

A Look Back in Tax Reform Time for Lessons Learned

SJSU | LUCAS GRADUATE SCHOOL
OF BUSINESS

TAX EXECUTIVES INSTITUTE, INC.
Silicon Valley Chapter

TEI-SJSU Tax Policy Conference

Tax Reform – Getting Ready for Action in 2017

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October 22, 1986

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Public Law 99-514
99th Congress

An Act

To reform the internal revenue laws of the United States.

Oct. 22, 1986
[H.R. 3838]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Tax Reform Act
of 1986.
26 USC 1 *et seq.*

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the “Tax Reform Act of 1986”.



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Internal Revenue Code of 1954

*Enacted During the Second Session of the
Eighty-Third Congress
of the United States of America*

1954



Internal Revenue Code Of 1986

P.L. 83-591 (8/16/54)
changed IRC from 1939
to 1954

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SEC. 1. TAX IMPOSED.

(a) **RATES OF TAX ON INDIVIDUALS.**—A tax is hereby imposed for each taxable year on the taxable income of every individual other than a head of a household to whom subsection (b) applies. The amount of the tax shall be determined in accordance with the following table:

If the taxable income is:	The tax is:
Not over \$2,000.....	20% of the taxable income.
Over \$2,000 but not over \$4,000.....	\$400, plus 22% of excess over \$2,000.
Over \$4,000 but not over \$6,000.....	\$840, plus 26% of excess over \$4,000.
Over \$6,000 but not over \$8,000.....	\$1,360, plus 30% of excess over \$6,000.
Over \$8,000 but not over \$10,000.....	\$1,960, plus 34% of excess over \$8,000.
Over \$10,000 but not over \$12,000.....	\$2,640, plus 38% of excess over \$10,000.
Over \$12,000 but not over \$14,000.....	\$3,400, plus 43% of excess over \$12,000.
Over \$14,000 but not over \$16,000.....	\$4,260, plus 47% of excess over \$14,000.
Over \$16,000 but not over \$18,000.....	\$5,200, plus 50% of excess over \$16,000.
Over \$18,000 but not over \$20,000.....	\$6,200, plus 53% of excess over \$18,000.
Over \$20,000 but not over \$22,000.....	\$7,260, plus 56% of excess over \$20,000.
Over \$22,000 but not over \$26,000.....	\$8,380, plus 59% of excess over \$22,000.
Over \$26,000 but not over \$32,000.....	\$10,740, plus 62% of excess over \$26,000.
Over \$32,000 but not over \$38,000.....	\$14,460, plus 65% of excess over \$32,000.
Over \$38,000 but not over \$44,000.....	\$18,360, plus 69% of excess over \$38,000.
Over \$44,000 but not over \$50,000.....	\$22,500, plus 72% of excess over \$44,000.
Over \$50,000 but not over \$60,000.....	\$26,820, plus 75% of excess over \$50,000.
Over \$60,000 but not over \$70,000.....	\$34,320, plus 78% of excess over \$60,000.
Over \$70,000 but not over \$80,000.....	\$42,120, plus 81% of excess over \$70,000.
Over \$80,000 but not over \$90,000.....	\$50,220, plus 84% of excess over \$80,000.
Over \$90,000 but not over \$100,000.....	\$58,620, plus 87% of excess over \$90,000.
Over \$100,000 but not over \$150,000.....	\$67,320, plus 89% of excess over \$100,000.
Over \$150,000 but not over \$200,000.....	\$111,820, plus 90% of excess over \$150,000.
Over \$200,000.....	\$156,820, plus 91% of excess over \$200,000.

←----- Individual rates in 1954.

Corporate tax rate = 30%
 + Surtax of 22% of taxable income
 over \$25,000
 (so top rate of 52%)

By 1986:

Individuals 11% - 50%
 Corporations top rate 46%

<https://www.irs.gov/pub/irs-soi/02corate.pdf>

http://taxfoundation.org/sites/default/files/docs/fed_individual_rate_history_nominal.pdf

Rates of TRA'86

Individuals

- 15% and 28%
- Capital gains at same rate.

