

DRAFT – Trends and Their Relevance to Tax Reform

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| Trend and Examples | Relevance to Tax Law Design |
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| <p>U.S. businesses face an increasingly greater competitive environment</p> <ul style="list-style-type: none"> ▪ Technology and tax or financial incentives have lowered the barriers to entry into many markets ▪ Economic growth is projected in non-OECD countries post-2000 ▪ Reduction in trade barriers (NAFTA for example) ▪ Growth in E-commerce | <ul style="list-style-type: none"> ▪ Double taxation of corporation income increases the cost of capital in the U.S. Many other countries have an integrated corporate/individual tax system. ▪ Many countries offer research incentives. U.S. research tax credit is a temporary measure. ▪ U.S. tax treaty network is not complete. ▪ Withholding rates may not align with free trade policies. ▪ Some tax rules don't work well with e-commerce, such as sales tax collection and sourcing of transactions ▪ Corporate tax brackets are not adjusted for inflation. |
| <p>Shift from industrial age to information age</p> <ul style="list-style-type: none"> • Decrease in tangible goods as percentage of GNP, and growth in services • Changes in consumption patterns (such as consuming more services and intangibles and less tangible goods) | <ul style="list-style-type: none"> ▪ For many intangibles, 15-year life under IRC Section 197 is often too long. ▪ Eroding tax bases for state and local governments - typically, property and sales tax bases do not include intangibles and services. ▪ P.L. 86-272 - the protections and clarifications of this law only apply to income taxes and tangible personal property. ▪ Consumer Price Index (CPI) has reportedly not kept up with product and consumer changes. The CPI has tax implications: annual inflation adjustments to personal exemptions, standard deduction and non-corporate tax brackets. A 1997 estimate noted that failure to correct the CPI (downward) reduced federal revenues.," March 1997; http://www.house.gov/jec/fed/inflat/cpi-tax/cpi-tax.htm. |
| <p>Taxation shifts to payroll and personal income taxes, base broadening, and environmental tax considerations</p> <ul style="list-style-type: none"> • Decline in marginal tax rates and broadening of tax base • Expanding view of tax as an incentive tool • Shift from corporate income and property taxes to individual income and payroll taxes • Growth in use of consumption taxes and environmental taxes (worldwide) | <ul style="list-style-type: none"> ▪ Increased cost of non-taxable fringe benefits, including employer-provided health insurance, erodes payroll and personal income tax bases. ▪ Increase in deductions, exclusions and credits makes the law less neutral and creates inefficiencies. Such provisions also make the law more complicated. ▪ P.L. 86-272 - The protections and clarifications of this law only apply to income taxes. ▪ The U.S. is the only OECD country that does not have a VAT. ▪ Opportunity to address environmental concerns with polluter pays taxes and have a tax shift that may improve efficiencies in other taxes. |
| <p>Changes in business operations</p> <ul style="list-style-type: none"> • Growth of virtual workplaces and markets • Telecommuting and distant workers, global work teams • Increasing need for special expertise on an as-needed basis • Shorter product life cycles due to global competition • Changed production techniques: JIT, | <ul style="list-style-type: none"> ▪ Some depreciation (MACRS) lives may be too long. ▪ Inventory valuation rules (Sec. 263A) are fairly complex and require more costs to be treated as inventoriable than is required for financial reporting purposes (GAAP). Rapid turnover and quick obsolescence of goods may not have been considered in 1986 when these rules were adopted. ▪ Property tax valuation/obsolescence schedules may be too conservative. ▪ For many intangibles, 15-year life under IRC Section 197 is often too long. |

See related blog entry of 6/12/08:

<http://21stcenturytaxation.blogspot.com/2008/06/trends-as-guide-to-tax-reform.html>

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| <p>outsourcing, ability to address specialized customer needs</p> | <ul style="list-style-type: none"> ▪ Temporary nature of research tax credit limits the benefits of this credit to the U.S. economy. ▪ Nexus standards need to be reviewed and standardized among states. For example, should location of telecommuting employee in a state cause employer to have nexus in that state? ▪ The tax law should not hinder alternative compensation techniques, including equity compensation. ▪ Outdated and complex worker classification rules play too great a role in hiring practices which adversely affects both employers and workers. |
| <p>Increasing gaps</p> <ul style="list-style-type: none"> • Increasing gap between high-income and low-income individuals (such as in California – see CBPP report) • Education opportunities • Access to technology (such as broadband, opportunities for skill development/enhancement) | <ul style="list-style-type: none"> ▪ Some low-income individuals may face high marginal tax rates due to phase-outs of earned income tax credit (EITC), child-care credit, education credits, etc. ▪ States as a whole rely on the regressive sales tax and excise taxes for about 50% of their revenues. See Census information at www.census.gov/ftp/pub/govs/www/statetax.html. ▪ Tax breaks for higher education are not refundable and therefore are not helping those most in need. ▪ Some state income tax systems are not as progressive as the federal income tax system. In states with incomes tax, the number of tax rate brackets ranges from one to ten, some states, such as Colorado and Michigan have a single flat tax rate. See FTA at http://www.taxadmin.org/fta/rate/ind_inc.html. ▪ Many states do not have the equivalent of the federal EITC (see 2008 report of the Center for Budget and Policy Priorities). ▪ Tax compliance costs tend to be high due to complications of the filing system in general and calculating the EITC in particular. Over 70% of individuals claiming the EITC used a preparer (AICPA, Understanding Tax Reform, 2005, p 3). |