergers differ from the transactions that occurred before 2004, which did not involve business combinations. Transactions today are driven by business factors such as patent expirations, rising costs of R&D development, and the strong US stock market.

In response to some newly merged companies electing a foreign tax domicile, the Obama Administration and some Members of Congress have called for enactment of retroactive tax legislation, with the stated intent of discouraging mergers that result in a foreign domiciliation and reduced US tax revenues. For example, House Ways and Means Ranking Member Sander Levin and former Senator Carl Levin last year introduced almost identical bills (H.R. 4679, S. 2360) to tighten existing anti-inversion rules under section 7874. Both bills were proposed to be effective for transactions completed after May 8, 2014 (an effective date announced by former Finance Chairman Wyden).

Separately, Senate Finance Committee member Charles Schumer (D-NY) introduced a bill (S. 2786) to modify the earnings stripping rules to further limit interest deductions for certain inverted companies with respect to related-party debt and guaranteed unrelated-party debt. For purposes of these proposed new restrictions, S. 2786 would have expanded the definition of an inverted company under section 7874 by reducing the shareholder continuity threshold from 80 to more than 50 percent and changing the effective date from transactions completed after March 4, 2003, to transactions completed before, on, or after that date.

On September 22, 2014, the Treasury Department issued Notice 2014-52, detailing proposed regulatory changes intended to limit tax benefits for inversions on or after that date. The Notice seeks to make it more difficult to access the earnings of US-owned foreign subsidiaries without incurring added US tax. The Notice indicated that additional guidance may be issued to address 'inversion' transactions, including guidance on the treatment of intercompany debt.

Absent action on business tax reform to improve the underlying competitiveness of US tax laws, one unintended, though predictable, effect of recent anti-inversion measures may be to make US companies more attractive targets for acquisition by foreign companies. Already, between 2000 and 2013, net acquisitions by foreign companies of US companies were $457 billion greater than net acquisitions by US companies of foreign companies, according to the 2014 United Nations Conference on Trade and Development World Investment Report.

IRS challenges and the impact on taxpayers

The IRS will continue to face challenges on many different fronts under Commissioner John Koskinen, who has completed a full year on the job following confirmation in December 2013. The IRS has been unable to move beyond the controversy with Congress surrounding the agency's handling of certain section 501(c)(4) tax exemption applications. Partly as a result, the IRS is facing a bleak budget outlook, as Congress has reduced its funding for the remainder of FY 2015. These factors continue to affect daily operations at the IRS and, ultimately, its interactions with taxpayers.

IRS budget, operations

Congress continues to trim the IRS budget. The FY 2015 federal government funding legislation enacted last December allocates approximately $10.95 billion for IRS funding—about $350 million less than the agency's FY 2014 budget of $11.3 billion and $1 billion less than its FY 2010 budget. Following several years of belt-tightening measures, it is unclear which areas of IRS operations can be cut further. As reflected in recent surveys, resource constraints are being felt by the public and are negatively impacting morale among IRS employees.

In a December 17, 2014 message to IRS employees, Commissioner Koskinen announced a hiring freeze with "only a few mission-critical exceptions," further limits on employee travel, and an end to most overtime pay. The Commissioner also warned that during the upcoming filing season only about half of taxpayer calls could be handled by the agency. Commissioner Koskinen expressed alarm over the negative impact the budget situation will have on taxpayers and the nation.

The IRS has experienced significant turnover in experienced personnel at all levels. In the Large Business & International (LB&I) operating division, more than one-third of the 24 executives holding the most senior positions are doing so in acting roles. One key position recently was filled with the selection of Douglas O'Donnell as Deputy Commissioner (International), following the departure of Michael Danilack. However, the role of Deputy Commissioner (Domestic) has not been filled with a permanent executive since 2013. The IRS also is losing experienced front-line personnel, with limited ability to hire new employees into vacated positions.

The lingering effects of the section 501(c)(4) application controversy are also affecting the IRS's interactions with lawmakers. While the level of attention appears to have abated somewhat following the November elections, the issue remains. For example, the legislation setting the IRS budget contains a provision prohibiting the IRS from using any of its funds to 'target citizens of the United States' for exercising their Constitutional rights to freedom of speech. Moreover, the IRS continues to devote resources to identifying and reviewing documents that might be responsive to various Congressional requests and subpoenas.

Focus on international issues

For several years, the IRS focused on international issues as businesses expand their global operations. The increased international focus reflects a recognition—fueled in part by Congressional inquiries into certain offshore 'profit-shifting' practices—of the large dollars associated with international operations and associated tax planning. At the same time, LB&I's workforce has not yet become aligned to the division's evolving focus. Of the LB&I workforce responsible for conducting examinations, only about one-fourth fall under the Deputy Commissioner (International), and there may be yet another reorganization within LB&I.

LB&I continues to revise its examination strategy as it evaluates the changing landscape of taxpayer actions, as well as its own priorities. These include the development of a pilot program to identify issues on tax returns that pose the greatest compliance risk. The program redeploys some resources assigned to the Coordinated Industry Case (CIC) program, through which the largest corporate taxpayers are under constant IRS examination, to conduct centralized risk assessments.

The IRS goal is to assist agents conducting CIC examinations to identify and focus on areas of risk. The ultimate aim is to increase the efficiency of CIC examinations and, potentially, shift resources to other areas in which LB&I has identified noncompliance. Whether this will ultimately result in increasing the number of agents assigned to international issues is yet to be seen.

The IRS also has begun to devote efforts to addressing areas of noncompliance involving partnerships. In this regard, there also has been support by some in Congress for legislation that would streamline partnership examination procedures.

Transparency initiatives

LB&I leadership continues to stress efforts to increase transparency between taxpayers and the IRS. These include the Schedule UTP and the requirement that smaller-sized taxpayers begin filing it with their returns. Another initiative is LB&I's new IDR procedures, which contrary to early fears do not appear to have resulted in increased issuances of summonses or summons enforcement actions. While this fact does not necessarily imply that implementation of the IDR procedures has been flawless, it may indicate that taxpayers and the IRS generally are working together to achieve the ultimate goal of shortening IDR response times and resolving examinations more quickly.

Other 2015 tax policy issues

Expired and expiring tax provisions

President Obama on December 19, 2014 signed into law H.R. 5771, the Tax Increase Prevention Act of 2014, providing one-year, largely retroactive extensions of business and individual tax provisions that had expired at the end of 2013. The Act also makes technical corrections to previously enacted tax law changes and establishes a new tax-advantaged savings account for disabled persons.

Key business provisions renewed through 2014 include the research credit, 50 percent bonus depreciation, CFC look-through treatment, and Subpart F exceptions for active financing income.