Corporations

- 15%, 25% and 34%

Marginal Tax Rate	Single Tax Brackets	
	Over	But Not Over
15.0%	\$0	\$17,850
28.0%	\$17,850	-

TRA'86

P.L. 99-514 (10/22/86)

- Broadened the base and lowered rates.
- Ended tax shelters and some corporate items that some were annoyed with.

HOW?

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First, why?

- Sufficient bipartisan and public support for a reformed income tax that was fairer, simpler and more supportive of growth.
 - Desire for a system where everyone pays their fair share.
-

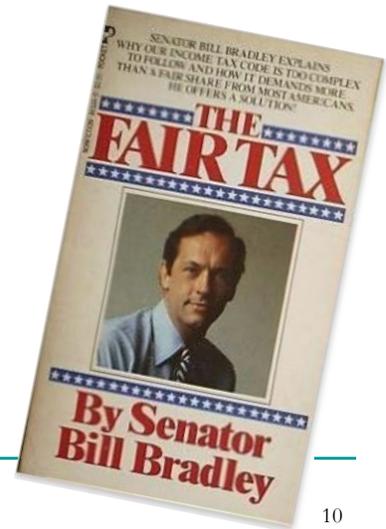
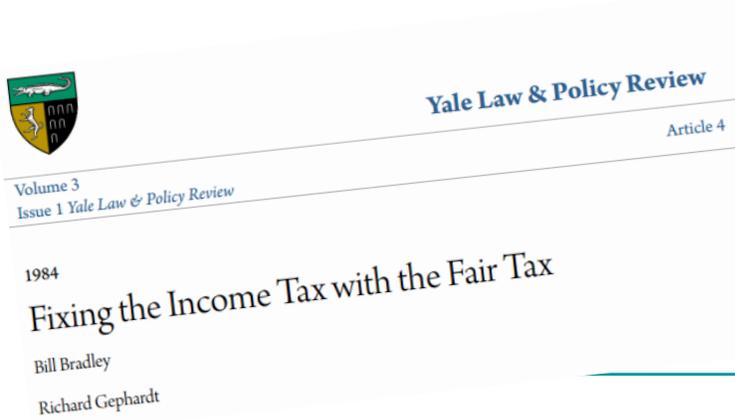
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Events leading to TRA'86

1982

- ❑ Senator Bill Bradley (D-NJ)
- ❑ Congressman Richard Gephardt (D-MO)

S. 2817 and H.R. 6944, Fair Tax Act of 1982
(97th Cong).



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1984 State-of-the-Union Address

“Let us go forward with an historic **reform for fairness, simplicity, and incentives for growth**. I am asking Secretary Don Regan for a plan for action to simplify the entire tax code, so all taxpayers, big and small, are treated more fairly. And I believe such a plan could result in that underground economy being brought into the sunlight of honest tax compliance. And it could make the tax base broader, so personal tax rates could come down, not go up. I've asked that specific recommendations, consistent with those objectives, be presented to me **by December 1984**.”

President Reagan 1/25/84

<http://www.presidency.ucsb.edu/ws/index.php?pid=40205>

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Nov. 1984 – Treasury Report

Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President

- Volume 1: Overview
- Volume 2: General Explanation of the Treasury Department Proposals
- Volume 3: Value-Added Tax

https://www.treasury.gov/resource-center/tax-policy/Pages/reports_main.aspx

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Transmittal letter of Secretary Regan

- “we believe we have followed your mandate of May 1984 **to design a sweeping and comprehensive reform of the entire tax code**. The Treasury Department study focused on four options: a pure flat tax, a modified flat tax, a tax on income that is consumed, and a general sales tax, including a value-added tax and retail sales taxes.”

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And ...

“These proposals are bold, and they will be controversial. Those who benefit from the current tax preferences that distort the use of our nation's resources, that complicate paying taxes for all of us, and that create inequities and undermine taxpayer morale will complain loudly and seek support from every quarter. But a far greater number of Americans will benefit from the suggested rate reduction and simplification. The achievement of fundamental tax reform and the manifest benefits it would entail -- will require extraordinary leadership.”

