

STATEMENT

OF

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ON BEHALF OF



TAX EXECUTIVES INSTITUTE, INC.



ON

TAX SIMPLIFICATION

BEFORE THE

COMMITTEE ON FINANCE  
UNITED STATES SENATE

APRIL 26, 2001

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*Mr. Chairman and Members of the Committee:* Good morning. I am Betty Wilson, Vice President of Taxes for MGM MIRAGE in Las Vegas. I appear today as President of Tax Executives Institute, whose 5,300 members represent the 2,800 largest companies in the United States, Canada, and Europe. I am accompanied by the Institute's General Counsel and Director of Tax Affairs, Timothy McCormally.

Mr. Chairman, thank you very much for scheduling this hearing on simplifying the Internal Revenue Code. The IRS National Taxpayer Advocate has identified the complexity of the tax laws as the number one problem facing taxpayers. As you learned earlier this month when you addressed TEI's 51<sup>st</sup> Midyear Conference, our members agree, and we applaud your efforts to give fresh impetus to the subject of tax simplification. Thanks are also due the Majority and Democratic staffs of the Finance Committee, as well as the staff of the Joint Committee on Taxation, for their dedication and commitment to establishing an open process for identifying and addressing areas of tax law complexity.<sup>1</sup> I also want to

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<sup>1</sup> This testimony was prepared without the benefit of reviewing the staff of the Joint Committee's report on tax simplification, which TEI understands will be released in conjunction with the Senate Finance Committee's April 26, 2001,

acknowledge the efforts of the other organizations who are represented here today and to associate myself and TEI generally with their testimony. TEI is quite pleased to have worked closely with the American Bar Association's Section of Taxation and the American Institute of Certified Public Accountants' Tax Division to develop joint recommendations for simplifying the tax code. We firmly believe that our best chance for real simplification lies in collective, coordinated action. Finally, I want to note that, although TEI has not formally collaborated with the National Association of Enrolled Agents on tax simplification, the Institute is pleased that very important organization is also represented here today. The subject of tax simplification is too important to be considered the province of a single organization or even a group of organizations.

## **BACKGROUND**

Tax Executives Institute was established in 1944 to serve the professional needs of in-house tax practitioners. Today, the Institute has 53 chapters in the United States, Canada, and Europe. Our more than 5,300 members are accountants, attorneys, and other business professionals who work for the largest 2,800 companies in North America and their European affiliates; they are responsible for conducting the tax affairs of their companies and ensuring their compliance with the tax laws. TEI represents a cross-section of the business community, and is dedicated to the development and effective implementation of sound tax policy, to promoting the uniform and equitable enforcement of the tax laws, and to reducing the cost and burden of administration and compliance to the benefit of taxpayers and government alike. TEI members deal with the tax code in all its complexity, as well as with the Internal Revenue Service, on almost a daily basis.

Mr. Chairman, the organizations appearing before you today are uniquely qualified to comment on the costs, burdens, and headaches of tax complexity. Our members have the expertise and experience to identify not only the problems but the possible solutions. I would note, however, that unlike the other three organizations, TEI is not an organization of tax practitioners who represent taxpayers. Rather, we are an organization of taxpayers themselves. It is our costs, our

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hearing. TEI is committed to analyzing the Joint Committee's recommendations and submitting follow-up comments to both the staff and to the Finance Committee.

burdens, our headaches and loss of productivity that we are talking about.

### **THE CASE FOR TAX SIMPLIFICATION**

Two years ago, Tax Executives Institute joined with the AICPA Tax Division and ABA Tax Section to draw attention to the pressing need for tax simplification. Our action was met with skepticism in some quarters because the members of our three organizations (plus the NAEA) are sometimes seen as the beneficiaries of tax complexity. "Isn't it true," we were asked, "that the more complicated the laws are, the more business you will get?" "Isn't it true that most tax laws could be subtitled 'The Tax Lawyers and Accountants Full Employment Act'?" Mr. Chairman, I assure you that I would not be here today if TEI subscribed to these views. To say that tax professionals oppose simplification because they benefit from complexity is akin to saying that doctors oppose flu shots and inoculations and the promotion of hygiene because the absence of these would be "good for business." It may be good for a laugh, but it misses the fundamental point.