The more than 50 expired tax provisions renewed for 2014 also include the following:

- 15-year recovery for qualified leasehold, restaurant, and retail property
- Work opportunity tax credit (WOTC)
- Section 179 small business expensing
- Reduction in S corporation built-in gains holding periods
- Basis adjustment of S corporation stock for charitable donations
- Certain regulated investment company (RIC) provisions
- Renewable electricity production credit
- Biodiesel and renewable diesel credits
- Deduction for state and local general sales taxes
- Discharge of indebtedness on principal residence
- Certain charitable giving provisions.

JCT staff estimated the overall package of tax extenders to cost $41.6 billion over 10 years.

Earlier in 2014, the Senate Finance Committee had approved a tax extenders bill renewing more than 50 temporary provisions through the end of 2015, while the House had passed several bills making permanent specific provisions. The final legislation, as noted above, is more limited than those bills.

Congressional action to pass this one-year tax extenders legislation came after an unsuccessful effort in late November by House and Senate leaders to complete action on a roughly $450 billion tax package that would have made permanent some temporary provisions. A bipartisan agreement negotiated by former Ways and Means Committee Chairman Camp and former Senate Majority Leader Harry Reid (D-NV) would have made permanent the research credit, increased section 179 expensing limits, and eight other provisions. Other tax extender provisions, including 50 percent bonus depreciation, would have been renewed for two years (2014 and 2015) under the agreement.

The Administration threatened to veto the agreement because it did not include permanent extensions of the child tax credit and earned income tax credit (EITC) expansions scheduled to expire at the end of 2017. Prior to the President's immigration announcement, Congressional Republicans appeared willing to consider extensions of both the child tax credit and EITC expansion. Post-announcement, however, these provisions became controversial because of concerns that they might bestow tax benefits on undocumented immigrants covered by the President's immigration actions. Administration officials also said tax extenders should be addressed in a manner that is fiscally responsible.

If efforts to enact business tax reform in 2015 are unsuccessful, Congress is expected to renew the push for legislation that could make permanent the research credit and certain other business and individual tax provisions that expired at the end of 2014, and renew certain other provisions temporarily while allowing some provisions to remain expired.

The President's FY 2016 budget is expected to include a number of revenue-raising provisions that the Administration previously has identified as potential offsets for the cost of making permanent the research credit and certain other provisions. It appears doubtful that the new Congress will approve revenue offsets for stand-alone legislation addressing temporary tax provisions, and the lack of offsets could lead to a veto threat from the Administration. As a result, the outlook for some temporary tax provisions being made permanent outside revenue-neutral tax reform remains uncertain.

Healthcare

Implementation of the 2010 Affordable Care Act (ACA) continues this year with a previously delayed mandate for certain employers to provide health insurance coverage taking effect this month. Employers have had four years to consider the law's implications, plan how to count full-time employees, and decide what coverage to offer. Employers and insurers now must prepare to file information returns with individuals and the IRS for 2015, listing the coverage offered and accepted as well as additional details.

A mandate for certain individuals to purchase health insurance has been in effect for one year. Individuals who did not have health coverage in 2014 and did not qualify for an exemption may be required to pay an individual mandate penalty when they file their tax returns.

In contrast to the much-criticized first-year launch of healthcare exchanges, the second year of enrollment for state- and federally-based exchanges went more smoothly, with millions more enrolled for coverage in 2015.

ACA challenges

Senate Majority Leader McConnell and House Speaker Boehner have called for full repeal of the ACA. However, Senator McConnell has noted that Republicans lack the votes to override President Obama's expected veto of ACA repeal legislation, even if such legislation were to clear the Senate.

Short of full repeal, Congress may consider bills to modify the ACA. For example, there was bipartisan support in the last Congress to repeal the 2.3 percent excise tax on medical devices, as noted above. Senate Finance Committee Chairman Hatch on January 13 was joined by a bipartisan group of Senators in introducing a bill (S. 149) to repeal the medical device excise tax. House Ways and Means Committee members Erik Paulsen (R-MN) and Ron Kind (D-WI) have introduced a similar bill (H.R. 160) that has been cosponsored by more than 250 House members.

The House earlier this month approved a bill (H.R. 30) to change the ACA definition of full-time employee from 30 hours a week to 40 hours a week. However, Administration officials have said that President Obama would veto this bill if it were also passed by the Senate and sent to the White House. H.R. 30 passed in the House by a vote of 252 to 172, which is less than the two-thirds majority that would be required to override a presidential veto.

Congress may consider repealing or changing a tax on high-cost plans that is slated to go into effect in 2018. This tax—often called the 'Cadillac tax'—already is having an effect on corporate financial statements and is causing employers to make changes to their plans. The tax is opposed by a number of labor unions as well.

Congress also may consider proposals to repeal or modify the 3.8 percent tax on net investment income that applies to individuals with incomes above certain threshold amounts.

Supreme Court decision could require response

The Supreme Court in 2015 is expected to decide in *King v. Burwell* whether federal tax subsidies are available to individuals who purchase coverage on the federal exchange, rather than from one of the 13 states or the District of Columbia that have established their own exchanges.

If the Supreme Court rules that subsidies are not available to individuals in the federal exchanges, President Obama and Congress would face the challenge of how to respond so that millions of Americans would not be at risk of paying penalties for failing to buy insurance they no longer can afford. The Administration would be expected to call for legislation specifically authorizing subsidies for eligible individuals buying insurance on a federal exchange, while many in Congress might renew proposals to repeal the individual mandate.

State tax legislation

Several issues affecting state taxation—from remote seller sales tax collection requirements to nonresident withholding on employee wages—are expected to be considered by Congress in 2015. None of these issues will be new to 114th Congress, as they have been in play for years. The following is a summary of the key state tax legislation on which Congress may act in 2015.

Internet Tax Freedom Act

A long-standing moratorium on Internet access taxes—in effect since 1998—was scheduled to sunset on November 1, 2014. On July 13, 2014, the House passed by voice vote H.R. 3086, The Permanent Internet Tax Freedom Act (ITFA). The bill would have made permanent the moratorium prohibiting state and local governments from taxing Internet access or imposing discriminatory taxes on electronic commerce. The bill also would have eliminated the moratorium's grandfather clause, which allows seven states that had taxed internet access prior to October 1, 1998 to continue to tax access charges. H.R. 3086 was not considered by the Senate. Instead, following another temporary extension, the FY 2015 spending bill enacted last December extended the ITFA through September 2015.

House Judiciary Committee Chairman Bob Goodlatte (R-VA) on January 9 re-introduced a permanent ITFA bill (H.R. 235). If Congress does not make this provision permanent, another temporary extension, possibly with the grandfather clause left intact, could be considered.

Marketplace Fairness Act

Various versions of 'marketplace fairness' legislation authorizing states to require remote seller sales tax collection have been developed over the last 12 years. On May 6, 2013, the Senate passed the Marketplace Fairness Act (S. 743), providing that full member states under the Streamlined Sales and Use Tax Agreement and non-member states that meet certain minimum simplification requirements may require remote sales tax collection. In the House, the bill was referred to the Judiciary Committee. No further action was taken on S. 743 in the 113th Congress, although some in the Senate had hoped to combine the Marketplace Fairness Act with legislation extending the ITFA.

