S. HRG. 114–61

PRESIDENT'S BUDGET FOR FISCAL YEAR 2016

HEARING

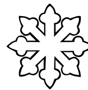
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

FEBRUARY 5, 2015



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PUBLISHING OFFICE

96–062—PDF WASHINGTON : 2015

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON FINANCE

ORRIN G. HATCH, Utah, *Chairman*

CHUCK GRASSLEY, Iowa
MIKE CRAPO, Idaho
PAT ROBERTS, Kansas
MICHAEL B. ENZI, Wyoming
JOHN CORNYN, Texas
JOHN THUNE, South Dakota
RICHARD BURR, North Carolina
JOHNNY ISAKSON, Georgia
ROB PORTMAN, Ohio
PATRICK J. TOOMEY, Pennsylvania
DANIEL COATS, Indiana
DEAN HELLER, Nevada
TIM SCOTT, South Carolina

RON WYDEN, Oregon
CHARLES E. SCHUMER, New York
DEBBIE STABENOW, Michigan
MARIA CANTWELL, Washington
BILL NELSON, Florida
ROBERT MENENDEZ, New Jersey
THOMAS R. CARPER, Delaware
BENJAMIN L. CARDIN, Maryland
SHERROD BROWN, Ohio
MICHAEL F. BENNET, Colorado
ROBERT P. CASEY, Jr., Pennsylvania
MARK R. WARNER, Virginia

CHRIS CAMPBELL, *Staff Director*
JOSHUA SHEINKMAN, *Democratic Staff Director*

CONTENTS

OPENING STATEMENTS

	Page
Hatch, Hon. Orrin G., a U.S. Senator from Utah, chairman, Committee on Finance	1
Wyden, Hon. Ron, a U.S. Senator from Oregon	3

ADMINISTRATION WITNESS

Lew, Hon. Jacob J., Secretary, Department of the Treasury, Washington, DC	5

ALPHABETICAL LISTING AND APPENDIX MATERIAL

Grassley, Hon. Chuck:	
Prepared statement with attachment	41
Hatch, Hon. Orrin G.:	
Opening statement	1
Prepared statement	46
Lew, Hon. Jacob J.:	
Testimony	5
Prepared statement	49
Responses to questions from committee members	70
Portman, Hon. Rob:	
Letter from Dave Mason and Tim Boes to Senator Portman dated January 21, 2015	119
Letter from Jeffrey Carrier and Tim Rowe to Senator Portman dated January 27, 2015	120
Wyden, Hon. Ron:	
Opening statement	3
Prepared statement	121

COMMUNICATIONS

Family Business Estate Tax Coalition (FBETC)	123
Puerto Rico Manufacturers Association (PRMA)	128

PRESIDENT'S BUDGET FOR FISCAL YEAR 2016

THURSDAY, FEBRUARY 5, 2015

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:04 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Grassley, Crapo, Thune, Portman, Toomey, Coats, Heller, Scott, Wyden, Schumer, Stabenow, Cantwell, Menendez, Carper, Cardin, Brown, Bennet, Casey, and Warner.

Also present: Republican Staff: Chris Campbell, Staff Director; Tony Coughlan, Tax Counsel; Everett Eissenstat, Chief International Trade Counsel; Jim Lyons, Tax Counsel; Mark Prater, Deputy Staff Director and Chief Tax Counsel; Jeff Wrase, Chief Economist; and Nicholas Wyatt, Tax and Nominations Professional Staff Member. Democratic Staff: Adam Carasso, Senior Tax and Economic Advisor; Michael Evans, General Counsel; Tom Klouda, Senior Domestic Policy Advisor; Todd Metcalf, Chief Tax Counsel; Jocelyn Moore, Deputy Staff Director; Joshua Sheinkman, Staff Director; and Tiffany Smith, Senior Tax Counsel.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Today's hearing is on President Obama's budget for fiscal year 2016. I want to thank Secretary Lew for appearing before us today.

I am not going to sugarcoat anything with this budget. Instead, I am going to cut right to the chase. The President's budget proposes to hike taxes by $2.1 trillion, seemingly not content with the $1.7 trillion in new taxes he and his allies in Congress have imposed over the past 6 years.

The President, with this budget, wants to again raise taxes on savings, investment, small business, and more, somehow thinking that it will help the economy. Sadly, this insatiable desire to raise taxes is not intended to bring our budget into balance. Rather, the President's $2.1-trillion tax hike is accompanied by proposals to further expand the government to an even greater share of our economy.

The proposed budget never balances. Deficits continue, which means that the debt as a share of the economy would remain at levels not seen in our Nation's history, outside of a few years surrounding World War II. That outcome would mean continuing risk of what the nonpartisan Congressional Budget Office has labeled a,

quote, "fiscal crisis." In fact, CBO has warned us repeatedly about potential fiscal crises under President Obama's tenure. They have also made clear that unsustainable entitlement spending is at the heart of the potential for a fiscal crisis.

Yet, the President's budget proposes precious little in the way of reigning in spending on our health care entitlements and does virtually nothing to address Social Security. Despite having pledged in 2009 that he would not kick the can down the road on Social Security, that is exactly what the President is now proposing to do with his budget, even while the Disability trust fund is projected to be exhausted next year.

Simply put, there are too many shortcomings in the President's budget to adequately address in my opening statement, but they include higher taxes that would stifle job creation, economic growth, savings, and investment; new wealth taxes; muddled thinking about distributional issues; a lack of significant reforms to our unsustainable entitlements; ongoing deficits and outsized, risky Federal debt; and a repackaged bank tax that nods to the ineffectiveness of the Dodd-Frank law.

The budget even puts forward a tax on section 529 education savings, which suggests that the budget's authors are out of touch with the American people. Of course, we have heard that the proposal to tax 529 education savings has been withdrawn and labeled a distraction. But it is still supported on policy grounds by the administration, although I am happy to see it is withdrawn.

This is unhelpful, and that is the kindest possible word I can think of to describe that particular proposal and others like that that are apparently founded on the notion that the American people's savings are not their own, but instead targets for more redistribution.

Like I said, there is a lot I could complain about when it comes to President Obama's budget, but let us be honest. Rehashing these complaints over and over again is not going to be the best use of the committee's time.

So, Secretary Lew, let us try to look at some areas in the budget where the administration seems willing to go in a positive direction, even if, in my opinion, it falls short on the substance. In those areas, let us try to work together toward what I believe is the shared goal of everyone here: to help Americans where we can and get out of the way when we should.

For example, I believe that we share a desire to reform our tax code, which everyone agrees is severely broken, does not help American families, and harms American businesses. And by businesses, I mean businesses of all types, not just one particular organizational form.

I believe we share a desire to renew Trade Promotion Authority, as you identify in your testimony. I believe we share a desire to promote productive investments in infrastructure. Of course, if we are going to effectively address these issues, the President and his administration owe it to the American people to suspend what often seems like an unending political campaign for enough time to at least explore bipartisan cooperation.

I will close with a question for you, Secretary Lew. It is a question that you did not answer and evaded in testimony earlier this

week. The IRS Commissioner evaded a similar question when he was here on Tuesday. Secretary Burwell did the same in our hearing yesterday. The American people deserve an answer to this question, and I hope you will be willing to give us one today.

The question is: do you have contingency plans in place in the event the Supreme Court invalidates the current structure of the Affordable Care Act tax subsidies later this year? I would like you to address this question in your opening remarks, if you will, and I will note that it is a simple question, requiring only a one-word answer: "yes" or "no."

Once again, I want to thank Secretary Lew for appearing here today.

[The prepared statement of Chairman Hatch appears in the appendix.]

The CHAIRMAN. With that, I will turn it over to the ranking member, Senator Wyden, for his opening statement.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you very much, Mr. Chairman. And thank you, Secretary Lew, for being here on day 3 of what is essentially budgetpalooza here at the Finance Committee.

While the committee examines the administration's budget proposal today, the underlying issue remains the health of the budgets of middle-class workers and families trying to get ahead. The fact is, too many middle-class Oregonians are hurting.

Our job is to put America's middle class on solid economic ground, lift wages, and make sure that everybody benefits when the economy grows. The President's budget proposals go after that challenge in a number of ways, and many of them are designed to improve America's badly broken tax code. For example, the budget proposes to make incentives for education, child care, and retirement savings more generous. It would take several steps to address the unfair ways our tax system treats wage-earning middle-class workers compared to others. And I was pleased to see that the proposal would move towards ending the system of tax deferral that traps the profits of America's businesses overseas instead of reinvesting them here in this country.

These are all strong ideas, but I see an opportunity to do something even bolder. When it comes to the tax code, colleagues, why keep bailing water out of the boat instead of fixing the leaks? The most effective improvements Congress can make to middle-class tax incentives are going to come through comprehensive tax reform. That is the best route to a modern tax system that is simpler and fairer for all, and it is the best way to end the uncertainty caused by our tax code and to address its most persistent issues.

Through comprehensive reform, the Congress can ensure that incentives provide the biggest help to the people most in need. Too often that is not how the code works today. Comprehensive reform can do more than piecemeal changes to level the playing field for wage earners and make filing easier to manage. And there is one indisputable fact. A comprehensive approach to tax reform is the best option for middle-class families, not one that is focused exclusively on business taxes.

A lot of Americans—and certainly there are a number in the administration—have advocated a corporate-only or business-only plan for reform. I would not want to have to explain to a single parent in Oregon why the Congress overhauled the tax code for corporations but not for that middle-class person. The corporate side of our tax code undeniably needs reform. Tax reform can and should make American businesses more competitive in the tough global marketplace, but it would be a grave mistake to leave millions of middle-class families and small businesses out.

Now, of course, the Finance Committee is going to be working with the Treasury Department closely over the upcoming year on a variety of issues in addition to tax reform. The Treasury Department is working hard to look at new approaches to make sure that American workers and American priorities are maintained in tough global markets.

So I look forward to hearing about the administration's efforts to address misaligned currencies, particularly with respect to the ongoing discussions on the Trans-Pacific Partnership. And it is important not to forget that Treasury plays an integral role in managing economic sanctions against countries like Russia, Iran, and Cuba. We welcome, Secretary Lew, as you know, updates on how those sanctions are working and how the administration envisions them changing in the future.

So there is a lot on your plate, Secretary Lew. We thank you for being here.

Colleagues, I just want to note, as I tried to do yesterday, when it seemed, at some point, the Finance Committee looked like it was becoming a mock trial, kind of getting into a whole host of legal issues, I think there is something ironic about the fact that a number of our colleagues on the other side of the aisle have filed a Supreme Court brief challenging the law and then keep demanding various Cabinet Secretaries explain how they plan to avert the disaster that is going to occur if their brief is successful.

So I hope that we can have a discussion on the important issues relating to the budget, taxes, and our competitiveness. I think we talked about this at great length yesterday. At some point, I admitted that Chairman Hatch is a real lawyer, he is a trial lawyer. I am a lawyer in name only, having run the legal aid program for the Gray Panthers, but yesterday felt like we were going back to the Socratic method here in the Finance Committee, and I hope we can tackle these major issues in the Treasury budget today.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. I think you are a good lawyer, and anybody who can do what you did with the Gray Panthers has to have some moxie, is all I can say, and I have a lot of respect for you.

[The prepared statement of Senator Wyden appears in the appendix.]

