WNTS Insight

A Washington National Tax Services (WNTS) Publication

March 20, 2012

House Republican budget calls for tax reform; 25-percent top rate for individuals and corporations

House Budget Committee Chairman Paul Ryan (R-WI) today released a proposed FY 2013 House budget resolution that reaffirms support for comprehensive tax reform. The draft budget includes proposals to limit future growth in spending on Medicare and other federal mandatory spending programs, and also assumes repeal of the Affordable Care Act of 2010.

Congressional budget resolutions, which are not subject to signature or veto by the President, set the expected budget levels for discretionary spending, mandatory spending, and revenues for the federal government. Under the budget proposed by Chairman Ryan, discretionary spending for FY 2013 would be capped at $1.028 trillion, less than the $1.047 trillion limit set under the Budget Control Act enacted last year by the House and Senate. The House proposal to reduce spending below levels agreed to as part of last year's debt limit agreement may complicate efforts to pass spending bills later this year for the federal government's new fiscal year that starts on October 1, 2012.

Chairman Ryan's proposed budget resolution also would replace the automatic "sequestration" spending reductions set to begin in January 2013 with new proposed spending reductions. The draft budget provides "budget reconciliation" instructions for several House committees, including the Ways and Means Committee, to submit by April 27, 2012 recommendations on spending reductions totaling $261.5 billion between fiscal years 2012 and 2022. As part of this overall deficit reduction, the Ways and Means Committee is directed to propose changes to laws within its jurisdiction that would reduce the deficit by $53 billion over that period.

The House Budget Committee is scheduled to consider Chairman Ryan's proposal tomorrow. If the Budget Committee approves a budget resolution, the House is expected to vote next week in advance of the April 15 statutory deadline for action on a budget resolution.

Senate Majority Leader Harry Reid (D-NV) previously has stated that the Senate is not expected to vote on an FY 2013 budget, but would instead rely on spending limits set by the Budget Control Act. Senate Budget Committee Kent Conrad (D-ND) has stated that his committee may hold hearings on a budget resolution, but he today reaffirmed his support for keeping in place the spending levels agreed to last year by Congress and the Obama Administration.

Proposals for "pro-growth tax reform"

The budget outlined by Chairman Ryan incorporates general recommendations on tax reform principles outlined in a letter to the House Budget Committee by House Ways and Means Chairman Dave Camp (R-MI).

Key goals for tax reform featured in Chairman Ryan's budget report -- "The Path to Prosperity: A Blueprint for American Renewal" -- include proposals to:

- Consolidate the current six individual tax brackets into two brackets of 10 and 25 percent;
- Repeal the Alternative Minimum Tax;
- Reduce the corporate income tax rate to 25 percent; and
- Shift from a "worldwide" system of taxation to a "territorial" tax system that "puts American companies and their workers on a level playing field with foreign competitors."

In his letter to the House Budget Committee, Ways and Means Chairman Camp states that a territorial tax system would end "the 'lock-out effect' that discourages companies from bringing back foreign earnings to invest in the United States."

The 99-page budget report released today by Chairman Ryan does not specify how the cost of lowering individual and corporate tax rates would be offset, but does state that the lower rates would be "revenue neutral through base broadening." The budget report calls for tax reform legislation to "maintain revenue growth at a level consistent with current tax policy and at a share of the economy consistent with historical norms of 18 to 19 percent [of revenues relative to GDP] in the following decades." The statutory budget resolution released by Chairman Ryan incorporates this assumption into projections of future federal revenues.

The budget report cites "deductions, loopholes, and carve-outs" in the tax code as adding both complexity and unfairness to the tax law, with the sum of all "tax preferences" amounting to over $1 trillion annually. The report states that because the United States "has a highly progressive income tax, these tax preferences are disproportionately used by upper-income individuals."

The budget report expresses concerns over the uncompetitive nature of the U.S. corporate income tax, and notes that the combined federal, state, and local rates in the United States total more than 39 percent, the highest in the world after Japan on April 1 lowers its corporate rate. At the same time, the report notes that only 10 percent of total federal tax revenues come from taxing corporate income, and "like the individual income tax, the corporate tax contains a host of special carve-outs and deductions which serve to narrow the tax base by about 25 percent."

The timing and specifics of any future tax reform legislation remain uncertain. It is generally expected that formal Congressional action on tax reform proposals may not occur prior to the next Congress, although hearings will continue in both the House and Senate tax committees this years. Future action on tax reform legislation will be influenced by the outcome of the 2012 elections.

General budget proposals

Spending under the proposed House budget resolution would fall relative to President Obama's proposed FY 2013 budget and relative to the current-law baseline. First, as noted above, the proposed House budget resolution would reduce the cap on discretionary spending beyond the levels enacted as part of the Budget Control Act, resulting in cumulative spending that is $950 billion (approximately 7 percent) lower than the current-law baseline over the 2013 to 2022 period. Mandatory spending would decrease by $3.3 trillion (almost 12 percent) over the same period relative to the current-law baseline.

Total spending under the proposed House Republican budget would fall to 19.8 percent of GDP by 2022, according to material released today by Chairman Ryan. By comparison, the Congressional Budget Office (CBO) projects that total federal spending will be 22.8 percent of GDP by 2022 under the Obama Administration's FY 2013 budget.

The decrease in mandatory spending is primarily attributable to the proposed elimination of the new health insurance subsidies scheduled under the Affordable Care Act, reform of certain income support programs, and a slowing of the growth under the Medicaid program. Other proposals, such as adopting a premium support model for the Medicare program in the future, would have relatively small impacts through 2022 but larger impacts in later years.

The proposal would slowly phase down deficits through 2022 and beyond. In 2022, the federal budget deficit would be approximately 1.2 percent of GDP and the debt held by the public would be 63 percent. By comparison, the 2011 values were 8.7 percent and 68 percent, respectively. Deficits would be eliminated around 2040 under the proposed House budget resolution, and budget surpluses are projected for subsequent years. Under the Administration's budget, CBO projects that deficits would fall to 3 percent of GDP by 2022, and debt held by the public would be 76 percent of GDP.

For more information, please contact:

John Stell	*(202) 312-7583*	*john.l.stell@us.pwc.com*
Larry Campbell	*(202) 414-1477*	*larry.campbell@us.pwc.com*
Andrew Prior	*(202) 414-4572*	*andrew.prior@us.pwc.com*

Link to WNTS Insight archive: http://www.pwc.com/us/en/washington-national-tax/newsletters/washington-national-tax-services-insight-archives.jhtml

This document is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

SOLICITATION

© 2012 PricewaterhouseCoopers LLP. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers LLP, a Delaware limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.