The concept of a remote seller sales tax collection requirement has had some bipartisan support in Congress, from some governors, and among a number of major retailers across the country, but also has opponents. A key issue is whether the concerns expressed by opponents, such as the burden on small sellers or on retailers located in states without a sales tax, can be addressed.

House Judiciary Chairman Goodlatte on January 12 released a discussion draft of the Online Sales Simplification Act of 2015. Unlike the Marketplace Fairness Act, the Goodlatte draft bill adopts an origin based imposition of tax along with the creation of a multi-state commission to oversee a distribution agreement that addresses how tax is collected and distributed among party states. Under the draft, a state may tax a remote sale only if it is the origin state of the sale and also party to the distribution agreement.

A number of states have passed legislation requiring simplification of their sales and use taxes if Congress enacts the Marketplace Fairness Act or similar legislation. Some states, not waiting for Congressional action, have enacted expansive state nexus laws that expand the meaning of what is considered taxable physical presence in the state.

Mobile Workforce State Income Tax Simplification Act

Legislation intended to provide administrative simplification and aid in compliance with nonresident income tax liability and employer withholding did not advance in the 113th Congress. A bill, H.R. 1129, was introduced in the House by Reps. Howard Coble (R-PA) and Hank Johnson (D-GA), but was not acted on by the House Judiciary Committee. A companion Senate bill, S. 1645, was introduced by Finance Committee member Sherrod Brown (D-OH). These bills would implement a 30-day threshold for both the state taxation of nonresident employees' income and for the employer's requirement to withhold state taxes on nonresident employees' wages. In the 112th Congress, the House had approved a similar version of the Mobile Workforce State Income Tax Simplification Act.

Business Activity Simplification Act

H.R. 2992, introduced on August 2, 2013 by Rep. James Sensenbrenner (R-WI), would have expanded Public Law 86-272 protection, codified a physical presence nexus standard, and require that apportionment provisions follow the *Joyce* standard. Under the *Joyce* standard, each member of a unitary group stands alone in the determination of the sales factor numerator. Under this rule, a state cannot include in the numerator of the sales factor sales made by a member of a unitary group where the member itself does not independently have nexus in the state. A subcommittee hearing was held on the bill, but it was not acted on in committee.

The nexus issue addressed by this bill continues to increase in significance as the concept of an economic presence nexus standard gains acceptance in a growing number of states. As a result, legislation addressing a physical presence standard for business activity taxes is expected to be introduced in 2015.

Other state tax legislation

Additional recurring issues expected to be considered in 2015 include the Digital Goods and Services Tax Fairness Act, which is intended to prevent discriminatory and duplicative taxes on digital goods and services, and the Wireless Tax Fairness Act, which garnered more than 200 cosponsors in the 113th Congress but was not approved in committee. The legislation would place a moratorium on any new state or local discriminatory taxes or fees on wireless services.

Tax treaties and other international agreements

No new US treaties or protocols have entered into force since 2010. In June 2011, the Senate Foreign Relations Committee approved proposed tax agreements with Hungary, Switzerland, and Luxembourg. However, because Senator Rand Paul (R-KY) objected to Senate floor consideration of the three pacts, no action was taken, and all three were returned to the Foreign Relations Committee for reconsideration at the end of the 112th Congress.

During the 113th Congress, the US-Chile treaty and protocols to the US treaties with Spain and Poland were sent to the US Senate for approval. On April 1 and July 16, 2014, the Senate Foreign Relations Committee reported out favorably all six pacts, along with a protocol to a multilateral treaty on mutual administrative assistance in tax matters, to which the United States is a party.

The timing for possible consideration by the full Senate and ratification of these agreements in 2015 remains uncertain due to the ongoing objections raised by Senator Paul about information-sharing agreements that generally are part of all US tax treaties. Because these items were not approved by the Senate before the close of the 113th Congress, they have been returned to the Senate Foreign Relations Committee for reconsideration during the 114th Congress.

A protocol to the US tax treaty with Japan was signed in January 2013, but has not yet been sent to the Senate Foreign Relations Committee. Tax agreements reportedly have been reached with Norway, Romania, the United Kingdom, and Vietnam. Negotiations are underway with Brazil, and discussions with Colombia and Israel are continuing. Discussions are said to be underway with Venezuela, Malaysia, and the Netherlands Antilles, and there has been correspondence with South Korea. The Treasury Department reportedly has not decided whether to pursue tax treaties with Hong Kong or Singapore.

New US model treaty, other guidance

Treasury has announced that it is planning to publish a new model income tax convention that would supersede the existing US model published in 2006. Treasury officials are looking at the possibility of significant changes in the US model, prompted by the OECD's BEPS project.

The 2014-2015 Treasury-IRS Priority Guidance Plan again includes a project to provide guidance under section 894 on issues under income tax treaties, including the application of various treaty provisions to payments through hybrid entities. The 2014-2015 Plan also includes a project to provide guidance under section 6105 on the confidentiality of tax convention information.

The 2014-2015 Plan includes a project to update Rev. Proc. 2006-54 on procedures for taxpayers requesting Competent Authority assistance under tax treaties. Notice 2013-78, which was issued in November 2013, provides for public comment on a proposed revision to the procedures for requesting assistance from the US Competent Authority under the provisions of an income, estate, or gift tax treaty to which the United States is a party. According to the Notice, the proposed revenue procedure would substantially restate Rev. Proc. 2006-54 to improve clarity, readability, and organization and would reflect structural changes undertaken by the IRS since 2006. It is also intended to effect a limited number of significant substantive changes.

Trends in US tax treaty policy

The United States is expected to continue to strive in its treaties for effective protection against 'treaty shopping.' Other priorities include strong exchange of information commitments, modernization of the treatment of cross-border retirement plans, and changes to the personal services articles of treaties (mainly, eliminating the independent personal services article as being redundant of the business profits article). In addition, Treasury likely will continue its recent policy of including binding arbitration as a means of deciding Competent Authority cases that otherwise are unresolved.

LOB articles in the treaties and protocols negotiated since the early 2000s typically have contained 'substantial presence' provisions in the publicly traded test that generally require that the taxpayer either be listed and regularly traded on a stock exchange in its country of residence (or within the economic region in which the taxpayer is located), or that the taxpayer have its 'primary place of management and control' in its country of residence.

This focus on limiting treaty benefits of companies viewed as 'inverted' intensified in 2014. The IRS released Notice 2014-52 in September 2014, announcing an intention to issue guidance in connection with what was referred to in the Notice as 'inverted groups.' The Notice indicated that Treasury is reviewing its tax treaty policy regarding inverted groups and the extent to which taxpayers inappropriately obtain tax treaty benefits that reduce US tax collected through withholding on US-source income.

