

# Tower of Babel or Smorgasbord?: Comments on Toder-Viard 2016

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# So many plans, so little consensus

Individual tax reform: general expert consensus, albeit subject to debating rates, income tax vs. consumption tax.

But in corporate tax reform, it seems everyone has his/her own plan.

E.g., in addition to Toder-Viard: ALI Andrews, ALI Warren, CBIT, Kleinbard, Auerbach, Graetz, Grubert-Altshuler ...

I'd get in the game too, but policymakers have not as yet met my terms.

# Why the Tower of Babel?

Even if all experts agreed, Congress still probably wouldn't listen.

Cf. U.S. vs. New Zealand (1991 GST) or vs. various parliamentary countries with just 1 or 2 “leading experts.”

But why such a Tower of Babel on corporate tax reform?

Because there's no really good answer! So it's a game of pick your poison.

# The unattainable ideal

Lewis Carroll's Red Queen boasted that she could believe 6 impossible things before breakfast.

For corporate tax reform to have a slam-dunk, no-brainer solution, we only need to believe 2 impossible things:

(1) that perfect flow-through of corporate income to the owners is feasible, and

(2) that taxing owners indirectly at the entity level, rather than directly, makes no political economy or administrative difference.

# Why ain't it so?

Perfect flow-through: unless can use MTM, impeded by non-pro rata deals & the fact that taxable income  $\neq$  economic income.

For tax-exempts or foreigners, in practice [entity-level taxation] may  $>$  [owner-level taxation] despite economic equivalence.

This may offer 2 reasons for favoring some entity-level taxation.

But the price is pain if [entity residence  $\neq$  owner residence] &/or [entity tax rate  $\neq$  owner tax rate].

Plus, one then must inter-relate the 2 levels of tax.

# How *should* we tax corporate income earned by foreigners?

If we're self-interested & define them as not among "us," may want to revenue-maximize ...

But: (a) in terms of economic, not nominal, incidence,

(b) taking account of DWL & externalities as to "us," and

(c) subject to comity/ feasibility (e.g., reasonable claim of residence or source, despite the "Monty Python tax plan").

Not a formula for clear or simple answers!

# Corporate income of tax-exempts

Tax-exempt owners add a further layer of complication.

Charities: not clear how large the tax subsidy should be, how it should relate to charities' intertemporal choices, etc.

Retirement saving vehicles: might want savers to be able to exempt the *normal* risk-free rate of return (even in an income tax).

Not just path-dependent to say we might want to preserve (at least) current revenues.

# Prior corporate integration efforts

Various 2<sup>nd</sup>-best methods have been around for decades – e.g., imputation, dividend exemption or deduction, CBIT.

Each inevitably has problems. See, e.g., Schler 1992.

Plus, no observable floodtide for any of them, encouraging a search for new approaches.

A smorgasbord, rather than a Tower of Babel?



# The latest twist

Much recent talk of dividend deduction + withholding tax.  
This can = imputation (e.g., with nonrefundability for both).

Note companies still “shouldn’t” repatriate foreign earnings,  
for the same reasons as under present law.

But the theory is that the change would induce repatriation  
due to agency costs (if they DO care about reported earnings, DON’T care  
about SH welfare).

Lots more questions need to be asked about this gambit  
before endorsing it.

# Toder-Viard 2014 vs. 2016

2014 was true integration, with tax only at the SH level – both in principle good features.

But problems included (a) publicly-traded vs. the rest, (b) revenue loss, (c) big gains to foreigners & tax-exempts.

Hence the big changes in 2016 (e.g., 15% corporate tax, 15% withholding tax for interest paid to tax-exempts).

These retreats from 2014's purity were (in my view) needed, but they suggest reclassifying the plan.

# “Grouping” Toder-Viard 2016

While aims & effects may overlap, I’d distinguish between corporate (a) integration & (b) rate reduction proposals.

For convenience, I’ll group Toder-Viard 2016 with (b).

Those in (b) can seek offsetting revenue from either *inside* or *outside* existing corporate (or business) taxation.

Inside funding: Toder-Viard 2016, Grubert-Altshuler; 1986-style base-broadening.

Outside funding: new revenues from VAT, carbon tax, etc.

# Narrowing the field

1986-style reform is not the answer here.

Not enough there, new vs. old investment, non-corporate businesses, owner-employees (dual income tax?).

I'm also skeptical about outside funding (VAT, carbon tax).

Other claimants for those revenues! And the shift in tax burdens would raise big issues.

So, 2 in-category finalists: Toder-Viard, Grubert-Altshuler.

# Adjudicating the choice

There's a lot to like in Toder-Viard 2016.

E.g., collect tax annually based on FMV, debt-equity balance re. tax-exempts, going-public transition.

But I still worry about the publicly traded/closely held divide.

Compliance / tax planning issues under the withholding tax?

Realization at death would be great (under both proposals, or as a standalone) – but it, too, has been on the table for years.

# The opposition (Grubert-Altshuler)

Here I worry about the deferred tax.

Interest charge helps a lot, & pure Auerbach-Bradford (perfecting Vickrey) isn't happening, but:

(a) Still major lock-in for mega-gains (e.g., Zuckerberg/Facebook),

(b) For large & long-deferred gains, the sticker shock & political economy problems may be prohibitive.

# A bunt instead of a grand slam?

Beach Boys' *Smile* -> *Smiley Smile*: "bunt instead of grand slam."

The Beach Boys blew it – but corporate tax reform is different!

What are the worst problems, how address them narrowly?

My "big 3" relate to (a) debt, (b) disguised labor income if we lower the corporate rate, & (c) international.

So how about (a) stronger thin cap, (b) normal vs. extra-normal returns, (c) international changes that I've discussed elsewhere.