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Volume 1 introduction

“Treasury Department is proposing a new income tax system which is broad-based, simple, and fair. It reflects the enormous public input generated by a series of public hearings held throughout the country.

Treasury Department's recommendation reflects broad political consensus of American people that present system is too complicated and favors special interests at expense of the general public. While much more comprehensive and far-reaching than other proposals, it resembles several plans for tax reform advanced by members of Congress, especially the Kemp-Kasten and Bradley-Gephardt plans. This bipartisan congressional consensus augurs well for quick action by the Congress.”

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The President's
Tax Proposals
to the Congress for
Fairness, Growth,
and Simplicity



House Ways & Means Committee -
numerous days of committee
hearings and markup sessions.

12/3/85 – reports favorably, H.R.
3838

Senate Finance Committee –
numerous days of hearings and
markup sessions.

5/6/85 – reports favorably

Conference Committee started July
1986.

House vote 292-136 (9/25/86)
Senate vote 74-23 (9/27/86)



May 1985

489 pages

“Fair share” provisions included ...

- §448 requiring most large C corps to use accrual method.
 - §469 limiting use of passive activity losses and ending tax shelter industry that enabled many high income individuals to significantly reduce taxes.
 - Tightening of both individual and corporate AMT.
 - Removed many low-income individuals from income tax.
-

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What remains?

- Several key provisions – §§263A, 448, 469, AMT (but not for small corps)

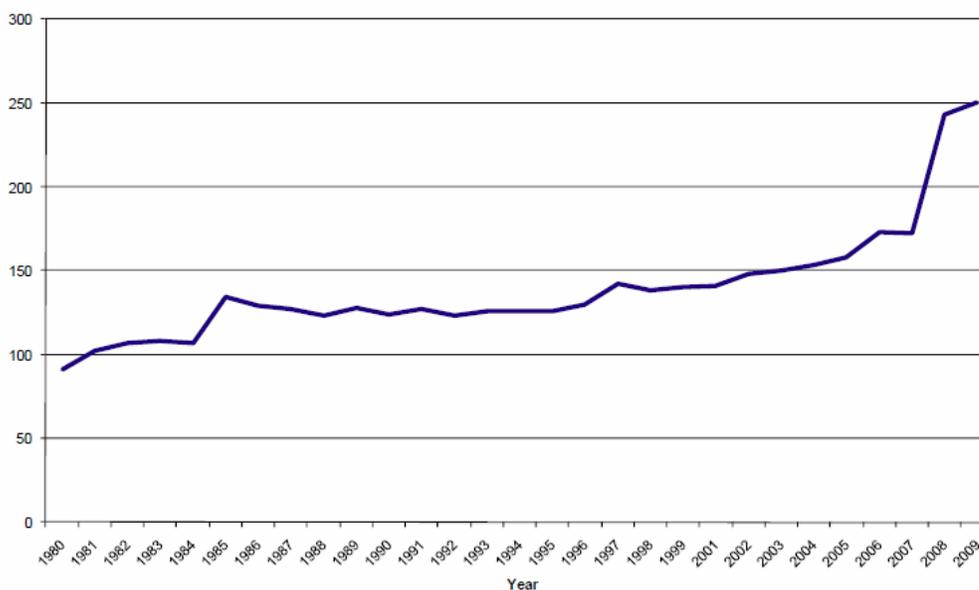
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What was lost?

- Max individual rate of 28 % ended with addition of 31% bracket by OBRA'90 (P.L. 101-508), effective for 1991.
 - Max capital gain rate remained at 28%.
- Corp rate raised to 35%
- AMT preference for contributions of appreciated property was repealed by RA'93 (P.L. 103-66).
- Base broadening slowly eroded with addition of new preferences, particularly with Taxpayer Relief Act of 1997 (P.L. 105-34).
 - Added child tax credit, Hope Scholarship credit, expanded §121 gain exclusion for residence, and repealed AMT for small corporations.
- Numerous credits and special deductions added (§199, energy credits, and more)

Changes in Quantity of Tax Expenditures

Figure 5.—Joint Committee on Taxation Count of Tax Expenditures, 1980-2009



Note: This chart shows the number of tax expenditures listed in the tables that appear in the Joint Committee on Taxation's annual pamphlet on tax expenditures. Certain methodological changes in how tax expenditures were defined and listed, notably expanded breakouts of certain tax provisions formerly listed as a single tax expenditure, account for the bulk of the substantial rise in listed tax expenditures from 2007 to 2008.