In discussing the Notice at a public forum in November 2014, a Treasury official indicated that Treasury is considering treaty policy in light of inversions, and that among the topics under contemplation may be withholding rates in certain jurisdictions with preferential regimes and the zero dividend rate on certain parent/subsidiary dividends.

Further thinking about treaty policy and LOB provisions on the part of Treasury has also been spurred in light of the treaty component of the OECD's BEPS project, as noted by a Treasury official at a public forum in December 2014.

Tax information exchange agreements

During 2014, protocols to the 2009 US-Gibraltar Tax Information Exchange Agreement (TIEA) and the 2008 US-Lichtenstein TIEA entered into force. In addition, a TIEA and protocol with the Hong Kong administrative region entered into force.

FATCA intergovernmental agreements

FATCA, the Foreign Account Tax Compliance Act, was enacted in 2010 to enhance information reporting by foreign financial institutions (FFIs) and non-financial foreign entities of US taxpayer accounts in order to combat tax evasion. Final regulations issued in 2013 provide for a phased-in approach to the implementation of the FATCA requirements between 2014 and 2017.

Treasury has collaborated with foreign governments to develop two alternative model intergovernmental agreements (IGAs) to facilitate FATCA implementation—Model 1, under which reporting FFIs satisfy their FATCA requirements by reporting information about US accounts to their respective tax authorities, followed by the automatic exchange of that information on a government-to-government basis with the United States, and Model 2, under which FFIs report specified information directly to the IRS in a manner consistent with the final regulations, supplemented by government-to-government exchange of information on request.

The United States has signed IGAs with 47 jurisdictions and has agreed in substance to IGAs with another 65 jurisdictions. On December 1, 2014, Treasury released Announcement 2014-38, providing guidance regarding jurisdictions that are treated as if they have an IGA in effect through December 31, 2014. The announcement also adds 11 jurisdictions that will be treated as having IGAs in effect as of November 30, 2014. Treasury's website contains a list of IGAs in effect and those that have been agreed to in substance: http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx.

Trade and tariff legislation

Trade Promotion Authority

Trade Promotion Authority (TPA), which expired in 2007, had been renewed and amended multiple times since its enactment in 1974. Also known as 'fast track' trade negotiating authority, TPA gave the President authority to negotiate comprehensive reciprocal free trade agreements with major trading partners, subject to certain conditions that included Congressional consultation and access to information. Those agreements were to be considered under an expedited Congressional legislative process that allows for limited debate (i.e., no filibuster) and an up-or-down vote (i.e., no amendments allowed) once all debate time has expired.

On January 9, 2014, former House Ways and Means Chairman Camp, former Senate Finance Committee Chairman Baucus, and then Finance Ranking Member Hatch introduced the Bipartisan Congressional Trade Priorities Act of 2014 (H.R. 3830, S. 1900) to renew TPA. Ways and Means Ranking Member Levin did not co-sponsor the bill, stating that he did not view the legislation as meeting the needs of a rapidly globalizing economy.

Although President Obama voiced support for the bill in his 2014 State of the Union address, his Administration has not yet formally requested a renewal of TPA. Such a formal request has been the practice of previous administrations to begin the renewal process. However, speaking to the President's Export Council on December 11, 2014, President Obama said that he hopes to work with Congress to win approval of key trade legislation, including TPA.

Voicing Republican support for TPA, former Ways and Means Chairman Camp and former Trade Subcommittee Chairman Devin Nunes (R-CA) on March 4, 2014 released statements calling for its renewal. On July 17, 2014, Republican members of the Ways and Means Committee sent a letter to US Trade Representative Michael Froman urging the Obama Administration to build support for the renewal of TPA.

In the House, H.R. 3830 was referred to the Committees on Ways and Means, Rules, and the Budget, but was not considered by any of them, leaving renewal of TPA to be considered by the 114th Congress. Legislation to renew TPA also may include the renewal of the Trade Adjustment Assistance program, which provides job training to workers displaced as a result of foreign trade; the program expired on December 31, 2014.

Trans-Pacific Partnership

Implementation of the Trans-Pacific Partnership (TPP) is one of the primary goals of the Obama Administration's trade agenda. In his December 11, 2014 remarks, President Obama said that he will work with Congress to try to secure approval for TPP.

TPP is intended to reduce and eliminate tariffs and non-tariff barriers to create a comprehensive and high-standard free trade agreement. If successful, TPP would advance a wider Asia-Pacific free trade area as well as serve as a US policy response to the rapidly increasing economic and strategic linkages among Asian-Pacific countries. It is expected to cover almost 40 percent of global GDP and over 25 percent of world trade.

On July 17, 2014, Republican Ways and Means Members sent a letter to US Trade Representative Froman, directing the Obama Administration not to complete TPP before TPA is renewed. On September 18, 2014, Ways and Means Ranking Member Levin issued a report outlining the major outstanding issues with TPP negotiations and highlighting the need for the focus to remain on TPP, rather than TPA.

Although Congress may consider TPP in 2015, it likely would require a renewed TPA to be in place to govern consideration.

Transatlantic Trade and Investment Partnership

In February 2013, the United States and the European Union (EU) announced plans to launch negotiations for a comprehensive Transatlantic Trade and Investment Partnership (TTIP). The stated goal of TTIP is to create growth and jobs on both sides of the Atlantic by removing trade barriers. In March 2013, the Obama Administration formally notified Congress of its intention to negotiate with the EU on TTIP. In January 2014, the European Commission launched a special Advisory Group to provide EU trade negotiators with advice in areas being negotiated in the TTIP talks.

Since the first round of talks in June 2013, the TTIP negotiations have continued every few weeks. Issues in the negotiations could include tariff reductions and elimination, regulatory compatibility and standards, improved market access for services, investment protection, enhanced government procurement opportunities, intellectual property rights protection and enforcement, and greater agricultural market access. Other issues to be addressed could include trade facilitation, state-owned enterprises, digital trade, and supply chains.

EU-US trade relations are likely to be among the key policy issues facing Congress in 2015. Congress could examine the impact of greater transatlantic trade liberalization on US economic growth, the future of US trade policy and other trade agreements, efforts to promote solutions to third countries' issues, and trade liberalization through multilateral negotiations.

Final negotiations of TTIP are not expected before 2016. As with TPP, it seems unlikely that any TTIP agreement would be considered by Congress absent a renewal of TPA.

Miscellaneous Tariff Bill

In July 2013, former Ways and Means Chairman Camp, Ranking Member Levin, and Trade Subcommittee Ranking Member Charles Rangel (D-NY) introduced the US Job Creation and Manufacturing Competitiveness Act of 2013 (H.R. 2708), to amend the Harmonized Tariff Schedule of the United States to suspend or reduce certain temporary duty rates on specified chemicals and other items. The legislation, which was referred to, but not considered by, the Ways and Means Committee, was intended to set the stage for moving the miscellaneous tariff bill (MTB) through the 113th Congress.

