Senate Finance Committee examines business tax reform issues; Ranking Member Wyden releases draft cost recovery tax reform bill

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In brief

The Senate Finance Committee today held a hearing on 'navigating' business tax reform, examining a range of issues and proposals related to the taxation of corporate and pass-through businesses. While acknowledging the challenge of developing bipartisan policy proposals that can move through the legislative process, Senate Finance Chairman Orrin Hatch (R-UT) said that he believes Congress "can, and should, find common ground on a path forward for comprehensive tax reform."

Chairman Hatch said "successful tax reform will take a President who truly makes it a priority," and remarked that "we haven't met that prerequisite with this administration." Chairman Hatch said the Finance Committee "will continue to lay the foundation and develop pro-growth proposals for when the approximate opportunity arises."

In addition, Chairman Hatch said that "corporate integration" to eliminate the double taxation of corporate earnings at both the corporate and shareholder levels "warrants real consideration" as a way to address "inequities and distortions" in US business tax laws. He added that corporate integration could be complementary to other reforms, such as international reforms that would move the United States to a territorial tax system. Chairman Hatch noted that he and his staff are preparing a corporate integration proposal, which is expected to be released in June.

During the hearing, Finance Ranking Member Ron Wyden (D-OR) cited a cost recovery tax reform discussion draft that he released today to simplify depreciation rules in ways that would benefit both large and small businesses. Senator Wyden said that his proposal "gets rid of the headache" associated with current depreciation rules" by laying out "six categories for depreciation that are easy to work with."

The Finance Committee hearing featured testimony on many of the business tax issues that were the subject of a report issued in 2015 by a Finance Committee working group on business tax reform, which was chaired by Senators John Thune (R-SD) and Ben Cardin (D-MD).

In detail

Business tax reform

Finance Committee members today expressed their concerns about the cost to business of complying with complex tax rules and a tax system that is out of sync with those of other countries.

Senators Thune and Cardin both noted that there was bipartisan agreement last year in the business tax reform working group that the US corporate income tax rate needs to be lowered through base broadening. They also said that there is agreement that Congress needs to ensure that pass-through businesses are treated equitably.

Senator Cardin urged consideration of a 'progressive consumption tax' bill that he introduced in 2015 as a way to achieve more fundamental reforms that would lower both individual and corporate income tax rates.

Senator Rob Portman (R-OH) and several other Finance Committee members expressed concerns over 'corporate inversions' and the loss of US headquarter jobs through foreign acquisitions. Senator Portman noted that the bipartisan Finance Committee international reform working group report he released last year with Senator Charles Schumer (D-NY) called for adopting a territorial-style dividend exemption system "with robust and appropriate base erosion rules."

Senator Schumer said he remains interested in seeing if an agreement can be reached this year on international tax reform. "I'm game to do it because I think it's really important for American competitiveness," said Schumer. "My advice would be, let's do the international side first, then we can deal with all the complicated issues elsewhere," he added.

The Finance Committee hearing also considered the question of whether the United States should provide 'patent box' or 'innovation box' tax incentive for intangible income. Dr. James Hines, of the University of Michigan, testified that policymakers need to consider what types of business activities might be lost to other nations that offer such incentives if the United States does not enact some form of comparable tax incentive. Dr. Eric Toder, of the Urban-Brookings Tax Policy Center, expressed concerns that such incentives would add to the complexity of the tax code and suggested that enhancing the current research credit might be more effective.

Joint Committee on Taxation (JCT) Chief of Staff Tom Barthold discussed the 'trade-offs' in revenue-neutral tax reform between lowering income tax rates and broadening the tax base by limiting or repealing tax deductions, credits, or preferences.

Corporate integration

Chairman Hatch cited the 2015 Finance Committee business tax reform working group report for addressing corporate integration as a way to "reduce or eliminate at least four distortions built into the current tax code: (1) the incentive to invest in non-corporate businesses rather than corporate businesses; (2) the incentive to finance corporations with debt rather than equity; (3) the incentive to retain rather than distribute earnings; and (4) the incentive to distribute earnings in a manner that avoids or significantly reduces the second layer of tax."

Chairman Hatch said that "depending on its design, corporate integration could have the effect of reducing the effective corporate tax rate and help address some of the incentives we are seeing today for companies to relocate their headquarters outside of the United States."

Finance Committee hearing documents and related material

For opening statements and witness testimony at today's Finance Committee hearing, click here.

For a 66-page JCT staff background paper on business tax reform, click here.

For a summary of the Senate Finance Committee tax reform working groups reports and links to the reports, see our July 8, 2015 Tax Insight.

