

Tax Reform Panel Hears Pros and Cons of Add-On Consumption Tax

By Heidi Glenn — hglenn@tax.org

Witnesses at the first hearing of President Bush's tax reform advisory panel said last week that fundamental overhaul of the current system is unlikely and instead suggested the group consider other options, including adding a consumption-based tax system to the current system as a way to pay for increased entitlement spending.

"The notion that we should scrap the code is a waste of time," said the panel's first witness, former IRS Commissioner Fred T. Goldberg Jr. "You shouldn't bother thinking about it." Once the panel takes into consideration the limitations Bush has put on reform to come up with revenue-neutral options that retain benefits for encouraging home buying and charitable giving, "you've got an income tax."

However, "that doesn't preclude you from doing radical reform," Goldberg said.

In addition to finding another revenue source, Goldberg suggested broadening the tax base or radically restructuring specific areas such as the taxation of savings and international taxation, a recommendation that appeared to produce results akin to the "five easy pieces" consumption-based reform plan. (For coverage of the five easy pieces plan, see *Doc 2005-1189* or *2005 TNT 12-1*.)

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"If we cut the shrubbery it's going to grow back," Goldberg said of the current code. Tinkering with the current system would produce a solution that will last about 10 to 15 years before reverting to a complicated mess, Goldberg said, while radical sector-based reform would add about 10 more years.

However, Goldberg said, looming problems in Social Security, Medicare, and Medicaid require a "rethinking of the tax system."

Harvard economist Louis Kaplow and Brookings Institution fellow William G. Gale, invited to speak

about the merits of a consumption tax and an income tax, made similar suggestions.

"If you think about the spending numbers, unless you're really serious about cutting Medicare and Medicaid, we're going to need more revenue," Gale said, calling a value added tax a "very powerful money machine." However, Gale warned that a national retail sales tax, an idea Bush has called "interesting," would be difficult to enforce.

Stephen J. Entin, former Treasury deputy assistant secretary for economic policy, warned that taxpayers may be afraid of having two tax systems for fear that policymakers would have two opportunities to raise taxes.

Panel Chair Connie Mack and Vice Chair John B. Breaux said they are still considering all options, including the add-on tax, and have not ruled out attempting fundamental reform.

Fundamental reform will be a "challenge," Breaux said, not the impossibility described by Goldberg. "What we are required to do is going to be extraordinarily difficult. If we end up finding out it's impossible to do we'll have to take it from there."

While Breaux said he did not prefer "going all the way in one direction or another," neither leader would endorse the add-on idea.

THOMAS TALKS TAX REFORM AT TCPI

Speaking at the Tax Council Policy Institute's recent tax symposium in Washington, House Ways and Means Committee Chair William M. Thomas, R-Calif., contradicted reports that he was already advocating specific approaches to fundamental tax reform.

Thomas reportedly indicated a preference for accomplishing reform through a series of changes to the tax system, as opposed to scrapping the system and developing an entirely new set of tax rules from scratch. "Every proposed system has pros and cons, and it is easy to roll out arguments against any specific proposal. It's also easy to argue against the current system," Thomas said.

Thomas warned that competitive pressure is not a static phenomenon and said that by the time the recent U.S. tax cuts are fully phased in, European governments will have already taken steps to further cut taxes and create a more favorable investment climate. ■

— Robert Goulder

"It's way too early. I thought the discussion today around those issues was interesting," Mack said.

However, that the White House would embrace an add-on tax appeared unlikely to Rachele B. Bernstein of the National Retail Federation.

"I cannot conceive how a Republican administration could condone or endorse the creation of a new revenue engine," Bernstein said.

Tax Expenditures and Dynamic Scoring

In her opening statement, panel member Elizabeth Garrett of the University of Southern California, a former staff member of former Senate tax-writer David L. Boren, said that the panel should scrub the code of outdated tax expenditures. Panelists must keep in mind that tax expenditures are justified only when they actually change behavior in the way intended, Garrett said. "It is not worth the revenue loss if a tax expenditure subsidizes behavior that would occur even without the tax incentive; all that happens is that we create a windfall for a few at the expense of all taxpayers," Garrett said.

'I cannot conceive how a Republican administration could condone or endorse the creation of a new revenue engine,' Bernstein said.

Goldberg and Entin agreed. "Trying to micro-manage behavior is a big mistake," Goldberg said. "You might want to consider taking social engineering programs out" and find places elsewhere in the budget for proposals with similar goals, Entin said.

However, Mack cautioned against politicizing the process.

"The reality is that every one of those tax expenditures was put in there for a reason," Mack said. "Many people could make very good arguments about every single one. If we take the position that we ought to come up with proposals that are based on what we believe is a sound tax plan then we're going to have to be willing to not be drawn into making the political decision about whether or not these are good or bad ideas."

Moving Forward

The hearing, which focused on a background of the current system as well as a description of consumption-based and income-based taxes, marked the first time the tax reform panel has met publicly since it was formed. It also provided the first glimpse at some of the members not well known in the tax community as well as staff members recently hired to assist the group.