Passage of an MTB has been complicated for several years by assertions by some that such bills constitute 'earmarks' and violate a Congressional earmark ban. This remains a stumbling block in the path of successful enactment of any targeted tariff relief measure. Since legislation was not approved in the 113th Congress, the House Ways and Means and Senate Finance Committees will need to restart the MTB process in the 114th Congress.

Generalized System of Preferences

The Generalized System of Preferences (GSP) provides non-reciprocal, duty-free treatment to certain products from more than 120 developing countries. First authorized in 1974 and last renewed in 2011, GSP expired in July 2013. In the last Congress, renewal of GSP was blocked by former Senator Tom Coburn (R-OK) over funding issues. Another obstacle to renewal was Russia's participation in the program. With Senator Coburn's retirement and President Obama's termination of Russia's participation in the program, there is an increased likelihood that GSP could be renewed in the 114th Congress.

African Growth and Opportunity Act

The African Growth and Opportunity Act (AGOA) is a US trade preference program that provides duty-free treatment to US imports of certain products from eligible sub-Saharan African (SSA) countries. Congress passed AGOA in 2000 to encourage export-led growth and economic development in SSA countries and deepen US trade and investment ties with the region. Since enactment of AGOA, Congress has amended the law five times, making some technical changes and renewing the trade preferences.

In terms of tariff benefits and country eligibility requirements, AGOA builds on GSP by providing preferential access to the US market for more products and sets out additional eligibility criteria. AGOA also includes other trade and development components, beyond preferences, that are not part of GSP.

AGOA's authorization is set to expire on September 30, 2015, making reauthorization a likely priority for consideration this year. Reauthorization is supported by President Obama and some Members of Congress. Trade Subcommittee Chairman Pat Tiberi (R-OH) is expected to consider AGOA a priority for the subcommittee.

Doha Round

The World Trade Organization (WTO) Doha Round is the latest round of multilateral trade negotiations among WTO countries. Officially launched in November 2001, the Doha Round's aim is to achieve major reform of the international trading system through the introduction of lower trade barriers and revised trade rules.

The Doha Round has been characterized by persistent differences among the United States, the EU, and advanced developing nations on major issues, such as agriculture, industrial tariff and nontariff barriers, services, and trade remedies. Developing countries have sought to reduce agriculture tariffs and subsidies among developed countries, enhance non-reciprocal market access for manufacturing sectors, and increase promotion for their service industries. Developed countries have sought to increase access to developing countries' industrial and services sectors, while attempting to retain some measure of protection of their agriculture sectors.

Given these differences, WTO members have been unable to reach a comprehensive Doha Round agreement. Some WTO members have suggested restarting broad Doha Round discussions that cover many sectors, but other members, including the United States, are exploring other, more focused negotiating options with like-minded trading partners.

Trade Facilitation Agreement

In December 2013, member countries at the WTO ministerial in Bali, Indonesia adopted an ambitious package of trade liberalization measures. Expectations ahead of the Bali meeting had been low, but member countries reached a Trade Facilitation Agreement (TFA), the first multilateral trade agreement concluded by members since the WTO was formed in 1994. TFA contains provisions for expediting the movement, release, and clearance of goods, improving cooperation among WTO members on customs matters, and helping developing countries fully implement the obligations.

The OECD estimates that such an agreement will reduce trade costs by 10 percent in advanced economies and almost 14.5 percent in developing countries, translating into hundreds of billions of dollars in global savings.

Following the Bali meeting, WTO members conducted a legal review of the final text of TFA. On November 27, 2014, WTO members adopted a Protocol of Amendment to insert TFA into Annex 1A of the WTO Agreement. TFA will enter into force once two-thirds of WTO members have completed their domestic ratification process.

What this means for your business

While the challenges faced by Congress in enacting tax reform—divided government and competing legislative objectives—remain significant, President Obama and the Republican-led Congress have identified business tax reform as a common goal. Key policymakers have expressed hope that tax reform legislation can be enacted in 2015, in advance of the 2016 presidential election.

Whether to promote tax reform that would be favorable to businesses or to prevent enactment of provisions that would have adverse impacts on particular industries or companies, it will be important to stay engaged in the tax reform discussion. Even if tax reform is not enacted during this Congress, the tax reform proposals Congress and the Administration develop may well serve as the building blocks for reform legislation in 2017 and beyond.

Meanwhile, heightened global tax scrutiny has increased the risk that a wave of unilateral actions by foreign governments could result in double taxation of MNEs and a proliferation of cross-border disputes. Constructive business input on the OECD BEPS Action Plan is essential to ensure that measures being developed are workable in practice. Companies would be well-advised to monitor the progress of the various OECD workstreams, proactively perform internal risk assessments of existing and planned structures, and engage with policymakers to explain the potential impact of these changes on business. Companies also should monitor and assess the potential impact of the European Commission's ongoing State aid investigations.

At a time when some policymakers and non-governmental organizations have targeted specific companies for increased tax scrutiny, businesses—especially those with a prominent consumer market presence—need to assess the reputational risks that may be associated with tax planning. These risks have elevated the importance of tax issues to the C-suite.

Businesses also will need to consider the impact of tax authorities' limited resources and a lack of effective cross border dispute resolution procedures on the ability to resolve their tax controversies. For example, IRS Commissioner Koskinen has stated that significant resource constraints likely will be felt by businesses attempting to complete audits and settle appeals procedures. As a result businesses are likely to face increasing pressure on their effective tax rate and cash taxes.

It will be important for businesses to stay engaged in the tax reform discussion.

Appendix A: Congressional budget process

Congressional hearings on the President's annual budget proposals typically take place in February and March, after which Congress generally adopts a budget plan ('budget resolution') that provides an overall framework for consideration of subsequent tax and spending legislation for the budget period.

The Obama Administration is required to submit a proposed federal budget for FY 2016 by the statutory due date of the first Monday in February (February 2, 2015), but that deadline is often missed and there is no penalty for late submission of a budget. Last year, the White House did not submit a budget to Congress until March 4, 2014. The White House Office of Management and Budget has said President Obama plans to release his FY 2016 budget proposal on February 2, 2015.

The statutory deadline for Congress to pass a budget resolution is April 15, but this date also has slipped often in the past. Because a budget resolution is only a Congressional blueprint, it does not require the President's approval.

Budget reconciliation process

The budget reconciliation process is designed to facilitate adoption of deficit reduction legislation that otherwise would face filibusters or other procedural delays. Reconciliation bills receive expedited consideration and have special procedural protections that facilitate passage. This is especially true in the Senate, where reconciliation bills cannot be filibustered and require a simple majority to pass.