Lessons learned - 1

- Base broadening and rate reduction is possible.
 - Even in bi-partisan arena.
 - Republican president and Senate
 - Democratic House



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Lessons learned - 2

- Avoid transition rules geared to specific taxpayers.
 - No names, but could figure it out.
- Problems of paying for lower individual taxes with corporate taxes.

Table 1: Tax Reform Act of 1986 Lowered Individual Taxes and Raised Corporate Taxes

<i>Income Tax</i>	<i>Five-Year Revenue Estimate</i>
Individual	(\$122 billion)
Corporate	\$120 billion
<i>Total</i>	<i>(\$2 billion)</i>

Source: Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1986* (JCS-10-87).

Lessons learned - 3

- Other countries may follow U.S. lead and lower rates.
 - As most industrialized countries did after 1986.

 - Rate differentials can lead to changed behavior.
 - Drop in # corps and increase in # of passthroughs.

 - Grassroots support helps.
-

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Lessons learned - 4

Former Senator Packwood – hearing on lessons learned from TRA’86.

How to do it:

- “1. Bring Democrats on board by getting rid of loopholes. This would bring in lots of money. 2. Bring Republicans onboard by using the money to lower rates. 3. Bring economists, editorialists and others onboard who wanted to get rid of deductions and achieve lower rates. They would also applaud the simplicity of the plan, an added bonus.”
 - SFC hearing, “Getting to “Yes” on Tax Reform: What Lessons Can Congress Learn From the Tax Reform Act of 1986?” S. Hrg. 114-157, 2/10/15; page 43;
<http://www.finance.senate.gov/imo/media/doc/98328.pdf>.
-

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After TRA'86

- Rate increases and base narrowing
 - Numerous tax reform activities
 - 1992 – Treasury reports on corporate integration (required by TRA'86)
 - https://www.treasury.gov/resource-center/tax-policy/Pages/reports_main.aspx
 - Mid-1990s with Congressman Archer, chair House Ways and Means
 - 1996 – The National Commission on Economic Growth and Tax Reform (“Kemp Commission”)
 - 1998 – IRS Restructuring & Reform Act (P.L. 105-206)
-

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More

- 2005 – Bush Advisory Panel on Federal Tax Reform
 - 2007 - Treasury Department reports on business competitiveness:
 - Business Taxation and Global Competitiveness (7/23/07)
 - Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century (12/07)
-

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And more

- 2009 - President Obama's Tax Reform Task Force chaired by Paul Volcker
- 2010 - National Commission on Fiscal Responsibility and Reform (President Obama's Deficit Commission; Simpson-Bowles)
- 2011 State-of-the-Union – Pres. Obama calls for lower corporate rate
- Jan 2011 – HWM & SFC start series of hearings
 - Over 50 held since that time
- 2014 – Congressman Camp's tax reform plan



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And ...

Recent years

- Bi-partisan study and working groups
- Senator Baucus discussion drafts
- “Road show” (2013)
- Blank slate project (2013)
- OECD Base Erosion Profit Shifting (BEPS) project
- 6/24/16 – House Republican’s “A Better Way” tax reform blueprint
 - <http://www.thetaxadviser.com/newsletters/2016/jul/house-republican-tax-reform-plan.html>

Throughout this time ...

- Calls for various forms of reform
- Regular proposals
 - H.R. 1040 – flat tax
 - H.R. 24 – national retail sales tax
 - Various other forms on consumption tax

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1986 versus Today

What drives tax reform today?