The CHAIRMAN. Our witness today is Treasury Secretary Jacob Lew. Secretary Lew was confirmed to his current position on February 27, 2013. Previously, Secretary Lew served as President Obama's White House Chief of Staff, and before that he was the Director of the Office of Management and Budget, a position he also held in President Clinton's Cabinet from 1998 to 2001.

Before returning to OMB, Secretary Lew first joined the Obama administration as Deputy Secretary of State for Management and Resources.

Secretary Lew also has broad-based private-sector experience. He served as managing director and chief operating officer for two different Citigroup business units and served as executive vice president and chief operating officer of New York University.

Secretary Lew has a long history with the Federal Government, including the Federal budget and the budget process. It goes all the way back to the tax bill in 1986 and the 3 years before that.

I am afraid, Secretary Lew, that if I detail your long history of public service, we will run out of time for this hearing. I am ashamed that you have had to work so long in the Federal Government, but I am really very proud of you for all the work that you have done all those years.

Suffice it to say, Secretary Lew, that we genuinely appreciate your long history of service to our country. I want to thank you for being here today. I want you to proceed with your statement.

I have to open the Senate, and I have to be in Judiciary, because one of my bills is coming up. So I have asked Senator Thune to take over until I can get back, or at least until 11 o'clock. Then, if I do not get back by then, I will have others take over.

So with that, let us turn the time over to you for your statement.

STATEMENT OF HON. JACOB J. LEW, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary LEW. Thank you, Mr. Chairman, for that very gracious introduction and welcome. Thank you, Ranking Member Wyden, members of the committee, for having me here today to testify on the President's budget.

A year ago, President Obama said that 2014 could be a breakthrough year for our economy, and the evidence is now clear that over the past 12 months, America has made great strides. We are seeing real progress in job creation, economic growth, family wealth, energy independence, manufacturing, exports, retirement accounts, the stock market, health care costs, graduation rates, and the deficit.

The fact is, our businesses created nearly 3 million jobs last year, the most jobs in any year since the late 1990s. This capped off roughly 5 years of job growth, the longest stretch of job growth in our Nation's history, and the creation of 11 million new jobs. In addition, the unemployment rate dropped to its lowest rate in 6½ years and our economy continued to expand, with healthy growth in the second, third, and fourth quarters of 2014 and forecasts projecting above-trend growth for 2015.

From a global perspective, we continue to outperform our trading partners, many of which are still trying to climb out of the vast hole created by the global economic crisis. At the same time, with the Affordable Care Act in place, about 10 million Americans now know the financial security of health insurance, and health care prices rose at the lowest rate in decades.

The automobile industry continued its rebound in 2014, even as we marked the official end of the auto industry rescue, and American taxpayers recovered more money than we invested.

Finally, thanks to the administration's all-of-the-above energy strategy, we moved closer to energy independence than we have been in decades, and gas prices fell, providing a shot in the arm for families and small businesses.

So today our Nation has turned the corner on a number of fronts. Yet, as we know, this resurgence has not reached every American. For too many hardworking men and women in this country, it is still too hard to get ahead and too hard to earn enough to raise a family, afford child care, pay for college, buy a home, and secure a retirement.

The President's budget meets these challenges by offering real solutions to grow the economy, strengthen the middle class, and make paychecks go further. This budget is built around the basic idea that hard work should pay off. It is practical, not partisan, and it lays out clear steps to rein in spending and eliminate wasteful tax breaks so we can reduce taxes for working families, as well as many businesses and manufacturers.

What is more, this budget replaces the across-the-board cuts from sequestration and makes sensible investments to increase our economy's competitiveness, while maintaining a responsible fiscal path.

As we know, not long ago, some were predicting that the President's policies would explode our deficits. A little history, though, makes clear the opposite is true. In the 1990s, when I was Budget Director, I oversaw three budget surpluses in a row, and we were on a path to pay down our national debt.

But when this administration took office in 2009, there was a very different reality. After years of runaway spending, including tax cuts for the most well-off and two wars, neither of which were paid for, and then the financial crisis, our deficits reached a post-World War II high.

The President moved to right our Nation's fiscal ship. With his balanced economic approach, the agreements forged with Congress, and a growing economy, the deficit has fallen by almost three-quarters, the swiftest downturn since the period of demobilization following World War II.

The deficit is projected to decline even further in the next fiscal year. And today we are putting forward a plan to lower our deficits to about 2.5 percent of GDP over the 10-year budget window.

Our Nation's improved financial footing has occurred even as Congress was able to undo a portion of sequestration in recent years, replacing these cuts with more sensible and balanced savings. Still, nothing has been done to address these dangerous cuts in 2016. Without congressional action, vital funding for our national defense and key priorities like education, infrastructure, and research will be severely cut back.

The President's budget provides a path to eliminate sequestration while achieving the President's longstanding commitment to a responsible and balanced fiscal approach. In other words, it charts a specific way forward to not only keep our fiscal house in order, but to create room for pro-growth economic policies which are needed to keep our Nation stronger for the future.

One pro-growth strategy is tax reform to restore basic fairness and efficiency to our system. By scrapping loopholes and tax breaks

that reduce the taxes for the most fortunate Americans but do not help our economy, we can provide critical tax relief for middle-class families and those struggling to join the middle class.

Our economy should work for everyone, and everyone should shoulder their fair share to maintain our Nation's fiscal health.

This budget also places a serious focus on achieving bipartisan business tax reform so that America is the best place in the world for businesses to locate, grow, and create the kind of good, high-paying jobs that support middle-class families.

This plan shows how members of both parties can reach common ground and realize the shared objectives of simplifying the system, removing wasteful tax preferences and distortions, and lowering tax rates so that we no longer have a system in which some businesses pay nothing while others pay the highest rates in the developed world.

It is time to stop rewarding the corporations and industries that have the best lobbyists and the most creative accountants and start strengthening businesses that build, hire, and invest here in the United States. It is also time to make inversions, a loophole that allows U.S. companies to lower their taxes after they buy foreign businesses, a thing of the past, and this budget does that. A more fair and efficient tax system will help create good middle-class jobs and grow our economy.

We know that with business tax reform, there will be one-time transition revenues. The President wants to use some of these one-time revenues to make long overdue repairs to our Nation's roads, bridges, ports, and airports. The need to rebuild our infrastructure is irrefutable, and that is why this budget tackles our infrastructure challenges by creating an extended period of sustained funding for a 6-year surface transportation bill and starting an innovative new bond program that will ignite more public-private partnerships in cities and States across the country.

Of course, keeping our comeback on track, building on the momentum we have made, and making it possible for every American to get ahead is going to require strategies that are both bold and effective, and that is what this budget is about. It proposes a series of targeted investments that have been proven to make a difference.

It invests in education by expanding student loans, strengthening tax incentives, and making community college free for those who earn it. It invests in America's workers by starting apprenticeship grants, enhancing job training programs, and boosting the Earned Income Tax Credit. It invests in working families by increasing the child care tax credit, providing tax relief for families when both parents are holding down jobs, and allowing more working families to earn paid leave.

It invests in retirement security by making it easier for employees to automatically save for the future and businesses to provide 401(k)s to their employees. And it invests in innovation by creating more advanced manufacturing institutes, creating cutting-edge medical research initiatives, and bringing broadband access to more communities.

In concert with these pro-growth strategies, this budget calls on Congress to send measures to the President's desk that will help

our economy now and far into the future. This includes raising the minimum wage and fixing our broken immigration system.

The President's trade agenda is another important component of our strategy to grow the economy and strengthen the middle class, and I look forward to working with all of you to pass Trade Promotion Authority to expand the reach of America's exports and create a level playing field for businesses and workers.

The strategies I have described are part of the President's plan to help improve the lives of millions of hardworking Americans while meeting our responsibilities to future generations.

The task before us now is to put political brinkmanship aside and find areas of compromise and common ground. I am certain we can get this done, and I will work with each and every member of this committee so that we can deliver for the American people.

I thank you and look forward to answering your questions.

Senator THUNE [presiding]. Thank you, Mr. Secretary.

[The prepared statement of Secretary Lew appears in the appendix.]

Senator THUNE. I am going to start with a couple of questions here, and hopefully the chairman will return soon. I will use 5-minute rounds and see where it goes from there.

I am particularly concerned about the administration's proposal to raise the capital gains tax and apply the tax when an asset is transferred at death or by gift, not when the asset is sold, as is the case today. That proposal, if enacted, would have a devastating impact on family farms and small businesses in my State of South Dakota, and I want to give you an example.

According to the South Dakota State University Agricultural Land Survey published last year, land values in South Dakota have more than doubled since 2010 and gone up 7 times since 2000. So, if you take a typical family farm in South Dakota that bought a section of land, which would be 640 acres, back in 2000 for $640,000, which would have been roughly the price at that time in certain areas of my State—and I would note that in South Dakota, that would be considered a small farm—today that same farm land is probably worth somewhere between $3.5 million and $4.5 million, depending on where it is located.

So, under the current estate tax law, which excludes assets up to $5.43 million, that family farm is not taxed when it passes from one generation to the next. Now, under the administration's proposal, that family farm would be hit with a significant tax when it is transferred to the next generation of family members.

Now your proposal, as I understand it, exempts $100,000 in capital gains or $200,000 per couple and raises the gains rate to 28 percent. So in that example, this South Dakota family would suddenly find themselves facing a tax bill of $1 million or more. So most farms of this size would not have liquid assets to deal with that large of a tax bill. The only way that they would be able to pay Uncle Sam would be to break up the family farm and sell off portions of it.

So I know the President likes to talk about loopholes and trust funds and the like, but this capital gains proposal that you all put forward, we really need to talk clearly about what it would do. It is a very punitive death tax on America's family farms and family

businesses, especially in places like South Dakota, where we have seen significant price appreciation for land.

So the question, Mr. Secretary, very simply is, what is the administration's intent with regard to this tax? If it is to break up family farms, obviously, it is going to have that effect. Or is it simply an unintended consequence of your interest in imposing yet another layer of taxation at death, which I think, again, would be very unfortunate?

Secretary LEW. Senator, let me step back and go to the reason for stepped-up basis and then get to the specific question about farms.

Stepped-up basis is really meant to make our system work in a way that is more fair. Right now, if any of us take savings in 401(k)s or IRAs for our retirement, we need to realize the income and pay income tax on that. For families that are able to accrue enormous fortunes that never need to realize the income, they are able to pass on, in stocks and bonds and other assets—without any taxes paid—the appreciated value.

Stepped-up basis would treat those families the same as it treats all of us in middle-class families. We were very concerned that it not have an impact that was unintended on small businesses and family farms. So we do have exemptions that apply for the first $100,000 for an individual, $200,000 for a couple. We also have an exemption that applies if there is a modest income, and we also have provided 15 years for the payment of any of the capital gains so that it would not require a forced sale.

And we would look forward to working with you and the committee on trying to refine this in any way we could to make this proposal, which we think is fundamentally fair, something that works well.

Senator THUNE. Well, I guess the way that I look at this, I mean, these are non-liquid assets. This is not like somebody who is selling stocks or bonds. We are talking about—farmers tend to be land rich and cash poor, and you are talking about shifting the point, the time the gain is realized. You are talking about raising the rate, and what you are talking about is just a huge tax liability for a lot of people who, at a time when you want to see some of these assets transfer to the next generation—if you want to maintain family farming and ranching operations, most of those require intergenerational transfers. I mean, that is how we keep that economy sustainable in States like South Dakota.