The fundamental point is that tax law complexity adversely affects us all. Society as a whole is harmed by tax complexity, which can operate as a pernicious, hidden tax and as a drag on the economy. Although quantifying and measuring its precise toll is difficult, complexity exacts a very real price. Complexity not only makes it more difficult to comply, but it can regrettably widen the divide between taxpayers and their government. So, too, it can undermine the basic confidence of the public in the tax system and frustrate the congressional policies underlying particular provisions of the Code. If people cannot compute their earned income credit, if they cannot figure out whether they are eligible for one or more of the Code's myriad educational benefits, if they throw up their hands at the calculation of the alternative minimum tax or the phase out of personal exemptions, then, the system has failed them. This is also the case in respect of corporations where the efficacy of particular incentives and the tax system itself is diminished by mind-boggling complexity.

*Why simplification?* Because if we do not act, the tax system may collapse of its own weight. This may sound like hyperbole, but we sincerely believe it to be true. What you cannot understand you are bound to distrust, and distrust can breed more than cynicism: It can breed a culture of noncompliance.

*Why us?* Because as tax professionals, TEI members and our colleagues in other organizations are well positioned to document the problems and to identify the means of dealing with them. To be sure, the companies that our members work for will strive to comply. That, after all, is our job: to deal with the Code in all its complexity. TEI recognizes that the laws governing the taxation of complex, multi-faceted, multinational business enterprises will never be simple. But they can be made a lot simpler. More to the point, the inevitable complexity of some provisions should not deter efforts to do as much as we can as quickly as we can. The groups testifying before you have identified several good targets for action that pertain to both individuals and businesses. Additionally, even though large corporations will not benefit directly from many of the recommendations contained in the joint AICPA-ABA-TEI submission, TEI supports them all. Everyone Congress, the Treasury Department and the IRS, tax professionals, and taxpayers bears responsibility for the current state of the law. Everyone has an obligation to work to make it better. TEI pledges its support for changes that will make the tax law simpler for all of us.

*Why now?* Because if we do not start the journey, we will never arrive at our destination. Because projected budget surpluses afford Congress greater flexibility to cut the Gordian knot of complexity than anytime in the past two decades. Because Congress and the Administration have signaled their desire to address questions of fundamental tax reform and because the opportunity is ripe for revisiting core decisions about the tax system that, despite their policy basis, have spawned bewildering and unwieldy complexities.

Mr. Chairman, TEI has no illusions that we will ever have a perfect, simple tax system, but as one of your predecessors, Russell Long, often remarked, the perfect should not be the enemy of the good. The Institute thus agrees that incremental simplification is better than no simplification. The time to begin is now.

## **DISCUSSION OF SPECIFIC PROPOSALS**

Other witnesses on this panel have addressed some of the more vexing provisions affecting individuals, which are detailed in the joint TEI-ABA-AICPA submission. As already noted, TEI supports these recommendations. I wish now to focus on several areas where the tax law could be simplified for business taxpayers.

First, Congress can effect meaningful simplification by repealing the **corporate alternative minimum tax**. The corporate AMT suffers from the same deficiencies and structural flaws as the individual AMT. It requires taxpayers to operate in, and comply with the myriad requirements of, two separate tax systems. It creates enormous administrative burden and, through its depreciation component, discriminates against capital-intensive companies. TEI strongly believes that taxpayers should not be required to compute their taxes twice and to keep two sets of books. Equally important from a policy perspective, taxpayers should not be subject to an additional levy at the very time they can least afford it, but that is precisely what the AMT does: It kicks in when companies are increasingly challenged to compete in an economic downturn. Even assuming that the AMT served a valid purpose when enacted, the burdens it imposes which grow every day cannot be justified in today's highly competitive global economy. It should be repealed for *all* taxpayers, individuals and corporations.