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Trait	1986	TRA'86 Law	Today								
INDIVIDUALS											
Tax rates	11% to 50%	15% and 28%, + 5% to remove 15% rate for high income individuals	10% to 39.6%								
Number of tax brackets (other than zero)	15	2	7								
Taxable income level for single person to reach top rate	50% - \$88,271	28% - \$17,851 Flat 28% - \$43,151	\$415,051 (2016) No phase-out of graduated rates.								
Tax structure for net capital gain	60% deduction	Taxed at ordinary tax rates	<table border="1"> <thead> <tr> <th>Reg rate</th> <th>Cap gain</th> </tr> </thead> <tbody> <tr> <td>10-15%</td> <td>0%</td> </tr> <tr> <td>25-35%</td> <td>15%</td> </tr> <tr> <td>39.6%</td> <td>20%</td> </tr> </tbody> </table>	Reg rate	Cap gain	10-15%	0%	25-35%	15%	39.6%	20%
Reg rate	Cap gain										
10-15%	0%										
25-35%	15%										
39.6%	20%										
Highest capital gain tax rate	20%	28%	20% + 3.8% tax of \$1411								
AMT rates	20%	21%	26% and 28%								
Percentage of individuals claiming standard deduction	54.9%	64.6%	68.5%								

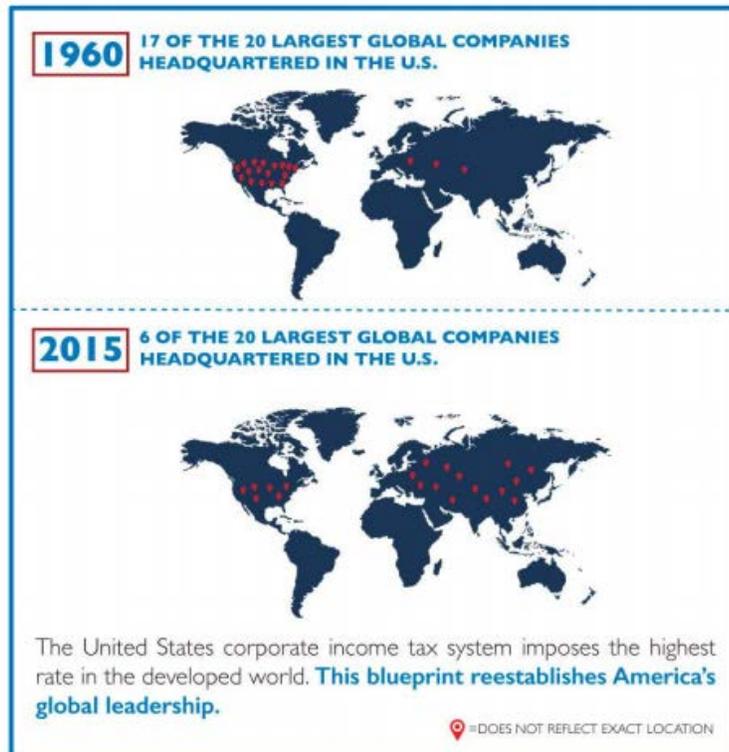
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Trait	1986	TRA'86 Law	Today
CORPORATIONS			
Tax rates	15% to 46% Additional 5% tax on taxable income over \$1 million to phase-out use of graduated rates	15% to 34% Additional 5% on taxable income over \$100,000 to phase-out use of graduated rates	15% to 35% Additional 5% on taxable income over \$100,000 and 3% on taxable income over \$15 million to phase-out graduated rates.
Number of tax brackets (ignoring surtaxes to phase-out graduated rates)	5	3	4
Taxable income to reach top rate	\$100,001	\$75,001	\$10,000,001
Tax structure for net capital gain	Maximum rate of 28%	Taxed at ordinary tax rates	Taxed at ordinary tax rates
AMT rate	15%	20%	20%

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Trait	1986	TRA'86 Law	Today
TAX AND ECONOMIC DATA			
	1986	1990	Today
Number of returns – C corporations	2,598,271	3,716,650	1,617,739 (2012) 38% decrease from 1986
Number of returns – S corporations	826,214	1,575,092	4,205,452 (2012) 409% increase from 1986
Number of returns – Partnerships	1,702,952	1,553,529	3,388,561 (2012) 99% increase from 1986
Number of returns – Non-farm sole proprietorships	12,393,700	14,782,738	23,553,850 (2012) 90% increase from 1986
Debt held by public (billions)	\$1,740.6	\$ 2,411.6	\$ 11,981.9 (2013)

Also ...