Under Senate rules, there are a number of limitations on the use of budget reconciliation. The Senate, in May 2007, adopted a rule barring the use of reconciliation in a manner that would increase the deficit or reduce a surplus. This rule can be waived only with a 60-vote supermajority. Another rule requires a 60-vote supermajority to approve provisions that lose revenue beyond the 10-year budget window. The 2001 and 2003 tax rate reductions were originally enacted using budget reconciliation, and thus were subject to this rule requiring the tax cuts to 'sunset' at the end of the budget period. The Senate in 2007 approved a rule change preventing the use of budget reconciliation for net tax relief.

PAYGO

Congress in 2010 passed a pay-as-you-go law ('PAYGO') generally requiring tax increases or reductions in permanent spending to offset the cost of tax cuts or new mandatory spending programs. Congress can waive the PAYGO law by declaring specific spending or tax reductions to be emergency legislation.

The House has a 'cut-as-you-go' rule that requires any bill that increases mandatory spending to be offset by spending reductions and not by tax increases. The House rule provides an exception for certain measures designated as an emergency under the statutory PAYGO Act. The Senate does not have a similar rule.

Appendix B: Tax policymakers

House and Senate leadership in the 114th Congress

House Leadership

Speaker of the House	John Boehner (R-OH)
Majority Leader	Kevin McCarthy (R-CA)
Majority Whip	Steve Scalise (R-LA)
Chief Deputy Whip	Patrick McHenry (R-NC)
Republican Conference Chair	Cathy McMorris Rodgers (R-WA)
Republican Conference Vice Chair	Lynn Jenkins (R-KS)
Republican Campaign Committee Chair	Greg Walden (R-OR)
Republican Conference Secretary	Virginia Foxx (R-NC)
Republican Policy Committee Chair	Luke Messer (R-IN)
Minority Leader	Nancy Pelosi (D-CA)
Minority Whip	Steny Hoyer (D-MD)
Assistant Minority Leader	Jim Clyburn (D-SC)
Democratic Conference Chair	Xavier Becerra (D-CA)
Democratic Conference Vice Chair	Joseph Crowley (D-NY)
Democratic Campaign Committee Chair	Ben Ray Lujan (D-NM)
Democratic Chair of Policy and Communications	Steve Israel (D-NY)
Democratic Steering/Policy Committee Chairs	Rosa DeLauro (D-CT) and Donna Edwards (D-MD)

Senate Leadership

President of the Senate	Vice-President Joe Biden (D)
President Pro Tempore	Orrin Hatch (R-UT)
Majority Leader	Mitch McConnell (R-KY)
Assistant Majority Leader	John Cornyn (R-TX)
Republican Conference Chair	John Thune (R-SD)
Republican Conference Vice Chair	Roy Blunt (R-MO)
Republican Policy Chair	John Barrasso (R-WY)
Republican Senatorial Campaign Committee Chair	Roger Wicker (R-MS)
Minority Leader	Harry Reid (D-NV)
Assistant Minority Leader	Richard Durbin (D-IL)
Democratic Policy and Communications Chair	Charles Schumer (D-NY)
Strategic Policy Advisor	Elizabeth Warren (D-MA)
Democratic Conference Secretary	Patty Murray (D-WA)
Democratic Senatorial Campaign Committee Chair	John Tester (D-MT)
Chief Deputy Whip	Barbara Boxer (D-CA)
Democratic Steering Committee Chair	Amy Klobuchar (D-MN)

Tax-Writing Committees

House Ways and Means Committee

The Ways and Means Committee membership currently is composed of 24 Republicans and 15 Democrats.

House Ways and Means Committee Members, 114th Congress

Republicans	Democrats
Paul Ryan (R-WI), Chairman	Sander Levin (D-MI), Ranking Minority Member
Sam Johnson (R-TX)	Charles Rangel (D-NY)
Kevin Brady (R-TX)	Jim McDermott (D-WA)
Devin Nunes (R-CA)	John Lewis (D-GA)
Patrick Tiberi (R-OH)	Richard Neal (D-MA)
Dave Reichert (R-WA)	Xavier Becerra (D-CA)
Charles Boustany Jr. (R-LA)	Lloyd Doggett (D-TX)
Peter Roskam (R-IL)	Mike Thompson (D-CA)
Tom Price (R-GA)	John Larson (D-CT)
Vern Buchanan (R-FL)	Earl Blumenauer (D-OR)
Adrian Smith (R-NE)	Ron Kind (D-WI)
Aaron Schock (R-IL)	Bill Pascrell Jr. (D-NJ)
Lynn Jenkins (R-KS)	Joe Crowley (D-NY)
Erik Paulsen (R-MN)	Danny Davis (D-IL)
Kenny Marchant (R-TX)	Linda Sanchez (D-CA)
Diane Black (R-TN)	
Tom Reed (R-NY)	
Todd Young (R-IN)	
Mike Kelly (R-PA)	
Jim Renacci (R-OH)	
Pat Meehan (R-PA)*	
Kristi Noem (R-SD)*	
George Holding (R-NC)*	
Jason Smith (R-MO)*	

* New members

Senate Finance Committee

The Finance Committee membership currently is composed of 14 Republicans and 12 Democrats.

Senate Finance Committee Members, 114th Congress

Republicans	Democrats
Orrin Hatch (R-UT), Chairman	Ron Wyden (D-OR), Ranking Minority Member
Charles Grassley (R-IA)	Charles Schumer (D-NY)
Mike Crapo (R-ID)	Debbie Stabenow (D-MI)
Pat Roberts (R-KS)	Maria Cantwell (D-WA)
Michael Enzi (R-WY)	Bill Nelson (D-FL)
John Cornyn (R-TX)	Robert Menendez (D-NJ)
John Thune (R-SD)	Thomas Carper (D-DE)
Richard Burr (R-NC)	Benjamin Cardin (D-MD)
Johnny Isakson (R-GA)	Sherrod Brown (D-OH)
Rob Portman (R-OH)	Michael Bennet (D-CO)
Patrick J. Toomey (R-PA)	Robert Casey, Jr. (D-PA)
Daniel Coats (R-IN)*	Mark Warner (D-VA)
Dean Heller (R-NV)*	
Tim Scott (R-SC)*	

* New members

Key Treasury and other Administration officials

Treasury Secretary	Jack Lew
Director, National Economic Council	Jeffrey Zients
Director, Office of Management and Budget	Shaun Donovan
Chair, Council of Economic Advisers	Jason Furman
Treasury Assistant Secretary for Tax Policy	Mark Mazur
IRS Commissioner	John Koskinen
IRS Chief Counsel	William (Bill) Wilkins