It strikes me at least that this is just a very punitive tax on family farms and small businesses.

Secretary LEW. Senator, I would say, on the capital gains rate, what we have proposed is returning to the capital gains rate that was in effect under President Reagan, at a time when we went through a period of economic growth with that capital gains rate.

So I do not think the capital gains rate is something that is an untested one.

In terms of the impact on illiquid assets, we designed it so that it would not require a forced sale, and we would look forward to working with you to deal with issues that arise in the design of a provision——

Senator THUNE. Even if the rate goes back to the 28-percent rate, which it was before, I mean, you are still talking about shifting the time at which the gain is realized and hitting people—essentially, I mean, it is a death tax.

Normally, for a gain to be realized, somebody has to sell the asset. In this case, that does not happen. I mean, this just seems like a really strange proposal, particularly if you represent a constituency like I do in a farm-based part of the country.

Secretary LEW. The problem with stepped-up basis under current law is that gains go untaxed forever in many cases, and I do not think that that is something that we would design the tax law to do.

If you were talking about stocks and bonds and not a family farm, it would be very hard to defend having tens of millions of dollars of gains that effectively go untaxed from generation to generation.

I understand the issue in terms of illiquid assets. We did put in the 15-year term to make it something that, for a working farm or a working business, would be something that could be managed in the normal conduct of the business.

I would just point out that in the case of the estate tax, CBO did a study that concluded that only 65 farms in a given year would have been subject to the estate tax. So I think a lot of the concerns about the imposition of burden have been out of line with the actual impact, and if there are issues here that we need to fine-tune, we would look forward to working together.

Senator THUNE. Again, you have a triple shot. You have an increase in the rate, you have a change in the time of realization, and you do away with stepped-up basis, all at the same time.

Again, these are pretty dramatic changes. And I understand what you are getting at, under a normal circumstance, to try to ensure that like transactions are taxed in a like manner, but we have always treated farm land and assets that are transferred at death in a very different way.

Anyway, my time has expired.

Senator Wyden?

Senator WYDEN. Thank you very much, Mr. Chairman.

Let us talk about the middle class for a few minutes, Secretary Lew. You all put in a number of proposals—the $500 second earner tax credit, tripling the child care credit, expanding the American Opportunity Tax Credit—and all of them are going to be well-received.

As you know, there has been pretty solid debate here that has already emerged, with people like the Tax Policy Center, about whether this is going to put more money broadly—broadly—into the pockets of middle-class wage earners or if it will be select groups like those with young children or college-aged children.

I am of the view that we grow the economy from the middle out, that you have to get the relief to a broad spectrum of middle-class Americans. Did you all consider a proposal such as significantly expanding the standard deduction? Not only does this put a significant amount of money into the pockets of middle-class people, it has bipartisan support. Senator Coats has been interested in that; former Chairman Dave Camp was interested in that.

I want to know what you think is in the budget that would, for example, grow the paycheck for a 50-year-old auto worker whose children are already out of the nest.

Secretary LEW. Senator Wyden, we designed a budget that was obviously very much intended to provide meaningful relief and support for middle-class families. I think that, from the education provisions that we have in the budget to the retirement provisions and the minimum wage proposal, we have shown that we want people who are in the middle class and who are aspiring to be in the middle class to have more opportunity.

The proposal to increase the standard deduction obviously would be of help to filers who do not have a lot of itemized deductions and, in the context of individual tax reform, is something that we would think is something to be looked at. So we were taking the view that we needed to target the specific things that are the steps on the ladder to opportunity, and our budget was designed around that.

Senator WYDEN. Let us continue this discussion, because, make no mistake about it, those kind of efforts, particularly in terms of education, they are absolutely key to repairing this pretty tattered ladder of opportunity.

I just want us to keep in mind somebody like a 50-year-old auto worker whose kids are out of the nest, because a lot of those families are hurting too.

Let me now turn to something you and I have talked about, and that is the question of tax simplification. The National Taxpayer Advocate—and, again, we are talking about the middle class—said that this year Americans are going to spend $168 billion and spend 6.1 billion hours trying to comply with the American tax code.

You have over 160 proposals in the Treasury Green Book, but to me, a lot of them look like add-on credits, deductions, new preferences, and it seems to me that, again, while I support very much this idea of getting relief to middle-class people, it looks like it is going to take taxpayers more time and more hassle.

So tell me, if you would, what, in your view, is in the budget that would simplify taxes for middle-class people? And then I would like your thoughts on an approach I am looking at. I would like to see middle-class people get their March and April back rather than spending all this time and money, and I would like your thoughts on whether or not we ought to be looking at a tax reform system where many Americans could fill out a tax return on something that fits on a postcard.

So what is in the budget that simplifies the tax system for middle-class people, and then, what do you think of this idea of our working together, again, on a bipartisan basis, to get the tax filing system for most people down to a postcard?

Secretary LEW. Senator, we have tried, in areas like education, to simplify some of the provisions—there were multiple provisions—combining them to be easier for taxpayers to understand and take advantage of.

I think the whole effort on individual tax reform is one where simplification is something that we very much aspire to. We obviously also think it is important to provide strong incentives for things like education and retirement savings and the like.

So there is a bit of a tension between the total simplification and having incentives for things that are very important for working, middle-class families. We would very much look forward to working together to try to make the tax code as simple as possible.

Senator WYDEN. Would postcard-size be okay?

Secretary LEW. I wish I could say that I thought that we could get it on a postcard.

Senator WYDEN. Let us work for that.

Secretary LEW. Not a bad goal, but it will be tough.

Senator WYDEN. Well, you have the W–2s, so you have a lot to work with right there. So I think if we bear down—and I also want to note that Senator Stabenow, and I think colleagues on the other side, are going to be working on the individual portion of the tax code.

There has to be a way to help the middle class who are hurting, like that auto worker, and get people out from under the bureaucratic water torture, which is what filling out all these forms is all about, as the Taxpayer Advocate noted.

Thank you, Mr. Chairman.

Senator THUNE. Senator Heller?

Senator HELLER. Mr. Chairman, thank you. I look forward to the continuation of this particular hearing.

Mr. Secretary, thank you for taking time.

I want to just follow up briefly on what my colleague from South Dakota's question was. Obviously, being from Nevada, we have similar concerns and problems with some of these small family farms and ranches. But in my State, there are over 230,000 small businesses.

It is my understanding, and correct me if I am wrong, that generally no tax would be due on small family-owned businesses until sold. Can you clarify to me what that business threshold would be that defines what a small business is?

Secretary LEW. Senator, there is a provision in our proposal that would exempt very small businesses, really small businesses.

Senator HELLER. Right. Right. What is that threshold?

Secretary LEW. The exemption, I believe, is $1 million in the proposal, and it was designed to ease the burden on family businesses, mom-and-pop stores.

I think that, for larger businesses that are still medium-sized, the 15-year provision that I described for a working business is a way to take the incidence of the stepped-up basis and spread it over a very long period of time, which we think is a way of addressing the needs of a small business.

Senator HELLER. Mr. Secretary, thank you. I do not believe people are always right—or always wrong for that matter—and when the President is right, I support him, but when he is wrong, I do not.

But you made some comments in your opening statement that I appreciate, and they concerned the efforts for infrastructure and their priority for this administration.

Obviously, I care quite a bit about infrastructure. Among the working group, with my colleague Senator Bennet, I look forward to moving forward on tax reform. I, like the chairman, believe that our tax code is too costly, too complex, and too burdensome.

But I still would really like to tackle this issue of infrastructure. I think that is good for the State of Nevada. We would bring more people in to portions of our State, and I think it is a core function of this government.

I am sure that you are aware that Chairman Dave Camp—former Ways and Means chairman—introduced a tax reform discussion draft, and one of the proposals that he had was a repatriation proposal that was composed of two rates: one for cash and one for assets.

Was there any reason why the administration did not look at this and impose two different rates?

Secretary LEW. Senator, there are a lot of similarities between the approach that we have and the approach that former Chairman Camp had. We think that the rates we have put in in our international proposals make good sense.

We have two rates. One would be a permanent rate of 19 percent and the other would be what we call a toll charge for earnings that have built up over years, and that would be 14 percent. In each case, there would be a credit for taxes paid overseas, calculated in an appropriate way. And we think that it would create a tax burden that would be very reasonable and would make it attractive for businesses to bring their taxes home.

Senator HELLER. How were those rates decided?

Secretary LEW. Excuse me?

Senator HELLER. How were the rates decided?

Secretary LEW. Well, the 14-percent rate is half of our—we have proposed a 28-percent rate, and we set the toll charge at half of it, 14 percent. I do not want to overstate the scientific nature of it.

Congressman Camp, when he put his proposal in, had a rate of 8.5 percent. There are rationales for a number of different levels.

The 19-percent number was in the zone of where we think it should be, and it was at a level that was revenue-neutral in our proposal.

So I think that, if you look at the structure of our proposal and the structure of the Camp proposal, it shows that there is a lot of room to work together. And the important thing about the toll charge, with your interest in infrastructure, is that we use it to pay for a 6-year reauthorization with a higher level for our surface transportation program. We think that would be enormously important.

If that toll charge were used for anything other than a one-time expenditure, for example, if it was used to lower rates permanently, it would not be revenue-neutral over time. So we think that it is a perfect combination of things that are important to American business and the future of our economy.

Senator HELLER. One quick question, because my time is running out. Would the administration support voluntary repatriation to fund infrastructure?

Secretary LEW. The experience in 2004 with a one-time voluntary repatriation holiday was not very good. It turns out to be a bad incentive because, after a repatriation holiday, you start to build up overseas with businesses waiting for the next holiday.

Secondly, we did not see the reinvestment come from it. We think what we have proposed is the right way to do it, to have a

transition to a new system where, going forward, businesses will bring their earnings home and they will make their investments based on where they are most economical, not where the tax advantage is greatest.

Senator HELLER. Mr. Secretary, thank you. Thank you, Mr. Chairman.

Senator THUNE. Thank you, Senator Heller.

Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman. And thank you, Secretary Lew.

I want to applaud the good work you and the President and all your crew have done on the budget. I think its focus on the middle class is really excellent. I think in your efforts to find some common ground and yet stay true to your principles, you thread the needle extremely well. I was very impressed with the budget, and I thank you for your hard work on that budget.

Obviously, one of the things you are all focused on, we are all focused on, is infrastructure. One of the ways you talk about paying for it is the one-time 14-percent tax on previously untaxed foreign income that comes back. I am very interested in that idea, with some variation of it. I think it makes a great deal of sense. It is something I have been talking about for a while, and I think you have refined it in a much better way than just about anybody has.

But here is my question. Do you believe it is feasible to consider the toll charge deemed repatriation by itself or in coordination with other international tax reform, even if we cannot reach an agreement on a broader reform package? It is my view, probably different than some here, that it is going to be really hard to get to real reform, particularly getting the rate below 28 percent, which may not make too many people happy.

But the idea of some kind of deemed repatriation for a broad infrastructure proposal, I think can get broad support on both sides of the aisle. So tell me what your thinking is on this.

Secretary LEW. Senator Schumer, I would say that the best way to do it would be through broad business tax reform, because, if we do not do something about our high statutory rate, which is the highest in the developed world, if we do not eliminate the incentive for companies to move overseas, if we do not close the loophole for inversions, we are going to see a lot of the problems that we still have. That cannot all be fixed just with the international provisions.