Also ...

“share of U.S. corporate stock held in taxable accounts fell more than two-thirds over the last 50 years, from 83.6 percent in 1965 to 24.2 percent in 2015.”

- Steven M. Rosenthal and Lydia S. Austin, “The Dwindling Taxable Share Of U.S. Corporate Stock,” *Tax Notes*, 5/16/16.
- <http://www.taxpolicycenter.org/publications/dwindling-taxable-share-us-corporate-stock/full>

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Tax Reform Themes Today

Include ...

- A. Lower tax rates with revenue neutrality
 - Lower the corporate tax rate; likely also the individual rate
 - Cut back or eliminate *tax expenditures* (tax preferences)
 - Tax distribution / equity (look at effect among income groups)
- B. International tax reform
 - Move to a territorial system
- C. Entity structure and differences
- D. Appropriate tax incentives for economy
- E. Administrative reforms

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Principles of Tax Reform from Tax Committee Chairs

Congressman Brady (4/16)

1. Make tax code “simpler, fairer, and flatter.”
2. Close loopholes and “special interest provisions” to lower rates for all.
3. Make system competitive.
4. Encourage business activity in US & move from worldwide to territorial system.
5. Pro-growth tax reform.
6. Reform to improve tax system, not to address spending problem.

Senator Hatch (12/14)

1. Economic growth.
2. Fairness.
3. Simplicity.
4. Permanence.
5. Competitiveness.
6. Promote savings and investment.
7. Revenue neutrality.

Wants broader base and lower rates + territoriality.

<http://waysandmeans.house.gov/tax-day-speech-2016/>

<http://www.finance.senate.gov/ranking-members-news/hatch-outlines-seven-principles-for-comprehensive-tax-reform>

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President Obama

PRINCIPLES FOR TAX REFORM

1. **Lower tax rates.** The tax system should be simplified and work for all Americans with lower individual and corporate tax rates and fewer brackets.
2. **Cut Inefficient and Unfair Tax Breaks.** Cut tax breaks that are inefficient, unfair, or both so that the American people and businesses spend less time and less money each year filing taxes and cannot avoid their responsibility by gaming the system.
3. **Cut the deficit.** Cut the deficit by \$1.5 trillion over the next decade through tax reform, including the expiration of tax cuts for single taxpayers making over \$200,000 and married couples making over \$250,000.
4. **Increase job creation and growth in the United States.** Make America stronger at home and more competitive globally by increasing the incentive to work and invest in the United States.
5. **Observe the Buffett Rule.** No household making over \$1 million annually should pay a smaller share of its income in taxes than middle-class families pay. As Warren Buffett has pointed out, his effective tax rate is lower than his secretary's. No household making over \$1 million annually should pay a smaller share of its income in taxes than middle-class families pay. This rule will be achieved as part of an overall reform that increases the progressivity of the tax code.

<http://www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/jointcommitteereport.pdf>

Sept. 2011

President Obama's Elements of Business Tax Reform

PRESIDENT OBAMA'S FIVE ELEMENTS OF BUSINESS TAX REFORM

- I. **Eliminate dozens of tax loopholes and subsidies, broaden the base, and cut the corporate tax rate to spur growth in America:** The Framework would eliminate dozens of different tax expenditures and fundamentally reform the business tax base to reduce distortions that hurt productivity and growth. It would reinvest these savings to lower the corporate tax rate to 28 percent, putting the United States in line with major competitor countries and encouraging greater investment in America.
- II. **Strengthen American innovation, clean energy, and manufacturing:** The Framework would expand incentives for research and development and clean energy while also refocusing the manufacturing deduction.
- III. **Strengthen the international tax system, including establishing a new minimum tax on foreign earnings to encourage domestic investment:** Our tax system should not give companies an incentive to locate production overseas or engage in accounting games to shift profits abroad, eroding the U.S. tax base. Introducing a 19 percent minimum tax on foreign earnings would help address profit shifting and discourage a global race to the bottom in tax rates.
- IV. **Simplify and cut taxes for America's small businesses:** Tax reform should make tax filing simpler for small businesses and entrepreneurs so that they can focus on growing their businesses rather than filling out tax returns.
- V. **Restore fiscal responsibility and not add a dime to the deficit:** Business tax reform should be fully paid for, which includes paying for provisions Congress has already enacted without offsets.

