Statement

Of

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before

Senate Committee on Finance

on

Our Business Tax System: Objectives, Deficiencies, and Options for Reform

September 20, 2006

Chairman Grassley, Ranking Member Baucus, and Members of the Committee: Thank you for inviting me to testify on behalf of Tax Executives Institute, where I currently serve as International President, to provide the perspective of business tax professionals on fundamental tax reform. Tax Executives Institute is the preeminent association of in-house tax professionals. Our 6,000-plus members represent more than 2,800 companies in the United States, Canada, Europe, and Asia. Our members deal with the tax laws — in the United States and throughout the world — on a day-to-day basis, and we are proud of our record of working with Congress, the Treasury Department and Internal Revenue Service, and their counterparts around the globe to improve both tax policy and tax administration.

In addition to my volunteer service to TEI, I am Vice President–Tax and Real Estate for Kimberly-Clark Corporation, where I have been employed for my entire 32-year career. Kimberly-Clark is a 130-year old company founded in Neenah, Wisconsin, by four young businessmen to manufacture and sell paper, pulp, and bathroom tissue. We have grown from an initial capitalization of $30,000 to a market capitalization of almost $30 billion, and today the company is a global leader in health and hygiene products, with products manufactured in 18 states and 39 countries and sold in more than 150 countries.

Mr. Chairman, not to date either us, but the tax world has changed considerably since I joined Kimberly-Clark and you were first elected to Congress. Back then, you could easily carry the Internal Revenue Code (1 volume) and regulations (2 volumes) in your briefcase with room to spare. Since those times, our tax code — like the world around us — has grown significantly and become increasingly more complex. This exponential growth of our tax law, in terms of size, scope and complexity, has spawned a universe of statutory law and regulatory pronouncements that is profoundly difficult for taxpayers to understand and comply with and for tax administrators to examine, interpret, and enforce. Part of the reason for this is society's increasing reliance on the Internal Revenue Code, not merely to raise revenue from individuals and entities to fund governmental operations, foster economic growth, and enable prosperity, but also to advance social and economic policies that, while perhaps laudable, impose heavy costs on the tax system and its participants. Thus, in a very real sense, the Code has lost its way, and all of us must accept a measure of responsibility for that having taken place.

The challenge to both government and business is to refocus our internal revenue laws. To TEI, that is what fundamental tax reform is all about.

We are not naïve about the challenge. We recognize that whatever the *need* for tax reform, the *prospects* for it remain uncertain, both because certain groups, industries, and advocates are heavily invested in the current system (or one or more of the competing alternatives) — not without reason — and because transitioning to a new system will never be easy.

But we must begin. Thus, we recommend that the following four principles (or themes) guide our collective efforts.

1. U.S. Business Does Not Operate in a Closed System

Mr. Chairman, American companies operate under a tax system that places us at competitive disadvantages in the world marketplace. Let me offer two brief examples — our regime for taxing foreign base company income under Subpart F and our foreign tax credit regime, both of which impede our ability to compete.

Specifically, Subpart F makes it difficult to operate in the same manner as foreign competitors since our competitors are generally *not* taxed in their home country on foreign operating income while U.S. businesses may be taxed in both the United States and the foreign country. To be sure, the Code provides a foreign tax credit in such cases, but that mechanism does not always eliminate double taxation.

In the case of my own company, tax is no longer an afterthought in deciding the location of a new manufacturing plant or a distribution center. Put simply, tax costs matter (as do labor and other costs), and the choice between a domestic and foreign location for a new plant can be significantly affected by the tax costs associated with each venue. Kimberly-Clark is a U.S. company, but we are increasingly forced — for competitive reasons — to build facilities overseas, not merely because that is where our customers are, but because the economic and tax environments

are often friendlier. We are fiercely patriotic, Mr. Chairman, but in a global marketplace, we owe it to our shareholders to be equally profit-oriented.