Panel staff, headed by Executive Director Jeffrey F. Kupfer, now totals three, Roseanne Altshuler will serve as senior economist and John Ackerman as senior counsel.

For some in the audience in the Ronald Reagan Building auditorium, the hearing set a positive tone for the process.

"I didn't get the sense the panelists had an agenda," one lobbyist at the hearing told Tax Analysts. "If one had taken a cynical view about the creation of yet another commission, the cynicism was proven unfounded. It was a serious, policy-grounded, very candid discussion that hopefully will continue as the panel does its work."

Panelists generally were optimistic that the objectives laid out by Bush were achievable.

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"I believe it's a good sign that we are holding our first meeting to discuss reform in the building that bears the name of Ronald Reagan, who initiated the last bipartisan effort to reform the tax code 20 years ago," Mack said.

The meeting was part of what Mack calls the first stage of the panel's work. The panel will begin by taking a comprehensive look at the existing tax system "to make sure we have a full understanding of the current problems in the tax code — specifically its complexity, its impact on economic growth, and its perceived fairness." The panel will then turn to options for reform.

"These options may include modifications to improve current law, overhauling the existing system, or replacing the current structure and starting over," Mack said.

Mack requested that as part of the first stage of work, submitted comments address several aspects of the code:

- unnecessary complexity and burden faced by individuals and businesses under the existing system;
- aspects that are unfair;
- examples of how the tax code distorts important business or personal decisions; and
- goals the panel should try to achieve as it evaluates the existing system and recommends options for reform.

"At this point we are not looking for specific proposals," Mack said.

The panel's next hearing is scheduled for March 3 at 9:30 a.m. at George Washington University. The

meeting will again focus on examining the problems in the current system with specific attention to complexity and the effect of complexity on compliance.

It is not yet known who will score the panel's proposals. According to Breaux, the panel has not decided whether to send proposals to Treasury or the Joint Committee on Taxation for scoring.

However, Senate taxwriters last month told members that not adhering to the JCT's scoring conventions would "severely undermine" the panel's recommendations.

Senate Finance Committee ranking minority member Max Baucus, D-Mont., reiterated the sentiment that the panel must work with lawmakers to produce results.

"A major change from our current progressive income tax to another type of tax involves significant complexities and difficulties, not to mention the constraints this panel must work under, including revenue neutrality and the carving out of a few specific tax benefits," Baucus said. "We need to work together to find significant and meaningful simplification of our current system. This is an achievable goal." ■

Full Text Citations

- Opening statement from panel member Prof. **Garrett**. *Doc 2005-3176; 2005 TNT 32-39*
- Opening statement from Treasury Secretary **Snow**. *Doc 2005-3181; 2005 TNT 32-48*
- Opening statement from **Mack**, panel chair. *Doc 2005-3184; 2005 TNT 32-40*
- Opening statement from **Breaux**, panel vice chair. *Doc 2005-3185; 2005 TNT 32-41*
- **Fact sheet** for the tax reform panel's first meeting. *Doc 2005-3186; 2005 TNT 32-42*
- Statement on panel meeting by Senate Finance Committee ranking minority member **Baucus**. *Doc 2005-3223; 2005 TNT 32-37*

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SILOs Are Designated As Listed Transactions

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The long-running sale-in, lease-out (SILO) saga has taken yet another turn, and the news isn't good for investors in the controversial leasing arrangements. Treasury and the IRS recently announced in Notice 2005-13, 2005-9 IRB 1, that SILOs were being designated as listed transactions. (For Notice 2005-13, see *Doc 2005-2968* or *2005 TNT 29-6*.)

The new designation means taxpayers will have to disclose their involvement in SILO transactions to the IRS.

Last year's massive tax bill, the American Jobs Creation Act of 2004 (P.L. 108-357), appeared to pretty much shut down the transactions going forward by enacting limitations on the deductibility of losses from future SILO agreements. Without the full benefit of the depreciation and interest deductions, taxpayers have less incentive to enter into the leasing agreements.

"SILO arrangements are designed to exploit the tax law by shifting tax benefits from a tax-indifferent party that cannot use them to a taxpayer that can," a press release from Treasury stated. "Taxpayers entering into SILO arrangements cannot claim tax benefits as the purported owners of property subject to the lease because they do not acquire tax ownership of the property."

Senate Finance Committee Chair Charles E. Grassley, R-Iowa, praised the announcement. Grassley said making SILOs listed transactions "complements" the new law provision intended to shut down the arrangements.

Grassley said making SILOs listed transactions 'complements' the new law intended to shut down the arrangements.

The decision by Treasury and the IRS "reaches back to the deals that otherwise might have gotten away," Grassley said in a prepared statement.

In an interview with Tax Analysts, prominent leasing industry lobbyist Kenneth J. Kies of Clark Consulting called the announcement a "rather curious development."

The statutory changes made by Congress, according to Kies, indicated that SILOs entered into before March 13, 2004, were valid under the law.

"This notice would tend to suggest that it's the IRS's view that those transactions never worked under the old law," Kies said.