Appendix C: Senate seats up for election in 2016

Democrats	Republicans
Bennet, Michael (D-CO)	Ayotte, Kelly (R-NH)
Blumenthal, Richard (D-CT)	Blunt, Roy (R-MO)
Boxer, Barbara (D-CA)*	Boozman, John (R-AR)
Leahy, Patrick (D-VT)	***Burr, Richard (R-NC)***
Mikulski, Barbara (D-MD)	***Coats, Daniel (R-IN)***
Murray, Patty (D-WA)	***Crapo, Mike (R-ID)***
Reid, Harry (D-NV)	***Grassley, Chuck (R-IA)***
Schatz, Brian (D-HI)	Hoeven, John (R-ND)
Schumer, Charles (D-NY)	***Isakson, Johnny (R-GA)***
Wyden, Ron (D-OR)	Johnson, Ron (R-WI)
	Kirk, Mark (R-IL)
	Lankford, James (R-OH)
	Lee, Mike (R-UT)
	McCain, John (R-AZ)
	Moran, Jerry (R-KS)
	Murkowski, Lisa (R-AK)
	Paul, Rand (R-KY)
	Portman, Rob (R-OH)
	Rubio, Marco (R-FL)
	Scott, Tim (R-SC)
	Shelby, Richard (R-AL)
	Thune, John (R-SD)
	Toomey, Patrick (R-PA)
	Vitter, David (R-LA)

*Not running for re-election

Senate Finance Committee members shown in ***bold italics***

Appendix D: Selected federal tax expenditures

Tax Expenditure	5–year FY 2014–2018 tax expenditure estimate ($ billions)
Corporations	
Deferral of active income of controlled foreign corporations	418.0
Exclusion of interest on public purpose State and local government bonds	49.2
Deduction for income attributable to domestic production activities	65.1
Inventory property sales source rule exception	15.3
Depreciation of equipment in excess of the alternative depreciation system*	-28.8
Credit for low-income housing	38.8
Expensing of research and experimental expenditures	28.4
Last-in, first-out inventory method (LIFO)	7.8
Reduced rates on first $10,000,000 of corporate taxable income	20.4
Exclusion of investment income on life insurance and annuity contracts	13.9
Credit for increasing research activities (section 41) **	N/A
Special treatment of life insurance company reserves	15.4
Deferral of gain on non-dealer installment sales	34.0
Deferral of gain on like-kind exchanges	68.0
Individuals	
Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums	785.1
Deduction for mortgage interest on owner-occupied residences	405.2
Reduced rates of tax on dividends and long-term capital gains	632.8
Net exclusion of pension contributions and earnings for defined benefit plans	248.3
Earned income credit	352.8
Deduction of non-business State and local government income taxes, sales taxes, and personal property taxes	316.4
Net exclusion of pension contributions and earnings for defined contribution plans	399.0
Exclusion of capital gains at death	174.8
Deduction for charitable contributions, other than for education and health	186.6
Exclusion of Medicare Benefits: Hospital Insurance (Part A)	180.7
Exclusion of untaxed Social Security and railroad retirement benefits	209.1

Tax Expenditure	5–year FY 2014–2018 tax expenditure estimate ($ billions)
Exclusion of benefits provided under cafeteria plans	193.0
Exclusion of investment income on life insurance and annuity contracts	144.2
Exclusion of Medicare Benefits: Supplementary medical insurance (Part B)	128.1
Credit for children under age 17	285.5
Deduction for property taxes on real property	182.1
Exclusion of interest on public purpose State and local government bonds	131.2
Exclusion of capital gains on sales of principal residences	149.3
Individual retirement arrangements: Traditional IRAs	69.5
Net exclusion of pension contributions and earnings for plans covering partners and sole proprietors (Keogh plans)	52.1
Deduction for medical expenses and long–term care expenses	59.9
Exclusion of miscellaneous fringe benefits	38.3
Credits for tuition for post-secondary education	110.1
Exclusion of Medicare Benefits: Prescription drug insurance (Part D)	41.4
Deferral of gain on non-dealer installment sales	9.1
Deferral of gain on like-kind exchanges	30.6
Carryover basis of capital gains on gifts	36.1
Deduction for charitable contributions to educational institutions	32.0
Deduction for health insurance premiums and long-term care insurance premiums by the self employed	29.4
Exclusion of foreign earned income: Salary	39.7
Exclusion of veterans' disability compensation	35.9
Exclusion of benefits and allowances to armed forces personnel	32.4
Individual retirement arrangements: Roth IRAs	30.2
Credits and subsidies for participating in health insurance exchanges	318.1
Exclusion of employer-paid transportation benefits	26.3
Depreciation of rental housing in excess of alternative depreciation system	21.2
Exclusion of cash public assistance benefits	19.7
Exclusion of income earned by voluntary employees' beneficiary associations	16.1
Exclusion of workers' compensation benefits (disability and survivors payments)	14.4
Tax credit for small businesses purchasing employer insurance	5.3
Deduction for income attributable to domestic production activities	24.7
Exclusion of employment benefits for premiums on accident and disability insurance	21.3

Tax Expenditure	5–year FY 2014–2018 tax expenditure estimate ($ billions)
Exclusion of workers' compensation benefits (medical benefits)	25.1
Deduction for charitable contributions to health organizations	16.4
Credit for child and dependent care and exclusion of employer-provided child care	23.5
Exclusion of medical care and TRICARE medical insurance for military dependents, retirees, and retiree dependents not enrolled in Medicare	12.2
Additional standard deduction for the blind and the elderly	15.3
Exclusion of scholarship and fellowship income	14.4
Exclusion of interest on State and local government qualified private activity bonds for private nonprofit and qualified public educational facilities	13.2
Parental personal exemption for students aged 19 to 23	25.2
Build America bonds	16.0

* Includes bonus depreciation and general acceleration under MACRS.

** Table reflects legislation enacted by June 30, 2014. Credit for research and experimentation expenses expired for amounts paid or incurred after December 31, 2013.

Note: The methodology used by Joint Committee on Taxation staff to estimate tax expenditures differs from the methodology used to estimate revenue-raising proposals.

Source: Joint Committee on Taxation. Estimates of Federal Tax Expenditures for Fiscal Years 2014–2018. JCX-97-14

Appendix E: Selected potential revenue-raising proposals

Provision	Source of proposal	Revenue Estimate over 10 Years ($ millions)
International		
Modify the rule for the sourcing of income from exports	CBO	4,000
Defer deduction of interest expense related to deferred income of foreign subsidiaries	Administration FY 2015 Budget	43,138
Tax currently excess returns associated with transfers of intangibles offshore	Administration FY 2015 Budget	25,965
Disallow the deduction for non–taxed reinsurance premiums paid to foreign affiliates	Administration FY 2015 Budget	7,568
Modify tax rules for dual capacity taxpayers	Administration FY 2015 Budget	10,382
Limit shifting of income through intangible property transfers	Administration FY 2015 Budget	2,728
Determine the foreign tax credit on a pooling basis	Administration FY 2015 Budget	74,672
Restrict deductions for excessive interest of members of financial reporting groups	Administration FY 2015 Budget	48,581
Limit the ability of domestic entities to expatriate	Administration FY 2015 Budget	17,004
Prevent avoidance of foreign base company sales income through manufacturing service arrangements	Administration FY 2015 Budget	24,608
Create a new category of Subpart F income for transactions involving digital goods or services	Administration FY 2015 Budget	11,660
Tax Accounting and Corporate		
Increase corporate income tax rates by 1 percentage point	CBO	102,000
Repeal last-in, first-out (LIFO) method of accounting for inventories	Administration FY 2015 Budget	82,708
Make the 0.2 percent unemployment insurance surtax permanent	Administration FY 2015 Budget	15,200
Increase certainty with respect to worker classification	Administration FY 2015 Budget	9,610
Repeal gain limitation for dividends received in reorganization exchanges	Administration FY 2015 Budget	3,051
Financial Services		
Impose a financial crisis responsibility fee	Administration FY 2015 Budget	56,024
Tax carried (profits) interest in investment partnerships as ordinary income	Administration FY 2015 Budget	13,797
Reinstate superfund taxes	Administration FY 2015 Budget	23,270
Repeal lower-of-cost-or-market (LCM) inventory accounting method	Administration FY 2015 Budget	7,495
Employee Benefits		
Tax Social Security and railroad retirement benefits like defined-benefit pensions	CBO	412,000