It is always hard to do broad tax reform. It was hard in 1986. It is going to be hard now because there are interests that very much value the deductions and credits that they have right now.

Theoretically, could you separate out the international piece? You could——

Senator SCHUMER. I know that is not your preference.

Secretary LEW [continuing]. But it would not solve the whole problem.

Senator SCHUMER. I understand. Although, by the way, I have to say on inversions—and you guys do not get enough credit or take enough credit—the reforms that you have made internally have stopped most inversions in their tracks, and the financial people in

New York I talk to say, in most cases, it is not worth it anymore. So you have done an excellent job on that.

Secretary LEW. Thank you. We went—I am sorry.

Senator SCHUMER. I am sorry. We only have a short time, and I want to go to a less happy topic, at least one between you and me, which is the trade bill and currency manipulation.

Look, overall on trade, my views have shifted some. I think the decline of middle-class incomes is the greatest problem America faces, bar none. We will have a different country if it keeps going for another 10 years.

Obviously, it will be disputed by members on both sides, but if these trade agreements—even though they might increase GDP and even though they might increase corporate profits—serve to decrease middle-class wages—because a company makes money whether it makes the product here or in China, so they will make profits, and you might even get some GDP gain for a lot of reasons—I cannot support trade agreements like that anymore. I just cannot because of my value system, when middle-class decline in income has become so great.

So I am looking—and I have talked to you about this, I have talked to the President about this—for something where we can counterbalance many of the things that you want to do in TPP, many of which are good. And the geopolitical stuff is indisputable that you want to do, and currency is the most logical one because it has broad support. A currency bill that I authored, along with Senator Brown, Senator Stabenow, Senator Graham, Senator Collins, and Senator Sessions, got 60 votes a while ago.

And so what I am asking you is—now, we have heard some talk from the administration that currency is not going to be part of TPP, whether against Japan, which is part of TPP, or more important to me—although Japan is important to me—China, which takes more jobs away, does not play fair, steals our intellectual property.

When America has a good product, 80 percent of the time or so, they do not let it in, and we just shrug our shoulders. And it is estimated that millions of jobs have gone away.

So my question is, because I know my time is running out, will you, will the administration, support some kind of rigorous controls on currency manipulation aimed at China alongside this bill, if not in the bill, and in the bill aimed at Japan?

I have heard that we have said that currency should not be part of TPP, and that would be, I think, a really wrong move. Tell us about currency and its relationship, in your view, to TPP and TPA. When I say TPP, I mean both.

Secretary LEW. Senator, may I respond?

Senator SCHUMER. Yes. You get the last word. My time is up.

Secretary LEW. I was asking the chairman if I could take a couple of minutes.

Senator Schumer, let me start by strongly agreeing with you that if countries do things to intervene in a way that is designed to gain unfair advantage in trade, it is wrong and we oppose it. We do not just oppose it, we take very strong action in international bodies: in the G–7, in the G–20, in the IMF, and, most importantly, bilaterally.

I can tell you that when I meet bilaterally with countries where there is any question, it is the number-one topic that we raise. And when we push back, there is a response where we have, I think, been quite successful in the time that we have been here pushing back on even the hints of interventions that have those characteristics.

I think the challenge in the context of a trade agreement is how to address the issue in a way that helps and does not hurt. I would be concerned that the effectiveness we have dealing through the existing channels could be diminished in some ways if some approaches were taken.

I think that we need to make sure that we use every tool that we have to make sure that countries do not take the steps to intervene in ways that are unfair. And I think if you look at recent years, we have been quite successful.

I mean, the G–7 agreement——

Senator SCHUMER. That is where we disagree.

Secretary LEW. Well, I think if you—there certainly are historical problems if we go back, but I am talking about the immediate present. Two years ago, there was an agreement at the G–7 that we drove forward, which is that countries can only use domestic tools for domestic purposes.

We had quantitative easing (QE) policies in the United States. The United Kingdom had QE policies. QE policies have been critical to getting economies moving after the Great Recession.

I do not think any of us think that those kinds of policies should in any way be equated with unfair intervention. We have not seen the kinds of intervention that I think you are describing as much in recent times, and we have actually made progress pushing back on it.

With that said, we want to work together as we go through the discussions on trade legislation to see if there is a way for us to build a bridge between the tools that we have and the trade discussion, and I would look forward to having that conversation.

Senator SCHUMER. I would just say one sentence. We have not been very successful against China. I totally disagree with you. We need much more.

Secretary LEW. Can I just say one thing, Senator, in response on China? I mean, since 2010, we have actually seen an appreciation in China's currency that bounces around day to day, but is roughly at 10 percent. We have pushed hard to have China stop intervening in ways that they had been. They have agreed to limit their interventions to macroeconomic circumstances.

We have pushed hard for transparency policies. They have agreed to subscribe to the IMF's transparency policies.

I am not going to say that there have not historically been issues. Our currency report makes it clear. But we have actually made progress working through these issues.

Senator THUNE. All right. You guys can carry on this conversation outside the room.

Senator Stabenow?

Senator STABENOW. Thank you. To continue this conversation—welcome, Secretary Lew. And I do want to say, not to debate it but just for the record, before talking about another issue, that I appre-

ciate your efforts to address currency manipulation in international forums like IMF and the G–20, but these actions have not kept pace with increasing adverse impacts of currency manipulation and the impacts on U.S. businesses and workers, and we are seeing this.

Economists across the political spectrum—the Economic Policy Institute, the Peterson Institute, former advisor to President Reagan Arthur Laffer—all agree that currency manipulation has cost the United States millions of jobs.

And specifically on TPA and TPP, you know what is coming before us: Japan with the most closed auto market in the world and the importance to the middle-class economy in America of the auto industry—and I appreciate very much this administration standing with us in the auto industry.

But as you know, the top financial executive at one of our U.S. automakers, Ford Motor Company, said recently that a weak yen gives Japanese competitors as much as $11,000 more profit per car per year. So $11,000 per car is a big deal in a very sensitive marketplace.

I want to actually talk about something else. I know your concerns about this. I disagree that quantitative easing in domestic policy is the same as intervening in foreign currency. We will debate that more later, but this is a big deal. And with 60 of us in the Senate, in that bipartisan letter Senator Graham and I led, saying we want currency addressed in any trade agreement, I hope you understand that we are very serious about this.

Secretary LEW. Senator, as we have discussed, we would look forward to working together to see if there is language that we can work through that would address the concern in a way that is consistent with our legal obligations and policy.

But if I could just say one word about Japan. For 15 years, we had the view that it was bad for the U.S. economy and the global economy for Japan to be in an economic rut. They initiated monetary policies that were similar to those that our Fed put in place and they initiated fiscal policies, and they, for the first time, gave the Japanese economy a bit of a boost, which was good for the global economy and good for the U.S. economy.

They are not growing as fast as they should be. They need to use all the tools. They need to use fiscal policy tools. They need structural reforms. But I think if you look at the monetary policy that they have put in effect, it does not meet the criteria of unfair practices in these last few years.

That is different from what might have happened in the 1970s. I am not going to say that there was not bad behavior in the past. But I think that we just have to be careful not to define a standard that would lead to a set of rules that would make it impossible for monetary authorities to get economies out of recession.

Senator STABENOW. And I appreciate that. But let me just say that, since they agreed through the IMF that they were not going to do this, they have done it like 300 times, something like that; I have seen the number. And all I will say is, we are an open market. Japanese companies benefit by everything, including what we have done in our monetary policy and quantitative easing, and yet they have the most closed market.

We cannot get into it. We cannot sell at an auto dealership in Japan. You cannot see an American-made vehicle. So this is a big deal. This is a big deal.

Secretary LEW. We totally agree that barriers need to come down.

Senator STABENOW. I want to change the subject for just one second to something that we agree more on, and just simply ask you to respond again to the big structure in terms of how we move forward in the economy, because I think we ought to talk about what works, and not just in theory.

So when you look at the Clinton years, we actually raised the top two rates on Americans, asking them to pay a little bit more to help balance the budget, created 22 million jobs, and actually saw a robust economy, asking folks at the top to do a little bit more.

The Bush years, which everybody seems to want to go back to, President Bush's years only helped those at the top, left everybody else waiting and holding their breath—will it trickle down? You wage 2 wars, do not pay for them, have a reckless speculation going on on Wall Street, do not regulate it. We saw what happened: the Great Recession.

Now, we are back. Again, in 2012, we asked those at the top to do a little bit more. Our friends said the world would end. It did not end. Not only that, we have reduced the annual deficit by two-thirds and added 11 million jobs.

So I wonder if you might just very briefly speak to the macroeconomics of actually putting money in people's pockets, paying down the debt the right way, and growing the economy through a strong middle class.

Secretary LEW. Well, Senator, I think we had an experiment. We saw what the tax rates and policies of the 1990s did, and we had the longest period of uninterrupted growth in history. And we saw what happened in 2001–2004, where we had policies that cut taxes, particularly at the top and, as you say, had wars and other things that we did not pay for, and we ended up with a financial crisis on top of that, producing the biggest deficits that we have had in history and the economic hole that we have been digging ourselves out of.

So I think we have actually had a test of the two theories, which is why I am confident that the tax proposals that we put forward are good for the economy.

Senator STABENOW. Thank you. Thank you, Mr. Chairman.

Senator COATS [presiding]. I have only been on the committee 3 weeks, and I have been sitting out there in the left field bleachers with my friend from Nevada, and I noticed Senator Warner in the right field bleachers had other things to do, and all of a sudden I am here at home plate with a gavel in my hand. Ron Wyden leans over and says, "I have been working 10 years to get to this spot. You have been here for 3 weeks." And now I am in control.

I feel like recognizing myself for a long speech, but they would never ask me back if I did that. [Laughter.]

Senator Cantwell, you are up.

Senator CANTWELL. Thank you, Mr. Chairman. [Laughter.]

Mr. Secretary, thank you for your comments this morning and your focus on the economic strategy moving forward, and for your emphasis on exports.

My views are a little different than some that have been expressed by my colleagues, but we have a more integrated trade-dependent economy in the Pacific Northwest.

So I want to get your views on a couple of things that I believe are critical for this opportunity. Given that 95 percent of consumers live outside of the United States and that the doubling of the middle class around the globe in the next 15 years is a great economic opportunity for the U.S., what are the policies that we need to pursue to take advantage of that?

So things on our agenda—I mean, I almost feel like our economic agenda should just have the word "export" on it—include freight mobility, improving our freight infrastructure so we can get product to market quicker, the State export assistance program, which is a key tool for small businesses to become exporters.

But one of the stumbling blocks we are facing right now is the reauthorization of the Export-Import Bank. And if you could talk a little bit about what you think the importance of that structure is in this context, how important it is for the U.S. to not only have financing tools, but also the fact that if you actually have an export credit agency, then you can participate in a world dialogue of credit agencies around the globe for policies that are fair and transparent. If we do not have that, we also will not be participating in this international discussion.

Secretary LEW. Senator Cantwell, I think you are totally right that exports are key to our economic future, and that is why we are pursuing Trade Promotion Authority. It is why we are negotiating the TPP.

We are looking at where the markets are growing, and we want American companies to have access to those markets. That will be a way to create good middle-class jobs in the United States. That is the only reason that we are focused so much on this trade issue.