As Congress moves forward on the important issue of tax reform, it must strive to create a tax environment that allows U.S. companies to compete around the world while retaining research, manufacturing, and jobs at home. Some economists bemoan tax competition as a "race to the bottom," but the competition America faces is real, persistent, and effective. Our foreign trading partners are not shy in vying for new plants, research facilities, and distribution centers, and — if the United States is to remain competitive — our rules must change.

Mr. Chairman, one final comment on the need for us to build a competitive tax system. A comprehensive debate on tax reform without consideration of some form of generally applicable consumption tax would ignore global trends. Accordingly, we recommend that Congress address the efficacy of enacting some form of national tax here, especially given the desire to reduce the income tax rate, the special concerns of federalism (and how a federal tax might be integrated with current state tax systems), and the importance of restoring fiscal discipline to the budget process. To date, Tax Executives Institute has not adopted a position on the question of a consumption tax, in part because of the diversity of views among our members, but we remain ready to assist the Committee in evaluating the merits and, equally important, the administrability of various proposals.

2. The U.S. Tax Rate Must Be Competitive

Mr. Chairman, how do you compete in a marketplace for the production and sale of goods and services when the price of operating here is higher than it is abroad? A critical aspect of tax competition is the tax rate. In the mid-1980s, the United States recognized this, and acted to reduce the top corporate tax rate from 46 percent to a then global-leading 34 percent. That was then. Now,

our top rate (which was increased to 35 percent in 1995) comes in near the top of the list. Thus, while we essentially were "running in place" on the issue of corporate tax rates, our European trading partners followed our lead and for the past decade have made rate reductions the rule of the day. In fact, from 1986 to 1996, the average top statutory corporate tax rate for the 25 countries of the European Union dropped more than 10 percentage points (from 43.2 to 32.6 percent).

One example will suffice: Ireland. In 1999, the Irish Republic passed legislation that over time reduced its overall corporate rate to 12.5 percent (slightly more than a third of the U.S. rate), which has helped spur strong economic growth. The Celtic Tiger is not a myth — it is a reality, and the results (including job, economic development, and tax revenues) have prompted Ireland's neighbors to follow suit, with Germany and Spain being the most recent countries to announce significant reductions and The Netherlands signaling the intention to follow suit.

Lower rates, however, do not necessarily mean lower revenue. Indeed, economist Martin Sullivan of the independent publication *Tax Notes* has confirmed that despite significant reductions in the tax rate in European countries, corporate tax revenue as a percentage of GDP is rising. This is not only due to changes in the tax base in the affected countries (which I discuss below), but also because lower rates (and, more generally, lower taxes) have spurred significant economic activity and job growth. The dynamic effect of tax cuts may not always be easy to measure, but it proves too much to say, for example, that the sharp increase in tax revenues in the United States has no causal link to recent tax rate reductions.

As part of fundamental tax reform, therefore, Congress should act to level the "rate" playing field and thereby make America's tax system — and American business — more competitive.

Mr. Chairman, there should be no doubt that American business wants to build technology centers here, manufacturing plants here, and testing facilities here, all of which engage local labor that, in turn, contribute to our local, state and national economies. Absent fundamental change, doing so will become increasingly difficult.

3. The Tax System Should Not Pick "Winners" and "Losers" — The Tax Base Should Be Broadened

The amount of revenue raised by a tax system is the product of the tax rate and the tax base. While some incentives such as those for research and education have widespread support, a growing consensus favors lower rates and a broader tax base to reduce complexity, ease tax administration, and minimize the government's role in picking "winners" and "losers."

Mr. Chairman, we recognize the challenge here is striking the appropriate balance between the need to fund the government with the goal of encouraging (or discouraging) certain behavior. For example, the Nation has long placed a premium on education and, as a result, Congress has enacted numerous incentives to advance that goal. Similarly, the strategic importance of having research conducted in the United States prompted the enactment of the research tax credit that, at the margin, has kept research facilities in this country.