Provision	Source of proposal	Revenue Estimate over 10 Years ($ millions)
Energy		
Increase excise taxes on motor fuels by 35 cents and index for inflation	CBO	469,000
Repeal domestic manufacturing deduction for oil and natural gas companies	Administration FY 2015 Budget	14,218
Repeal percentage depletion for hard mineral fossil fuels	Administration FY 2015 Budget	2,052
Repeal expensing of intangible drilling costs (IDCs)	Administration FY 2015 Budget	14,350
Repeal domestic manufacturing deduction for coal and other hard mineral fossil fuels	Administration FY 2015 Budget	726
Repeal percentage depletion for oil and natural gas wells	Administration FY 2015 Budget	13,030
Increase geological and small integrated geophysical amortization for independent producers to seven years	Administration FY 2015 Budget	3,081
Repeal capital gains treatment for royalties	Administration FY 2015 Budget	508
Increase the Oil Spill Liability Trust Fund financing rate by one cent and update the law to include other sources of crude	Administration FY 2015 Budget	951
Repeal expensing of exploration and development costs	Administration FY 2015 Budget	679
Repeal exception to passive loss limitation for working interests in oil and natural gas properties	Administration FY 2015 Budget	59
Repeal deduction for tertiary injectants	Administration FY 2015 Budget	100
Individual		
Limit the value of itemized deductions	CBO	64,000 to 139,000
Eliminate the deduction for state and local taxes	CBO	1,088,000
Curtail the deduction for charitable giving	CBO	213,000
Convert the mortgage interest deduction to a 15 percent tax credit	CBO	113,000
Use an alternative measure of inflation to index some parameters of the tax code	CBO	150,000
Raise the tax rates on long-term capital gains and dividends by 2 percentage points	CBO	53,000
Eliminate certain tax preferences for educational expenses	CBO	150,000
Further limit annual contributions to retirement plans	CBO	83,000
Provide short–term tax relief to employers and expand Federal Unemployment Tax Act (FUTA) base	Administration FY 2015 Budget	58,982
Lower the investment income limit for the earned income tax credit and extend that limit to the refundable portion of the child tax credit	CBO	6,000

Provision	Source of proposal	Revenue Estimate over 10 Years ($ millions)
Insurance		
Increase the payroll tax rate for Medicare hospital insurance by 1 percentage point	CBO	800,000
Require that derivative contracts be marked to market with resulting gain or loss treated as ordinary	Administration FY 2015 Budget	18,804
Expand pro rata interest expense disallowance for corporate-owned life insurance	Administration FY 2015 Budget	5,546
Modify proration rules for life insurance company general and separate accounts	Administration FY 2015 Budget	6,317
Modify rules that apply to sales of life insurance contracts	Administration FY 2015 Budget	495
Estate and Gift		
Require a minimum term for grantor retained annuity trusts (GRATs)	Administration FY 2015 Budget	5,711
Require consistency in value for transfer and income tax purposes	Administration FY 2015 Budget	2,501
Other		
Increase all taxes on alcoholic beverages to $16 per proof gallon	CBO	66,000
Levy a fee on the production of hardrock minerals to restore abandoned mines	Administration FY 2015 Budget	1,800
Increase levy authority for payments to Medicare providers with delinquent tax debt	Administration FY 2015 Budget	743
Deny deduction for punitive damages	Administration FY 2015 Budget	338

Source: Administration's FY 2015 Budget, March 4, 2014 and CBO: Congressional Budget Office "Options for Reducing the Deficit: 2015 to 2024," November 2014

Appendix F: OECD Base Erosion and Profit Shifting (BEPS) action plan timeline

Month	BEPS action point	Event
Sept. 2014	1: Digital	Report identifying issues raised by the digital economy and possible actions to address them
	5: Harmful tax practices	Finalize review of member country regimes
	8: TP: Intangibles 13: TP Documentation	Changes to the Transfer Pricing Guidelines
	2: Hybrids 6: Treaty Abuse 8: TP: Intangibles	Changes to the Model Tax Convention
	2: Hybrids 6: Treaty Abuse 13: TP Documentation	Recommendations regarding the design of domestic rules
Oct. 2014	8/9/10: Transfer pricing	Discussion draft re Low-value adding services
	7: Permanent Establishment	Discussion draft re PE status
Nov. 2014	10: Transfer pricing	Discussion draft re Low-value adding services
	6: Treaty Abuse	Discussion draft re Treaty abuse
Dec. 2014	1: Digital	Discussion draft re VAT B2C Guidelines
	8/9/10: Transfer pricing	Discussion draft re risk, recharacterization, commodity transactions and profit splits
	4: Limit base erosion	Discussion draft re interest deductions
	14: Dispute resolution	Discussion draft re dispute resolution
Jan. 2015	11: Establish methodologies	Discussion draft re economic analysis
Mar. 2015	12: Tax planning disclosure	Discussion draft re disclosure rules
Apr. 2015	3: CFC	Discussion draft re CFC rules
	8/9/10: Transfer pricing	Discussion draft re CCAs & Intangibles (ownership; hard to value)

Month	BEPS action point	Event
Sept. 2015	3: CFC 4: Interest deductions 12: Tax planning disclosure	Recommendations regarding the design of domestic rules
	5: Harmful tax practices	Strategy for non-OECD members
	8/9/10: Transfer pricing	Changes to the Transfer Pricing Guidelines
	7: PE 8/9/10: Transfer pricing 14: Dispute resolution	(Possible) changes to the Model Tax Convention
	9: TP: Risks and capital	Strategy to expand participation to non-OECD members
	15: Multilateral instrument	Recommendations regarding data to be collected and methodologies to analyze them
Dec. 2015	4: Interest deductions	Changes to the Transfer Pricing Guidelines
	5: Harmful tax practices 15: Multilateral instrument	Revision of existing criteria Develop a multilateral instrument

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