The Export-Import Bank is a critical component of our export strategy. In a world where nobody had export subsidies, one could have a conversation about whether or not we should have one. But in a world where our competitors have export programs and we might not, that is putting a burden on our exporters that is just not fair.

In Washington State, I know aircraft are a big issue. If you are selling aircraft against companies that have export financing because of programs like the Export-Import Bank and we do not, that is something that you cannot make up for just by running a tighter operation.

Now, we have discussions going on on an international basis to see whether we can, on a global basis, lower the export subsidy programs. In that kind of an environment, it would be a different question. But we cannot unilaterally put our companies in a position where exporters from other countries have export support and they do not. So I think the reauthorization of the Export-Import Bank is critical.

Senator CANTWELL. And what would the administration like to see as Congress—we are moving towards a period, I think it is May 31st or something, to get that——

Secretary LEW. We have for a long time advocated a reauthorization that would provide longer-term certainty around the program. And I think the sooner it is enacted the better, because uncertainty is not a good thing.

Senator CANTWELL. Thank you. Thank you, Mr. Chairman.

Senator COATS. Thank you, Senator.

Senator Menendez arrived just in the nick of time to secure the next spot.

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Secretary, I want to raise an issue with you that has huge bipartisan support in the Senate and also the support of the administration, which is reforming the Foreign Investment in Real Property Tax Act so that foreign pension funds can put much-needed capital into the U.S. commercial real estate market.

We have talked about this before and how bringing this needed equity to the U.S. can create jobs right here at home. As you know, the current tax on real estate investment trust shares owned by foreign pension funds was due to an administrative action, not a legislative one. And indeed, up until Treasury issued a notice in 2007, foreign pension funds investing in REITs were treated equally with their domestic counterparts. So it seems to me that since Treasury made this change in the first place, it could also undo this policy and eliminate a barrier to private infrastructure investment.

I am pleased to see that, once again, the President agrees with me on the need for FIRPTA reform, as illustrated in his budget. So since we all agree that this is a bad policy and Treasury clearly has the authority to reverse this ruling, I hope that you would look at taking some sort of action on FIRPTA.

So my question is, one, does it make any sense to create obstacles for foreign investment in the U.S., particularly considering our dire need for infrastructure investments, and will you commit to working with me and the bipartisan group of members of this committee and beyond who support this effort?

Secretary LEW. Senator, we have discussed this before, and, as you acknowledge, we agree that this should be fixed. We believe it needs to be fixed through legislation.

I actually hope that in the discussions we are having about business tax reform, it provides an opportunity for us to do this in a bipartisan way. And we have obviously put forward a legislative proposal again, and I would look forward to working with you on it.

Senator MENENDEZ. So you are not going to deal with it administratively, obviously. But you do support—the administration supports—FIRPTA reform?

Secretary LEW. We have a legislative proposal. Yes.

Senator MENENDEZ. Let me ask you, in the same light, one of the main themes in the President's budget is the need for extensive investments in roads, bridges, and other critical infrastructure.

One of the most effective ways to help local municipalities—and I say this as a former Mayor—make these critical investments is

the private activity bond program. Unfortunately, the caps on water and wastewater infrastructure projects make it extremely difficult for local communities to take advantage of the program for these critical needs, and that is because, for example, water projects are often multiyear ventures, making them complex and difficult to fit under the annual caps.

Now, I have legislation I plan to reintroduce that actually passed through this committee that would remove the caps for water and wastewater infrastructure projects, and I am pleased to see the President, in his budget, included positive reforms in this regard.

Would removing the caps help local communities upgrade their antiquated infrastructure?

Secretary LEW. Senator, we did put the new proposal in our budget to try to accomplish the same goal. Obviously, raising the caps would provide more room for local authorities. We think that what we have proposed really has a very similar theory behind it, and we would look forward to working together to get something enacted into law to enable local projects to go forward more easily.

Senator MENENDEZ. And finally, we have record job growth, and the administration has done, I think, economically a great job: lowest unemployment in some long period of time, private-sector job growth for a long period of time, deficit as a percent of the GDP probably the lowest in 50 years, and a whole host of positive economic factors. But we still have a stagnant middle class, which you referred to in your opening statement.

The long-term unemployment rate is still, however, far too high, leaving millions of Americans out of the recovery. They are stuck on the sideline. And while they do that, their skills and networks become out of date, which hurts them in trying to get back into the economy.

I have introduced legislation, called the Better Education and Skills Training for America's Workforce, that would provide a robust tax credit for businesses that pay for training for long-term unemployed workers and would create a competitive pool of tax credits for business clusters who come together to set up training programs at community colleges—and I see the President's initiative on community colleges.

Do you believe that designing a job training program focused on providing the long-term unemployed with skills in demand would help reduce the disproportionately high rate of long-term unemployed people in our country?

Secretary LEW. Senator, we have, through the policies we have put in the budget, I think embraced very strongly the idea that we need to make sure training is available to help people get into or get back into the workforce.

That is where our community college proposal comes in. It is where other training proposals come in. There are multiple ways one could accomplish it. We put in our budget the ways that we think would be most effective, but we would look forward to working together.

Senator MENENDEZ. I will close by saying that we would like to work with you. I understand and support the President's broader initiative. But how we deal with and focus on the long-term unemployed is a critical element.

Secretary LEW. I totally agree. And if you look at the kind of potential GDP in the medium term, getting people back into the labor force is not just something that is right for the individual, but it is a way to make sure our economy is growing more.

Senator MENENDEZ. Well, I am thrilled to find at least three places where we can largely agree.

The CHAIRMAN. Senator Carper?

Senator CARPER. Thanks, Mr. Chairman.

Welcome. It is good to see you. I just want to start off by thanking you and the administration for working so hard with us last year to try to find common ground on expatriate health insurance. If we can work that out, we can probably work out some of these issues as well.

You mentioned when you started off, Mr. Secretary, the strength of the economic recovery. I will acknowledge it is not everything we would like, but for us, it is encouraging, even today. Today we received from the Department of Labor the latest unemployment filings. The numbers are averaging right around 280,000. The week that President Obama and Vice President Biden were inaugurated, that number was 628,000 people filing for unemployment insurance, and right now we are running around 280,000. What that is going to do is, as we know, it is going to tighten up the labor market and hopefully is going to have a positive effect on wages for a lot of people who have not had much of an increase in wages for a while.

One of the things that I sought to do, coming out of the election, was to figure out what are some areas that we can agree on, and a number of those were touched on in your testimony and in the President's State of the Union address. Although we on this committee are not 100-percent in agreement, my hope is that we can move forward on trade, including TPA. My hope is that we can move forward on cyber-security to better protect our intellectual seed corn and a lot of R&D work that is being done by companies, by colleges.

And comprehensive tax reform—I would like very much to do that. You mentioned the need to do that. It is a tough nut to crack, but it is still important. Immigration reform—we need to take up immigration reform. It reduces the deficit. It raises, I think, the GDP very substantially over the next 5 to 10 years. We ought to just do that. Workforce—I like the President's proposals with respect to community colleges and trying to encourage folks to continue their education coming out of high school.

The last one I want to mention is transportation. Several of my colleagues have mentioned it. Senator Heller mentioned it. And we have jurisdiction over that. Environment and Public Works, as you know, is the authorizing committee, and we are the committee that has to figure out how to pay for these improvements. But we very much need to make them.

I am intrigued by what the President has proposed, what the administration has proposed, and I am not an advocate of repatriating money. If we simply repatriate—lower the rates and repatriate money every 10 years—companies will continuously leave money parked overseas until we lower the rate again and give them a free pass. I do not think that is a very good idea.

I think the administration's idea is intriguing. I think it will be difficult to achieve. But I am interested in exploring it with you and my colleagues.

Over the last 6 months, I think I have talked with just about everybody on this committee, a lot of Republicans in the Senate and in the House, Democrats in the Senate and in the House. This is what I say: "What do you think we should do for transportation funding?" And I have gotten a number of interesting ideas that I have gathered, and I just want to mention them today.

One of those is a user fee, 3 or 4 cents a year, 4 years indexing. It is essentially Bowles-Simpson and basically is a barebones approach that gives us about $100 billion, which is the minimum of what we need—$16 billion a year, $100 billion over 6 years.

In talking to my Republican colleagues, a number of them say, why do we not open some additional areas for oil or gas exploration, and some of the revenues that could flow from that could go into a transportation trust fund? Well, as it turns out, the President has proposed that the areas off of Virginia, North Carolina, South Carolina, and Georgia be opened for exploration, and that could actually marry an administration idea with some ideas I have heard from our Republican colleagues.

I have heard from a number of our Republican colleagues—and Democrats too—why can we not figure out how to do transportation projects less expensively? What are some ways we can get a better result for less money? As it turns out, USDOT last year entered legislation that outlined a number of ways. They have some new ideas to share with us this year. So that might be something the administration and Democrats and Republicans could agree on.

Those are just some of the ideas that I have heard. I like to talk about energy policy. We like to talk about energy policies, an all-of-the-above approach, and I think there might be sort of an all-of-the-above, more comprehensive approach on transportation funding that I had a year or so ago.

Your reaction, please. Thank you.

Secretary LEW. Senator Carper, we obviously very strongly share the sense of urgency to get a long-term surface transportation bill enacted. There is no way to effectively plan infrastructure going 6 months at a time or even a year at a time. You need to have the time to plan complicated projects.

We put in our budget a proposal that I think has the basis for bipartisan support. We genuinely want to pursue it, and we think it is the best approach. If that were to turn out not to be the approach that could muster bipartisan support, we would work together to look at other creative options.

But I actually think that there is a reason to be optimistic that we can get the President's proposal or a form of it enacted into law. It draws on principles that are shared on both sides. It is in the best interest of the country, it is good for the economy, and it will create good middle-class jobs.

So we are going to roll up our sleeves and try to get it done.

Senator CARPER. Thanks so much.

Mr. Chairman, I would just say to you and to our ranking member, States are beginning to shut down construction projects in the

spring and in the summer because of the lack of certainty and predictability. I think the President's idea has merit.

I think it is going to be hard to do. Sort of the question for us is, if we are not able to do that for a while, what are we going to do in the meantime? And the answer cannot be "nothing."

Thanks so much. Thanks, Mr. Chairman.

The CHAIRMAN. Let us go to Senator Cardin.

Senator CARDIN. Thank you, Mr. Chairman.

Secretary Lew, thank you for your service. I very much appreciate your longstanding commitment to public service and the effective job you are doing as Secretary of the Treasury.

I first want to talk about an area that I talked to you once before about, and that is our community banks. We are still seeing community banks in Maryland being challenged to be able to survive, not because of their viability individually, but because of the new regulations, et cetera.

They were not the speculators that brought about the financial collapse, and they are trying to figure out a way to remain relevant in today's banking world. One area where we could help is, since the TARP period, the preferred stock of community banks is held by Treasury, and they want to buy back that preferred stock, but there are certain obstacles in the way.

I would just ask that you get that on your radar screen to see whether we cannot facilitate the viability of community banks through considerations at Treasury to make it easier for them to recoup their preferred stock.

Secretary LEW. Senator Cardin, we share the view that community banks play a critical role in local economies in creating an engine for small business growth and local economic activity.