It can be argued, of course, that tax reform itself will produce "winners" and "losers," just a different group than under the current Code. While this may be true, especially on a transition basis, it cannot be permitted to stanch the debate. TEI contends that a broader tax base coupled with a simpler, more administrable code will generate a system of taxation in which sound tax policy takes precedence over a patchwork of tax incentives and inducements.

4. **The Tax System Must Be Simpler**

Achieving and maintaining an effective balance between fairness and simplicity — in the tax system or society generally — is not easy. At one extreme, fairness, *i.e.*, treating similarly situated taxpayers in the same way, demands tax rules to be complex. At the other, simplicity (or a lesser level of complexity) calls out for "rough justice."

American society is complex, and the tax rules that govern our conduct must, of necessity, reflect that complexity — but they need not be consumed by it. Simple is good, not only on its own account, but because complexity represents a daunting, hidden tax on American business. The Tax Foundation estimated that in 2005 taxpayers incurred total costs in excess of $265 billion to comply with federal income tax laws, with business's share being a staggering 55 percent.

As a broad proposition, a simpler tax system will also be easier for the Internal Revenue Service to enforce. The IRS currently seems to spend a disproportionate amount of its resources plugging so-called loopholes, often creating unintended (and expensive) consequences. Stated simply, the more complex the Code, the greater the likelihood for taxpayers to confront interpretative issues and questions that, if not addressed, will spawn opportunities for *lawful* tax avoidance. Simplifying the Code will also eliminate the need for Band-Aid-like compliance measures that can impede routine, day-to-day business transactions and force law-abiding businesses to absorb the heavy proxy tax of additional recordkeeping.

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Mr. Chairman, recently attention has focused on the so-called tax gap and what connection, if any, the tax gap may have to fundamental tax reform. Key to this question, of course, is the

definition of the term as well as the validity of the data that undergird any estimates of the gap. Indeed, these issues are connected, because it is impossible to measure something that you cannot define. The Comptroller General recently put it this way: "…[I]n large part because of the complexity and uncertainty in the application of tax laws, the actual level of corporation income tax non-compliance (illegal tax avoidance) is poorly understood. IRS estimates a corporate tax gap in the tens of billions of dollars, but also acknowledges that this estimate is not based on robust, recent and reliable research."[1] The tax gap estimate is itself an aggregation of estimates for three types of noncompliance, underreporting of tax liabilities on tax returns, underpayment of taxes due from filed returns and underpayment of taxes due to the failure to file a required return altogether or on time. Published estimates of the size and composition of the tax gap vary dramatically. The most recent tax gap estimate published in the *Washington Post*, citing a variety of government sources, totals $345 billion, of which about 10 percent is attributable to corporate tax sources.[2]

TEI firmly believes that the tax gaps can be significantly reduced by meaningful reform and simplification. This is because some portion of the tax gap is undeniably attributable to the complexity of the Code itself. If taxpayers do not understand its provisions, they may not be able to comply. Similarly, some portion of the tax gap may be attributable to taxpayers exploiting the complexity in a manner that is ultimately determined to be inappropriate. It may not be possible to quantify how much of the gap is attributable to the complexity of the Code, but beyond question making the code less complex will help narrow that gap.

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[1] *A Tune-Up On Corporate Tax Issues: What's Going On Under The Hood?, Hearing Before the Senate Committee on Finance*, 109th Cong., 2d Sess. (June 13, 2006) ("Tax Compliance: Challenges to Corporate Tax Enforcement and Options to Improve Securities Basis Reporting," statement of David M. Walker, Comptroller General of the United States at 13).

[2] *See* Christopher Lee, *Falling in to the Tax Gap*, WASH. POST, Sept. 4, 2006, at A17.

Conclusion

Mr. Chairman, Tax Executives Institute applauds the Senate Finance Committee's efforts to advance the dialogue and debate on tax reform. We stand ready to be actively participants in this ongoing discussion about how best to make the American system of taxation, more competitive and less complex, while at the same time preserving fairness for all taxpayers. I would be pleased to answer any questions that you or your colleagues may have.