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Obama Administration releases business tax reform framework

Overview

The Obama Administration today released a 25-page "framework for business tax reform" that calls for a 28-percent top corporate income tax rate. The framework proposes a tax rate of no more than 25 percent for certain domestic manufacturers and a permanent research credit. The framework also calls for a "minimum tax on overseas profits."

The Administration's framework suggests that efforts should be made to establish greater parity between C corporations and large pass-through businesses. At the same time, the framework outlines several small business tax relief provisions.

The Administration states that President Obama's goal is to have a corporate tax rate more in line with major U.S. trading partners. The Administration states that for OECD countries excluding the United States, the GDP-weighted average corporate tax rate is 27.8 percent, and the average corporate tax rate is 25.1 percent.

The Administration's business tax reform framework does not include any proposals for comprehensive individual tax reform.

Base-broadening options

The Administration states that the cost of lowering the U.S. corporate tax rate should be fully offset by limiting various business tax provisions. The framework provides a "menu of options" for base-broadening, and states that at least several of the following options would be necessary to reduce the corporate rate to 28 percent:

- Address depreciation schedules;
- Reduce the "bias toward debt financing;"and
- Establish greater parity between large corporations and large non-corporate businesses.

Note: The framework does not detail specific proposals in these areas. Instead, the framework states that "steps like reducing the deductibility of interest for corporations should be considered" and cites past options to change the tax treatment of large pass-through businesses that were included in the 2005 report of President Bush's Advisory Panel on Tax Reform and in reform options developed by President Obama's Economic Recovery Advisory Board in 2010.

The framework also states that reform should "improve transparency and reduce accounting gimmicks." The framework suggests that tax reform should reduce the gap between book income and taxable income, and also "could include greater disclosure of annual corporate income tax payments."

Several of the tax expenditures cited in the Administration's business reform framework also are featured in the President's FY 2013 budget, including proposals that would:

- Repeal the "last-in, first-out" (LIFO) method of inventory accounting;
- Eliminate oil and gas tax preferences;
- Reform treatment of insurance industry and products;
- Tax carried interest as ordinary income; and
- Eliminate special depreciation rules for corporate purchases of aircraft.

Incentives expanded for domestic manufacturing and research activities

The Administration's framework calls for a tax rate of 25 percent for qualified domestic manufacturing income by expanding the section 199 deduction to 10.7 percent. The deduction would be doubled for certain "advanced manufacturing income."

Note: The Administration's FY 2013 budget also includes a proposal to "target" the section 199 manufacturing deduction by eliminating the deduction for oil and gas manufacturing activities and certain "non-manufacturing" activities. The Administration's budget also proposes to double the manufacturing deduction for advanced manufacturing.

The framework proposes that tax reform should expand and make permanent the research credit. A similar proposal also is part of the President's FY 2013 budget.

The framework also calls for reforms that would "extend, consolidate, and enhance" clean energy tax incentives, including making permanent and refundable the tax credit for production of renewable electricity.

The Administration also calls for tax reform to review other temporary tax provisions to determine which provisions should be made permanent and which should not be renewed.

No territorial proposal; minimum tax on overseas profits part of worldwide tax system

The framework states that "income earned by subsidiaries of U.S. corporations operating abroad must be subject to a minimum rate of tax," but does not detail a specific minimum rate. Under the proposal, foreign income deferred in a low-tax jurisdiction would be subject to immediate U.S. taxation up to the minimum tax rate with a foreign tax credit allowed for income taxes on that income paid to the host country. The Administration's proposed minimum tax on overseas profits would expand the reach of the current U.S. worldwide tax system by limiting the ability of companies to defer U.S. taxes on foreign earnings until those earnings are repatriated.

The framework also calls for separate reforms to reduce incentives to shift income and assets overseas. The Administration proposes to tax "excess profits" associated with shifting intangibles to low-tax jurisdictions and to limit interest deductions related to unrepatriated foreign earnings. Both of these proposals are included in the Administration's FY 2013 budget.

The framework also includes proposals from the Administration's FY 2013 budget to remove tax deductions for moving production overseas and provide new incentives for bringing production back to the United States.

Last year, there were some reports that the Obama Administration might propose a "tough" territorial tax system, but the Administration today provided specific reasons for not supporting a territorial tax system. The framework released today states that the Administration believes that "if foreign earnings of U.S. multinational corporations are not taxed at all, these firms would have even greater incentives to locate operations abroad or use accounting mechanisms to shift profits out of the United States. Furthermore, such a system could exacerbate the continuing race to the bottom in international tax rates."

Under the Administration's corporate reform framework released today, the United States would remain the only G-8 country with a worldwide tax system. All other G-8 countries have moved to territorial tax systems; 26 of the 34 OECD countries currently have territorial tax systems.

In terms of proposals that call for a territorial tax system, House Ways and Means Chairman Dave Camp (R-MI) last October released an international tax reform discussion draft that calls for a top corporate rate of 25 percent and details proposals for moving to a territorial tax system featuring a 95-percent dividend received deduction for eligible foreign-source dividends. Chairman Camp's discussion draft also features three options for anti-base erosion measures, one of which would treat as Subpart F income overseas earnings on a per-country basis that are taxed at a foreign effective tax rate of 10 percent or less, other than same-country income. Senate Finance Committee member Mike Enzi (R-WY) on February 9, 2012 introduced a bill (S. 2091) that proposes a territorial tax system with a 95-percent dividend received deduction. Senator Enzi's bill differs from Chairman Camp's discussion draft in several aspects, including an anti-base erosion measure in S. 2091 that would treat as Subpart F income overseas earnings on a per-country basis that are taxed at an effective tax rate of less than half the maximum U.S. corporate statutory rate (i.e., 17.5 percent based on a 35-percent statutory rate), with exceptions for certain active income.

Tax reform outlook

Ways and Means Chairman Camp today issued a statement that he appreciates "the Administration has finally weighed in with a framework for corporate tax reform," and notes that the Administration's proposal "adopts many of the same principles of reform that House Republicans have championed, such as lowering rates by broadening the tax base and closing loopholes." At the same time, Chairman Camp noted in his press release certain policy differences that he looks forward to discussing with the Administration and House and Senate leaders, including the Administration's "apparent decision to expand a system that double taxes American employers when they try to compete with foreign corporations." Chairman Camp also stated that he wants "to more closely review how the Administration intends to bring home roughly $1 trillion in American profits that are currently trapped overseas." He also noted that the Administration has not proposed a comprehensive tax reform addressing both business and individual tax issues.

It is unlikely that the Obama Administration and Congress will agree on comprehensive tax reform legislation that can be enacted in advance of the November 2012 elections. In addition to the Administration's corporate reform framework, candidates for the Republican presidential nomination have been outlining alternative tax reform proposals. At the same time, tax reform has been the subject of more than 20 hearings by the House and Senate tax committees during the current Congress. These hearings and various proposals for tax reform by President Obama and others may help to shape future tax reform legislation if a consensus can emerge on the need for and the direction of a lasting overhaul of U.S. tax laws.

Click here for a copy of the President's Framework for Business Tax Reform.

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