We have, in the TARP program, worked with community banks. We will continue to. We obviously have certain constraints in the TARP program in terms of how we can dispose of assets, but I am happy to look into it again.

Senator CARDIN. I appreciate it very much. I was very interested in your exchange with Senator Wyden in regard to the U.S. harmonizing with the international community on tax rates and the fact that we have high corporate tax rates.

I also was interested in the exchange on simplification where Senator Wyden wants to get the code much more simplified, and I agree. So I would just at least put in a plug that you take a look at the progressive consumption tax that I filed. Taxpayers, joint taxpayers under $100,000, would not have to file any income tax, and we would have the lowest marginal tax rates in the industrial world, both on income and consumption.

If we are going to harmonize, then let us take a look at where the rest of the OECD countries are receiving their revenues if we want to be competitive. I just urge you to take a look at it, because I think it would answer some of your questions.

I want to get your comment in regard to the administration's position on doing business tax reform. Along with Senator Thune, I will co-chair a working group that will be looking at the business tax issues, and we have concerns as to how small business is treated. If you deal just with corporate tax rates, then those who have pass-through entities or use S corporations would be at a competi-

tive disadvantage if that is all we do, because of the high individual rates.

So I would ask, how can you really just do corporate tax reform and be fair to small businesses in our country?

Secretary LEW. Senator Cardin, we have always talked about business tax reform, not corporate tax reform, because we think it is important that when we do business tax reform, we look at small businesses as well as the corporate side.

We have in our proposal, for example, an expansion of the section 179 provision that allows for the taking of depreciation, so that, if you spend $1 million a year as a small business, you can take a full deduction in the year you make an investment. You do not have to do it over time.

We have done an enormous number of simplifications to make it easier for small businesses. I think that we have designed provisions that are going to help small businesses. We are open to ideas. If there are ideas that come out of the conversations you and Senator Thune have, we would look forward to working with you.

I would just point out that, one of the reasons businesses choose to file as individual businesses as opposed to corporations is that it is better for them to do. If it becomes advantageous, they can also switch back.

Senator CARDIN. But it changes the current competitive situation, and small businesses are already challenged today. I understand they can make that choice back and forth.

I want to get one last point in, if I might, and that is on retirement and savings. Once again, a progressive consumption tax would help reward savings and retirement. But one of the things that I have learned, working with Senator Portman when we were both in the House, is that the tax incentives alone are not enough for working middle-income families, and that is why the Saver's Credit is important; that is why employer-sponsored plans, when they put money on the table, are important.

I would just urge, as you look at your proposals for retirement securities, that we do not have the unintended consequence of adversely affecting employer-sponsored plans, where they have money on the table, where we would only be using the tax deferral as an incentive, because I do not think that is enough.

Secretary LEW. We agree, and we actually have a proposal in our budget to make it more advantageous for firms to contribute, for small businesses especially to make a contribution into an employee's retirement plan, and we look forward to working with you on that.

Senator CARDIN. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Brown?

Senator BROWN. Thank you, Mr. Chairman.

Mr. Secretary, welcome. It is good to see you again. Just first a short statement. I know that Senator Schumer and Senator Stabenow asked you about currency. I want to echo their remarks.

I also want to remind you and Ambassador Froman that there is strong, strong support in the Senate for real currency provisions, both in TPA and TPP, better and stronger than negotiating objectives—real enforceable currency standards.

I do not need you to comment on it now. I have heard your comments before. But I am hopeful that, as we move forward on that, we can bring you in our direction a little bit more.

I want to walk through the country-by-country global minimum tax that you and the President have proposed—just a series of questions, because I think that it is often difficult to sort of process this.

The global minimum tax you are proposing is 19 percent, correct?

Secretary LEW. That is correct, Senator.

Senator BROWN. So if corporations—again, corporations get a credit that is 85 percent of the effective tax rate that they have paid for the last 5 years in every country where they do business, correct?

Secretary LEW. That is correct as well.

Senator BROWN. So that means if a corporation shifts its profits to Bermuda, where the corporate tax rate is zero, that they would now owe 19 percent to our government on those profits, correct?

Secretary LEW. Correct.

Senator BROWN. But if the same corporation booked profits in South Korea, where the tax rate is slightly over 24 percent, or in India, where it is higher, or Germany, where it is in the high 20s, the corporation would potentially not owe a single dollar more in U.S. taxes, correct?

Secretary LEW. That is also correct.

Senator BROWN. So this is a proposal that fundamentally shuts down tax havens, as we have discussed before, and prevents a global race to the bottom. What is your opinion on that?

Secretary LEW. I think that is a very accurate description, and when we are in international meetings, there is huge discussion of what is called base erosion and profit shifting, and there are two halves to that problem.

One problem is the tax havens that have a race to the bottom. The other half is broken tax codes like ours that have these ridiculously high statutory rates.

We put in a proposal that we think does what we need to do to solve the problem that pushes companies to tax havens, and we are going to be vigorous in the international setting to push against the tax haven race-to-the-bottom rates. I think we have an enormously better argument if we have done our part.

Senator BROWN. So, to what do you ascribe the opposition to your proposal in Congress, among some in the business community here, not nearly all, but to what do you ascribe that?

Secretary LEW. Look, I think that there will always be an argument for a lower rate if there is the possibility of getting a lower rate. So it is not surprising that we are hearing an argument that it should be lower than 19 percent or lower than 14. We have not heard arguments that undermine the basic integrity of the approach, and I actually do not think that we have heard arguments that suggest that there is not the basis for a bipartisan discussion to work through this.

We do not think that the numbers that we have picked have kind of an absolute truth to them. We could have gone a little higher; we could have gone a little bit lower. This is the kind of thing that

we ought to be able to work out, and it would fix a broken tax system and keep American jobs here.

Senator BROWN. Let us speak of something that we can work out—thank you for that—and that we have worked out bipartisanly for decades, and that is the Social Security Disability Insurance.

The President's budget supports a routine accounting measure called reallocation. We have had hearings on this. We had hearings last year when Senator Wyden was the chair and Senator Hatch was ranking member. We have had discussions with pretty much everybody on this committee on the issue of reallocation.

It does not cost taxpayers money. It has been done 11 times before bipartisanly. Walk us through what you suggest, what the administration suggests, on reallocation and tell us, one, what will happen if we refuse to do it, and, two, why we should do it.

Secretary LEW. Senator, we have a two-part proposal. One is, we do have proposals that would do things like continuing disability reviews and incentives to get people back to work, and pilot programs to help people get back to work from disability.

But I do not think there are any experts who believe that any approaches that you could design would fix the Disability shortfall in the short-term. We saw a huge increase in the disability rate during the economic crisis, for a variety of reasons.

The only short-term solution is a reallocation of the rates. I have been doing this long enough that I remember when we had to reallocate from Disability to the Old-Age and Survivors Trust Fund in order to get to the 1983 reforms.

So it is many times that there have been reallocations, and they have gone in both directions. I think we do need to work together on kind of a longer-term solution, but I do not see any alternative but to have there be a reallocation to deal with the upcoming challenge.

Senator BROWN. My recollection is, we have known for some time, actuarially, about a fairly accurate prediction, right, of when this would happen?

Secretary LEW. Yes.

Senator BROWN. We have known this for some time.

Secretary LEW. The exact month shifts as you do updated projections, but we have known it was in the zone of the next year for some time.

Senator BROWN. Thank you. Mr. Chairman, thank you.

The CHAIRMAN. Thank you, Senator.

Senator Bennet?

Senator BENNET. Thank you, Mr. Chairman. Thank you for holding the hearing.

Mr. Secretary, thank you for being here. Just when things could not possibly get worse, the Congress distinguished itself at the end of the last Congress by passing a tax extenders bill that, among other things, included an extension of the wind production tax credit for 2½ weeks.

In that context and understanding that context, in your answer to Senator Brown, you, the Secretary of the Treasury of the United States of America, described our tax code as broken and ridiculous. And there is not any thinking person on this committee who does not agree with that characterization of the tax code.

And you have been around here for a long time and I think have acquired a lot of wisdom over that period of time, and I think the people of Colorado would like to know what are the conditions that are required to actually fix this tax code, to reform the tax code. What do we have to do to put this committee in the position to actually do the people's business, to not do this insanely minor and ridiculous legislating, but actually get to a place where we can fix this code and allow the private sector to compete in this global economy?

Secretary LEW. Senator, I could not agree more that short-term extenders are a terrible way to do business. For a company that, at the beginning of 2014, wanted to know what their tax status would be, waiting until the last week of the year does not help you plan your business.

So it is all retroactive for decisions that were made when people did not know what the tax code would be. So it could not possibly have the incentive effect that it would have if it was a permanent tax law.

We have proposed dealing with the extenders in the context of tax reform so that we pick the ones that should be made permanent and make them permanent, pay for them in the context of tax reform, and have a tax code that has stability and certainty to it.

I think the answer of what we have to do—we learned in 1986 what the answer on tax reform is. We have to work together, and we know there are going to be interests that oppose losing whatever special privilege they have, but on a bipartisan basis, we have to say it is worth broadening the base, closing loopholes, lowering the rate, having an international system that makes us competitive, and, if we do it together, we can get it done.

I am more optimistic than many because it just makes such profound sense to do it, and I also think that if we do not do it, it is going to lead to an economy where we see more companies doing things we do not like, and that is not a good outcome.

Senator BENNET. I want to thank the chairman for putting us in these working groups, because I think that at least presents a bipartisan start for our efforts.

I remember a principal of a charter school in my school district. I once asked him—you could hear a pin drop in this place—and I said, "How do you create these conditions where you can actually get this done?" And he said, "I visualize the conflict in advance and then, when it comes, I know it is going to be there, and we can get through it." And I think that is what we need to do on this issue.

It is not going to be easy to do, but we can do it.

Secretary LEW. And, Senator, I have offered to both the chairman and to Senator Wyden that we look forward to working with the bipartisan working groups to help, technically and with our ideas, and we look forward to working with you.

Senator BENNET. I think there are a number of us on both sides of the aisle, my colleagues here today, who feel the same way.

I wanted to ask you an education question—actually, two. The GAO found that in 2009, 1.5 million students failed to take a credit or a deduction for which they were eligible, and another study found that one in four taxpayers failed to take the maximum education tax benefit when they were eligible for multiple credits.

So I was really pleased to see that the budget simplifies our system of education tax expenditures and makes the American Opportunity Tax Credit more refundable.

I wonder whether you could discuss some of the limitations of the current patchwork of credits and deductions in more detail, and also describe how simplification and better targeting might actually increase overall college affordability.

Secretary LEW. Senator, we share the concern that the current patchwork of benefits—tax benefits and grants—makes it very difficult for a family to take full advantage of everything that is available to them. One of the reasons that we put together this approach was to simplify it, to make it so that families would understand what it is that they have available and to take it into account.

We have consolidated the education tax credits into an expanded AOTC. We have simplified taxes for Pell Grant recipients. We have improved reporting of tuition and related expenses for scholarships. Part of this is that, if the reporting is more straightforward, it will be easier.

We have repealed the student loan interest deduction for new students but allowed debt forgiveness to be excluded from income, and we have reduced the tax benefits of education savings accounts that—well, we have actually said we are not going to do that, so I take that back.