Next, it is time to reform and simplify the **depreciation** rules. The tax code now provides a modified Accelerated Cost Recovery System (MACRS) for determining depreciation deductions for most tangible property. There are also special recovery periods and methods that apply in certain situations. The law assigns tangible property to one of seven recovery periods that range from three to twenty-five years; real property has its own recovery periods. In 1998, Congress directed the Treasury Department to conduct a comprehensive study of recovery periods and depreciation methods. The study released last summer disappointed many observers because it did not include concrete recommendations for modernizing current law. The study did confirm one very important fact: *The current system is hopelessly outdated and needlessly complex.* For example, is there really a need to depreciate foreign assets at a different rate from that used in respect of domestic property? Asset class lives have been largely unchanged since 1981 and most date back to at least 1962. New industries, new technologies, and new manufacturing processes have been developed in the intervening years.

Mr. Chairman, when you addressed TEI earlier this month, you stated that this was one area that the Finance Committee will focus on this year. TEI applauds that decision, and we pledge our support to your efforts in replacing the current system with a simpler, more flexible model.

Uncertainty in the tax law also breeds complexity, and not knowing from one year to another what rules govern is the

ultimate in uncertainty. Several temporary provisions of the tax code have been extended with such regularity that they have become a recurring component of the annual legislative agenda. Most notable among "**the extenders**" are the research credit in section 41 and the educational assistance exclusion in section 127. TEI has long contended that these provisions cannot effectively serve their legislative purpose if taxpayers are unable to know whether they will remain in effect from year to year. Moreover, the retroactive extensions and gaps in coverage not only impair the incentive effect, but also impose significant administrative burdens. For example, the last time the section 127 exclusion expired, several TEI members instructed their Human Resources departments to issue Forms W-2 that included the amounts spent on educational assistance. When the provision was re-enacted retroactively several months later, the companies were forced to re-issue the W-2s, incurring additional costs and causing confusion among their employees.

The on-again, off-again nature of these provisions creates wholly unwarranted complexity. TEI thus endorses the Bush Administration's proposal to make the R&D credit permanent, and we urge Congress to act in this area sooner, rather than later. Hence, although the credit is not due to expire until 2003, the planning horizon for research projects is routinely more than three or four years; in other words, some may argue that there is no urgency in renewing the research tax credit, but we respectfully disagree. In addition, we recommend that permanency be extended to other provisions such as section 127 and the work opportunity credit.

Finally, Mr. Chairman, we second your call to take a serious look at the **Code's foreign provisions**. The foreign tax credit and Subpart F rules may never be truly simple for multinational corporations, but they can be simpler. For example, Subpart F was initially enacted as an exception to the deferral principle in order to tax the types of income considered relatively "movable" from one taxing jurisdiction to another and therefore able to take advantage of low rates of tax. In the nearly four decades since its enactment, however, Subpart F has been distended to capture active operating income. One solution to removing Subpart F's artificial barrier to competitiveness would be to exclude foreign base sales and services income from current taxation. Consider the case of a U.S. company wanting to sell in China. Setting up a subsidiary in that country would expose the corporation to currency controls and customs problems. The better business decision is to establish a Hong Kong

subsidiary, but doing so would subject the corporation to current taxation of sales income because of the Subpart F rules. U.S. companies face similar challenges in attempting to penetrate European markets.

Other international areas that should be considered for simplification include the translation of the deemed paid tax credit under section 986 and the interest allocation rules under section 861. We understand that Senators Hatch and Baucus are working together on an international tax simplification bill. We look forward to reviewing the proposals and working with this Committee to achieve meaningful reform.

## **CONCLUSION**

Tax Executives Institute commends the Senate Committee on Finance for holding this hearing and reaffirming its commitment to addressing the need for tax simplification. We all must resist the temptation, however, to think that this hearing is anything more than the beginning. We cannot simply pat one another on the back for being concerned, and then put the Joint Committee's report and our own testimony on the shelf. We must work together to make the quest for simplification real. Simplification must become more than an afterthought. It must permeate all decisions made about tax legislation. Please be assured that TEI fully supports your leadership in the area and pledges its own continuing efforts to simplify and improve the tax laws.