Wyden cost recovery discussion draft

Ranking Member Wyden's discussion draft is intended to simplify cost recovery by replacing the current depreciation rules with a pooling cost recovery system that retains accelerated depreciation. The proposal would implement a pooling cost recovery system for most tangible property and computer software, and a straight-line cost recovery system for real property and certain utility property.

The JCT staff estimates that the proposal would be approximately revenue neutral over the 10-year budget window. The rules are proposed to be effective for taxable years beginning after December 31, 2016.

The proposal is based around current class life categories but would reinstate the Treasury Department's authority, subject to Congressional oversight, to update asset lives to account for new technologies and a modern economy. Treasury also would be required to review the depreciation system and report to Congress every five years.

New proposed cost recovery system

The proposal would repeal the Modified Accelerated Cost Recovery System (MACRS) and Alternative Depreciation System (ADS) rules under Section 168 and replace them with an Accelerated Mass Asset Cost Recovery and Reinvestment System (A-MACRRS).

'Pooled property' is any tangible property that is not straight-line property, and any computer software that is not an amortizable Section 197 intangible. Under the proposal, assets would be assigned to one of six new pools based on current MACRS property classifications. The cost of pooled property would be recovered by multiplying the applicable recovery rate for each of the pools by the associated pool balance at year-end.

The current 3-, 5-, 7-, 10-, 15- and 20-year property classes would be assigned to one of six new pools:

- Pool 1: 49 percent recovery rate
- Pool 2: 34 percent recovery rate
- Pool 3: 25 percent recovery rate
- Pool 4: 18 percent recovery rate
- Pool 5: 11 percent recovery rate
- Pool 6: 8 percent recovery rate.

To determine the year-end asset pool balance, additions to and subtractions from the pool would be taken into account, as well as any depreciation deduction or negative pool balance adjustment. Dispositions of pooled property in exchange for property in the same asset pool generally would receive the deferral currently available under the Section 1031 like-kind exchange rules.

The proposal would modify the placed-in-service rules by repealing the half-year and mid-quarter conventions and allowing a full first-year depreciation deduction.

For 'straight-line property,' costs would be recovered ratably over the applicable recovery period, beginning with the midpoint of the month in which the asset is placed in service. Straight-line property includes nonresidential real property, residential rental property, water utility property, and railroad grading or tunnel bore.

Note: The Wyden discussion draft's approach to 'pooling' is similar to certain ways to a 2013 discussion draft released by then-Finance Committee Chairman Max Baucus (D-MT). However, the Wyden draft does not include proposals that were offered by Chairman Baucus to change certain amortization rules for Section 197 intangibles and to repeal the last-in, first-out (LIFO) inventory method of accounting. For more detail on the Baucus discussion draft, see our PwC Insight.

Comments requested

Comments are requested on all aspects of the discussion draft as well as other areas of cost recovery and capital investment. In particular, comments are requested on:

- Transition rules and the electability of application, and how alternative proposals may interact with the goals of tax simplification
- Proposals to provide relief for abandoned and certain low-disposition-value property
- Proposals to extend pooled depreciation to Section 179 property by, for example, establishing a 100-percent rate pool for such investments, or other options
- The need to maintain the alternative minimum tax (AMT) given the unification of depreciation methods
- The need to maintain like-kind exchange rules under a pooled depreciation system
- Broader interactions of the pooling system on the tax code
- Other opportunities for simplifying the cost recovery and capital investment system consistent with the proposed changes.

For details on the Wyden discussion draft, including statutory language and the JCT staff revenue estimate, click here.

Next steps

Key leaders in the House and Senate are working this year to develop tax reform proposals that may provide a basis for future legislation.

Today's Finance Committee hearing highlighted the ongoing work by Chairman Hatch and his staff to develop a detailed corporate integration proposal that can be considered as part of reform efforts. Finance Ranking Member Wyden also noted that his cost recovery tax reform discussion draft was being released now so that interested parties could comment in advance of possible action on tax reform legislation in 2017.

House Speaker Paul Ryan (R-WI) has called for House task force on tax reform to release a blueprint for comprehensive tax reform by June. House Ways and Means Chairman Kevin Brady (R-TX), who leads the House task force, also has said that the Ways and Means Committee is working this year on a detailed international tax reform proposal.

The takeaway

While the direction of future tax reform efforts will be influenced by the results of the 2016 elections for control of the White House and Congress, the work being done now in the House Ways and Means Committee and the Senate Finance Committee provides an opportunity for the business community to have a voice in the ongoing development of tax reform proposals.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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