Senator BENNET. I am out of time, Mr. Chairman. But I also want to call your attention, Mr. Secretary, to a bill that Senator Alexander and I have that would reduce the questions on the financial aid form, the FAFSA* form, from 108 questions to 2 questions. I think that would align with the work that you are trying to do, and I hope you are paying some attention to that.

The CHAIRMAN. Thank you, Senator.

Senator BENNET. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Scott?

There is a vote that just started. Senator Wyden is headed over so he can come back to continue. We would like to finish it so you do not have to sit around, Mr. Secretary.

Senator SCOTT. Thank you, Mr. Chairman. I promise not to take more than 30 minutes. I appreciate it. [Laughter.]

The CHAIRMAN. You are the only one who could get away with that I think right here right now.

Senator SCOTT. And I am smart enough not to try.

The CHAIRMAN. You sure are.

Senator SCOTT. Secretary Lew, I will say this. You have done something that I am very surprised at, and it almost bewilders me. You have actually answered questions, which is a remarkable experience for a new Senator from a witness. So, thank you very much. I have not liked your answers consistently, but at least you have provided true and clear direction for this committee, and I really appreciate that.

I want to go back to a question that you heard from Senator Thune and Senator Heller related to the inheritance tax. I started a small business a number of years ago and grew that business

*Free Application for Federal Student Aid.

from zero accounts, no cash, to being worth some real money, from my perspective.

And let us say that business ended up being worth $2 million. So I know there is a $1-million threshold where, if you are a small business owner, you do not pay taxes or inheritance on that. So I pass that business on to my nonexistent child. They get that business, a $2-million value. What is the tax that is owed?

Secretary LEW. Senator, we do have the $1-million exemption.

Senator SCOTT. So the first $1 million is gone.

Secretary LEW. I am sorry. Are you asking about the estate tax or stepped-up basis?

Senator SCOTT. Stepped-up basis.

Secretary LEW. So for stepped-up basis, we have a $1-million exemption.

Senator SCOTT. Yes.

Secretary LEW. And then we also have——

Senator SCOTT. The 15 years.

Secretary LEW [continuing]. A 15-year payment period.

Senator SCOTT. Yes.

Secretary LEW. And it would be taxed at the rate of the individual's income. So, if they were not earning a lot, they would pay a very low rate. If they were earning more, they would pay a higher rate.

Senator SCOTT. So a couple hundred thousand dollars, likely.

Secretary LEW. Over 15 years, yes.

Senator SCOTT. Right. The real challenge is, anytime that you have a non-liquid asset that you are required to sell and/or leverage in order to get the resources to pay the government, you reduce the actual value of that asset. For small business owners, and specifically minority business owners, the way that you create wealth in this Nation is by being in a position to create a profit. Creating a profit only happens a couple ways through the market that we talked about: through business ownership and the real estate.

So, in the area of business ownership, when you are in the position to create that profit, you have to be able to pass it on generation to generation, hence the Fords and the Chevys and all these big businesses. Well, the proposal from the President actually impedes the ability for small and minority business owners to transfer wealth so you actually create wealth.

I would love to see you guys go back to the drawing board and be at least a little malleable in this area, because a $1-million threshold on a non-liquid asset really is worth about $600,000, in my experience.

Secretary LEW. Senator, we obviously, through the exemptions we put in, tried to be sensitive to the issue through the long period of payment. We tried to make it not be overly burdensome.

I think if you look not at the illiquid assets, but things like stocks and bonds, it is much harder to make the case, and most of the money that is involved in stepped-up basis is in those kinds of assets, because that is where substantial wealth is transferred from generation to generation.

Senator SCOTT. I am trying not to take the 30 minutes I promised not to take. I will tell you that perhaps there is a part of the narrative that is factual. There may be only 65 farms that are im-

pacted by this conversation, but there are hundreds and thousands of small and minority business owners who would be impacted severely and negatively by this conversation.

But let me ask you a separate question in a different direction. I think it is section 165 of the Dodd-Frank Act that really gives the Fed unlimited discretion to make sure that banks and financial institutions are not taking on too much risk. Yet the President, in his budget, includes a new tax or a fee on banking liability supposedly designed to curb excess of risk-taking. I believe that any new tax on banks ultimately finds its way to the consumer.

Mr. Secretary, does the request for this new bank tax or fee suggest that the President believes that the Dodd-Frank Act, a law that was passed entirely, it seems, on party lines, does not provide ample tools for reining in excessive risk?

Secretary LEW. Senator, we think that the Dodd-Frank Act is working very well and has very much reduced the risk in the system. We think the tax proposal we put forward is entirely consistent with the Dodd-Frank Act. It is designed to make it a bit more expensive for firms to be highly leveraged, and that is one of the factors that contributes to risk.

I think that if you look at our overall tax proposals, by reducing the corporate tax rate, that is going to also have a benefit for financial institutions and those other companies. I think, if you look on balance, we treat financial institutions quite fairly.

Senator SCOTT. I will tell you that the seven basis points that you increase it by may mitigate risk, but at the same time, it really passes on a greater burden to the consumer, which makes it even more difficult for small business owners to borrow money.

I am looking at, as my time is running out, the proposal on the corporate tax restructuring. I would note that a 28-percent rate would be a positive rate, and it would put us in a position to be globally competitive.

However, for us to get there, the 14-percent repatriation deemed rate is, you must know, a non-starter in a conversation about actually bringing home—I guess you do not even have to bring it home. You are going to get taxed on it whether you bring it home or not.

You must know that that has to be a non-starter on our side of the aisle. So it would be helpful to go back to the drawing board and have a conversation that actually has a realistic expectation and/or opportunity to make progress.

Secretary LEW. Senator, I would just say that the structure of it is similar to the proposal put forward by the former Republican Chairman of the House Ways and Means Committee. So we view it very much as being in the realm of an issue that we could have a good constructive, bipartisan conversation on.

Senator SCOTT. Conversation, yes——

The CHAIRMAN. Senator, thank you.

Senator SCOTT [continuing]. Progress, probably not. Thank you.

The CHAIRMAN. Senator Portman?

Senator PORTMAN. Thank you, Mr. Chairman. I appreciate the fact that tax reform gets so much notice here today, because I do think it is an opportunity in this budget for us to try to make progress. I think Senator Scott is right. I think it is one where we have differences in terms of what the deemed repatriation rate is

and, for that matter, the prospective international rate, which would be a minimum tax, but I do think the structure is consistent with what many of us have talked about on this side of the aisle.

Look, we need to do it. In Ohio, as you know, we just had another company choose to invert, meaning buy a small company overseas and move the domicile from Ohio to one of our global trading partners in developed countries. And this is happening all over the country. More importantly, I think a lot of companies that are U.S. companies cannot compete, U.S. workers cannot compete, so foreign companies are buying them.

There is a study coming out from Ernst and Young soon that says that over 9,000 U.S. companies have been acquired by foreign companies in the past 10 years alone. And finally, it is just tougher to compete. So, even if you are not taken over by a foreign company, you tend to have a difficult time expanding, and I have heard this testimony from all kinds of Ohio companies.

One small business came in recently and said they completed a deal, all the negotiations in Korea, to buy a subsidiary there, and a German company walked in and said, we will pay 19 percent more, because they can afford to—their after-tax profits are higher—and they lost the ability to expand.

So this is happening, and it is American workers who are taking the brunt of it. So I want to commend you for putting into the budget—I have big concerns about the budget, as you know. Both of us used to be in the budget job, and I do not think it takes on the challenge of our time, which is the mandatory side of the spending.

But with this particular provision, I think it gives us a chance to try to do something that will help American workers and, therefore, not just increase economic growth but actually create those middle-class jobs that we are always talking about, because these jobs are the very ones that are at stake right now, and that is who loses out if we do not lower the rate.

There is a great study done by the Congressional Budget Office that shows that. This is not about the boardroom. It is about the workers. So we need to work on this.

I guess the one question I would have for you today—just to be sure that we understand where we are on this notion of helping the highway trust fund, because this came up with a lot of the different members. There has been discussion of saying, why do we not just do a tax holiday, in other words, as we did 10 years ago and 20 years ago, tell folks, you can bring money back to this country at a lower rate and then, therefore, we will be able to fund the highway trust fund.

Have you looked at that issue, if we did not do tax reform but rather just did a tax holiday, what would be the impact on revenues?

Secretary LEW. Senator, we have looked at it with both the Joint Tax Committee and our estimators at the Office of Tax Policy and have determined that it costs money, it does not save money.

Senator PORTMAN. So it would not create additional revenue for the highway trust fund?

Secretary LEW. Not through conventional scoring. And I think as a structure, as we were discussing a little bit earlier, a one-time

tax holiday, a voluntary tax holiday, does not solve the structural problem. What it does is, it tells companies, keep all your earnings overseas until the next tax holiday. It does not regularize the tax treatment in any meaningful way.

By putting in place a new structure with a minimum tax and a toll charge, I think we accomplish the goal of having our tax system work properly so that business decisions will be made on economic terms, not on tax-determined terms. And I think that it will create a better climate for creating jobs in the United States.

So, while I do not think the one-time voluntary tax holiday works well and accomplishes the goal, I do think that the proposal we put in structurally does. And, as you and I have discussed, the question of where you set the rates is something that people can disagree about.

If you start with the structure making sense, I think there is a basis for a bipartisan conversation.

Senator PORTMAN. Well, I hope you will reiterate today for the record what you have said publicly and at some of our meetings, that this is a starting point for you all in terms of the rates, because I do think—Senator Scott mentioned this—we are going to have some differences in terms of the rate.

We want to be sure this actually works to make our workers more competitive, and, if we end up with a rate of 19 percent, for instance, some would argue that we have not accomplished that, because, when you look at the comparable rates around the world now, the effective rate has to be, in my view, in the mid 20s in order for us to be competitive.

If you look at the tax rate here plus the 19-percent minimum, the average rate actually is above the average of the OECD countries. So we hope you will work with us on the rate and also to ensure that we do have the ability to help on the highway trust fund. I think we have to come to some understanding on how we are going to deal with the extenders. As you said earlier, maybe those could be part of this, which would make all the sense in the world, and let us be sure that we are working together to find a baseline that works.

If you did do the deemed repatriation, which is part of overall tax reform, do you think there could be some revenue for the highway trust fund?

Secretary LEW. Yes. I do think there could be revenue for the highway trust fund. And just to be clear, we think that as we deal with the expiring provisions, we need to deal with the individual provisions that expire as well, not just the business provisions.

Senator PORTMAN. Mr. Chairman, I would like to put in the record——

Senator WYDEN [presiding]. Without objection, so ordered.

Senator PORTMAN [continuing]. Two letters I got recently from the UAW and from the Ford Motor Company back in Ohio, two different plants. They are about this issue of currency.

[The letters appear in the appendix on p. 119.]

Senator PORTMAN. I do think that currency manipulation does affect trade. I hope that you, Mr. Lew, in your work on this issue, will help us to try to put in some enforceable standards on cur-

rency. I think it makes a lot of sense, because it does affect the way American workers can compete globally.

Thank you, Mr. Chairman.

Senator WYDEN. Senator Grassley, are you ready, or would you like me to go? I am happy to have you go.

Senator GRASSLEY. No. If we are limited to 5 minutes, you go ahead.

Senator WYDEN. Great. Secretary Lew, let me kind of walk through what look like the transportation choices we have, because I think that is an important part of this debate. To me, there are sort of three entrants in the discussion.

