Policy Alert

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The Prospects for Corporate Tax Reform

As the 2014 midterm elections approach, speculation is widespread as to whether tax reform can be successfully pursued in 2015. The successful 1986 Tax Reform Act navigated through a politically divided Congress a full generation ago—demanding the very best of our Congress and president, and requiring political leadership, bipartisan cooperation and substantive compromise—the essential hallmarks of the 1986 Act—over a sustained two-year period. Make no mistake about it—nothing short of a determined bipartisan effort and shared commitment will be required again.

At present, the fundamental building blocks for a successful tax reform effort are not in place. Those fundamentals include whether tax reform should be structured comprehensively to include both individual and corporate reform (the “1986 Act model”) or whether corporate tax reform should proceed separately and go first. In addition, a fundamental divide must be resolved between those favoring reform for public C corporations and those favoring more expansive “business” tax reform including sole proprietors and “pass-through” business entities including partnerships, Subchapter S Corporations and limited liability companies. Finally, a fundamental difference of opinion must be bridged between congressional Republicans who favor structuring tax reform to be “revenue neutral” and President Obama and congressional Democrats who favor raising some additional revenues from tax reform to be utilized for deficit reduction. This latter difference extends to the issue of whether “dynamic” scoring or conventional budget scorekeeping conventions should be used to measure the revenue effects of tax reform whatever its underlying structure.

Stipulating to an eventual political consensus on the “fundamentals,” what might corporate or business tax reform look like? While the devil will certainly be in the details, the policy momentum appears to be developing along the lines of “classic” reform, i.e., a substantial reduction in tax rates with a significant broadening of the income tax base. Structuring tax reform this way will create many “winners” and “losers.” Importantly, there are many common or similar features in the tax reform “discussion drafts” released by various congressional leaders and the “Framework for Business Tax Reform” advanced by President Obama. The commonality includes a substantial reduction in the top corporate tax rate from 35 percent to a top rate 8–10 points lower, adoption of a “hybrid” territorial tax system for international commerce and significant repeal or restriction of a wide variety of corporate “tax expenditures,” including proposed cutbacks to various capital investment incentives, sophisticated financial instruments, accounting methods, as well as deductions for accelerated depreciation, advertising, domestic manufacturing and research and development expenses. In addition, industry-specific cutbacks are proposed for real estate, energy and insurance companies.

Seen to a successful conclusion, tax reform holds the potential for significant policy change—with no guarantee of universally good results for all companies. Given the elements of the likely legislative “bargain” (lower rates for a broader tax base), corporations will have to do the math and evaluate the tradeoffs to determine whether they are a “winner” or “loser” as the legislation progresses. During its congressional journey, tax reform will present various policy threats and legislative vulnerabilities—and on occasion, opportunities for positive change. To end up on the right side of the tradeoff equation, a high level of substantive skill and political sophistication will be required to navigate the critical challenges ahead.

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