First released Sept 2012; released April 2016 with modifications such as for inversions.

<https://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-An-Update-04-04-2016.pdf>

Obstacles to tax reform

- Not enough widespread interest among public?
- The significance of the changes.
- Finding ways to pay for a lower rate.
- Reaching compromise.
- Issues of top corporate and individual rates differing.
- Transition rules – should there be any? Cost?
 - For example, allow phase-out of a deduction, rather than immediate, 100% elimination
- Every current provision has a group that will fight to keep it.
- Concerns of state and local governments.
 - Such as due to cut-back on exclusion for tax-exempt interest.
- Public's low understanding of current system and its inequities and complexities.
 - Might fight against changes that would help them and economy.
- Politics

Are You Ready?

- Able to run projection for your company of proposals?
 - Determine effect on employees, suppliers, customers, investors, community?
 - Effect on financial statements?
 - Your set of principles?
 - How to stay current on reform activities?
 - How proactive do you want to be?
 - What are the positions of organizations your company belongs to?
 - How proactive can you be? What is best approach?
-

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Resources from past – still good

- 1984, 1992, 2007 and others Treasury Reports
 - https://www.treasury.gov/resource-center/tax-policy/Pages/reports_main.aspx
 - Reports of past tax reform commissions
 - Bush 2005
 - Obama 2010
 - Lots from JCT, CRS, CBO, GAO, think tanks, hearings, more
-

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Resources – see links...

Tax Reform Information

The purpose of this web page is to objectively note reports and websites related to tax reform and provide links to further information from members of Congress and oth

Compiled by [Professor Annette Nellen](#)

"Visit Professor Nellen's 21st Century Taxation Blog - click [here](#)"

Activities in the 114th Congress - click [here](#)

Background Information on Tax Reform

- [21st Century Taxation](#) - Professor Nellen's website with a articles on various tax reform issues
- [Policy Approach To Tax Reform](#)
- Data on types of businesses in terms of numbers and receipts for 1980 - 2007 - [here](#)
- [List of various tax reform reports from the 1970s to today compiled at Capital Gains and Games blog](#)
- GAO, [Guide for Evaluating Tax Expenditures \(GAO-13-167SP\)](#)
- AICPA's [Tax Reform Alternatives for the 21st Century](#), 10/09

Sources of Background Data on Tax System and Reasons for Reform

- IRS Stats [website](#)
- IRS National Taxpayer Advocate's 2010 report: [The Time for Tax Reform is Now](#)
- Joint Committee on Taxation [tax expenditure reports](#)
- [Tax Policy Center](#)
- Brookings Institute - [Campaign 2016 - Eight big issues the presidential candidates should address](#)

Getting to Lower Tax Rates in a Revenue Neutral Manner

- JCT [report](#) to Ways and Means Committee Democrats ([10/27/11](#)) - 28% rate, maybe
- JCT [letter](#) to Congressman Levin (7/30/13) on cost to lower corporate rate to 25% (about \$110 billion per year) and to repeal corporate AMT (about \$115 per year)
- [Response](#) to the JCT report from Congressman Camp (11/4/11)
- Nellen, [The Rough Road to a 28% Corporate Tax Rate](#), *AICPA Corporate Taxation Insider*, 11/10/11

Recent Reports and Actions on Tax Reform (including discussion drafts from Camp and Baucus)



Links to hearings, reports, bills and more:

<http://www.sjsu.edu/people/annette.nellen/website/txrefupd.html>

Also: <http://www.21stcenturytaxation.com/>