There is the gas tax issue, and we got a sense last year that it would be hard to build significant bipartisan support for a major hike in the gas tax.

Then there is the repatriation issue, and I am certainly open to looking at this. As to the question of taxes and transportation infrastructure, there is clearly a nexus there because we have, of course, trust funds and we have excise taxes. So there is a clear nexus there. I think we also have learned from the 2004 experience that there is no repatriation rainbow out there, and, in fact, my sense is that, if you make it voluntary with respect to the whole process, the Joint Committee on Taxation or the scorekeeper will not score it. So that is certainly a path worth debating.

The path that we know works, because we have done it, is the bond question—the question of getting some of this vast sum of money off the sidelines and into infrastructure—because it is a good investment and bonding works.

It was in this room close to 6 years ago, after a decade's worth of bipartisan efforts, Chairman Baucus talked about Build America Bonds. People wanted to know what might happen, and I told people we might sell $3 billion to $5 billion worth of Build America Bonds. And in a year and a half, $183 billion worth of Build America Bonds were sold all up and down the eastern seaboard. And Senator Casey, Governor Rendell, and others are major supporters of Build America Bonds.

You can debate what kind of bonds they ought to be as well. In other words, there are different types, and I think we understand that. But to me, (A) because it has actually worked and helped us get more revenue, and (B) because there is a bipartisan history there, I think it would be very helpful.

You all have been interested in something that you call Qualified Public Infrastructure Bonds. As you are aware, I have a great interest in a variety of new approaches here that will draw more private investment into the country's infrastructure. Give us your thoughts on how the approach that you all are talking about would lend itself to a bipartisan alliance to get more private funding into infrastructure.

Secretary LEW. Senator, as you and I have discussed, this is an area that we violently agree on.

Senator WYDEN. Violent agreement. Oh, my goodness.

Secretary LEW. Yes, violent agreement. Your leadership in the design of bond provisions here has been extremely important. We have worked with you on these. I hope we can work on a bipartisan basis to get either the Qualified Public Infrastructure Bonds or you

can name it any number of things, whether you call them Build America Bonds or America Fast Forward Bonds or Qualified Public Infrastructure Bonds.

The idea is to create opportunities for private capital to be invested in infrastructure. One thing we know for sure is that, even if we are successful in extending our surface transportation bill for 6 years at a higher level, that will only meet a fraction of the infrastructure needs that we have in this country. So this is not a case where we should do an either/or. We need to do both. And we also need to pursue public-private partnerships as a third avenue. Our infrastructure deficit is one of the really serious economic challenges for us to deal with in order to make sure that the future of our economy is as bright as it has been in the past.

We cannot have ports that are not adequate to take the deep draft ships that are going to be coming through. We cannot have airports that are subpar and behind their international competitors. We cannot have roads that make it take hours longer to get from one place to another than it should. That costs time, it costs money, and it is a drag on economic growth. So we believe that, obviously, there are short-term benefits of job creation in infrastructure. Long-term, for the entire history of our country, it has been one of the keys to our economic success that we build the infrastructure we need for the future.

Senator WYDEN. My time has expired.

Senator Casey is next, Senator Grassley, both in order. I know colleagues have been very patient, and I appreciate it.

Senator CASEY. I want to thank the ranking member.

I want to apologize that I was not here earlier, Mr. Secretary. I did not have a chance to hear your testimony. It was one of those conflicted mornings. But we are grateful that you are here.

Secretary LEW. If you cannot sleep tonight, you will probably get another chance. [Laughter.]

Senator CASEY. That is right. So maybe we can watch the video later. But we are grateful you are here and certainly grateful for your work at a difficult time.

As you know, we had Ambassador Froman here just a number of days ago. And one of the parts of his testimony, and then the back-and-forth of questions, clearly indicated that an issue that you and I have talked about a lot over the years, as well as others, currency manipulation, has not been addressed in the TPP negotiations.

He directed questions to you, and that is the reason I raise it, first and foremost. I raise it as well, obviously, because of the concern I have, and that concern is rooted in the economic and often devastating economic impact of currency manipulation.

As you and I have discussed, my main concern has been about China. But with these negotiations, of course, some of our potential TPP partners, including Japan, cause us concern as well. The other concern, of course, is down the road, were China to be a part of the TPP. That is of great concern on currency manipulation.

Just in terms of some data—and then I just want to ask you maybe two questions about this. Just as it relates to Japan, the Economic Policy Institute recently found that currency manipulation was the main driver of our growing deficit with Japan and

that this growing deficit displaced 896,000 jobs nationwide in 2013, including 40,100 jobs in Pennsylvania. Now, not every one of those is directly attributable only to currency manipulation. It is the broader measure of the trade deficit. But they did find that currency manipulation was a driver.

So it is very frustrating, when we have raised this issue a number of times—and I know that you have worked on this—that in the negotiations this does not have a primacy or a priority that I would argue that it should.

I think currency manipulation is both unfair and very damaging, and it is kind of a double insult if it is not raised and then TPP goes forward and TPA goes forward, and we have not addressed it.

I just want to get your response to that, the first part.

Secretary LEW. Senator, first of all, I want to agree with you that if countries pursue policies that are designed to gain unfair advantage on exchange rates for the purpose of trade advantage, it is wrong. We should push back. We do push back in the current international forums—the G–7, the G–20, the IMF—but even more importantly, bilaterally.

I think that the EPI study on Japan is not entirely accurate. There is no evidence that in the last several years Japan has intervened in a way that would meet the standard that you are describing. I think that the activity that that report is pointing to is not government activity, but it is the investment of funds in the private pension fund.

Private pension funds in the United States, as well as other countries, have mixed portfolios. I think if you did the analysis, the United States invests in other countries as much as other countries invest in the United States. And I do not believe that there is any evidence of any manipulative investment.

I will say that I have raised the issue of currency with our Japanese counterparts more times than I can count. We do not just hold them accountable for their actions. We hold them accountable for their words. If their language even suggests that they are deviating from using domestic tools for domestic purposes, we come down very hard. And I must say, in all the bilateral engagements I have had, if we do that, we see change in language and a restraint on policy.

I do think that the question of kind of looking at macroeconomic tools is a very important one. If you look at our QE policy, to other countries, it was very disruptive, but without QE, we would not have been able to dig ourselves out of the recession.

I think Japan has the right to use quantitative easing as well. So we cannot compare situations that are macroeconomic to unfair manipulative practices.

Senator CASEY. I would just say this in response. I think both of us agree that whether there is a dispute, whether you raise a dispute about one particular study, we can agree that currency manipulation has been damaging to our economy. I do not think there is any question about that, number one.

Number two is, I am not willing to kind of let Japan off the hook on this. We can debate that. But the broader question goes even beyond Japan. I get the sense—and this is one of my real frustrations—that it is raised, it is prioritized. I remember talking to your

predecessor, Secretary Geithner, about it. And I understand that it is raised, I understand that it is asserted in bilateral discussions or even negotiations.

But the problem I see is, we never seem to get something tangible, a result that would put our workers at least on a level playing field or our companies on a level playing field. That is the frustration, and I get the sense that the administration does not place the priority that I place on the issue.

Secretary LEW. Well, I actually think that we are second to none in terms of pushing back on what are unfair practices. And I know I have raised it, not in just an occasional, offhanded way, but I make it central to our relationship with another country, and I have seen it have effect.

So I think we have been aggressive, and, as I said earlier, we are open to a discussion of how to build a bridge between trade discussions and trade legislation and the processes for dealing with currency through the current authorities, and I would look forward to that conversation.

Senator CASEY. And I would as well. I am sorry, we are over our time, but thank you.

Senator GRASSLEY [presiding]. I want to start out by telling you that I agree with Senator Casey, and I probably would have not ever gotten around to asking that question. But this is how I will phrase the question that I was going to ask along that line, and I will give you my opinion. I do not expect you to—I do not even want you to take time to answer it.

Following our meeting a week or two ago with Ambassador Froman, he said, like Senator Casey did, that it was up to the Secretary of Treasury, who was negotiating this or dealing with this subject. My question would have been, specifically: is the administration doing anything of consequence to address the currency manipulation by our trading partners around the world?

And my feeling is, not just watching the Obama administration but previous Republican and Democratic administrations, that everybody is afraid to tackle it. And I do not know why, because, if there are not consequences, there is not going to be any change of behavior. And particularly it is frustrating for me that we do not take on China, because they are such a—they are not involved in TPP, but they are involved in this whole business of currency manipulation.

I think we are afraid to take them on, because, every time you mention something about it, they say, you are interfering with our internal affairs.

Secretary LEW. Well, Senator, I know you did not want me to respond, but we have taken China on. The President has taken the President on. I have taken on the Senior Vice Premier and the President and the Finance Minister on this issue.

They have actually responded to our pressure. They have changed their policy, and I think we have—I am not saying that there is not a need for ongoing vigilance and pressure, but we have taken it very seriously, and I think we have made progress.

Senator GRASSLEY. I would not want to say that you are not—I know that those steps have been taken. But you know what the

Chinese say. They would never admit that you had anything to do with it.

Secretary LEW. But they have actually said this year that they would refrain from intervening. They did not used to admit that they intervened. They now say they will refrain in many circumstances, most circumstances, from intervening.

They have never been willing to abide by the transparency requirements of the IMF. In response to repeated pressure, they have now said that they are going to abide by the IMF transparency so we can see what they are doing in intervention.

I am in no way saying it is not a serious issue. It is a very serious issue. But we are very actively engaged, pushing very hard on China on this issue.

Senator GRASSLEY. Well then, let me say "thank you" if you are doing more than what I perceive you are doing.

I want to follow up on something that you discussed with Senator Thune and then more specifically with Senator Scott. You spoke about a $1-million issue as far as the way the President's plan was going to work. When speaking with Senator Scott, you mentioned that $1-million threshold.

Now, specifically, is this an exemption, or is it a dividing point between determining what is or is not a small business? Then more specifically, if the business is over $1 million, are they taxed on the whole gain or is it a $1-million exemption?

Secretary LEW. It is a dividing point. So it is definitional. And as I now think of Senator Scott's question, I may have to revise my response, because I think I may have treated it as if it were the other, and I apologize if I did.

Senator GRASSLEY. So then to clarify, there will be a $1-million exemption.

Secretary LEW. No. It is the dividing line. It is definitional.

Senator GRASSLEY. So if you are over $1 million, then the first $1 million is taxed too.

Secretary LEW. So the $1 million gets to the size of the business, not the size of the gain. And for a larger business, the provisions would apply. For smaller businesses, they would not.

Senator GRASSLEY. So you have to be under $1 million. If you are over $1 million, then the first $1 million is taxed. That is my question.

Secretary LEW. Well, you still get the—for a couple, there is a $200,000 exemption; for an individual, a $100,000 exemption. And you still get the 15 years to pay any taxes that are due.

Senator GRASSLEY. Yes.

Secretary LEW. And you are only taxed on the gain, not on the base value. So if the gain were $500,000, you would be paying on the $500,000 gain, not on the value of the whole property.

Senator GRASSLEY. I think, rather than take any more time, I will put a statement I have on this issue in the record. But I think it is very detrimental to family farming. That is the summation of it.

I think that if you want to keep a family farm in the family, it is going to be very destructive.

[The prepared statement of Senator Grassley appears in the appendix.]

Senator GRASSLEY. So, for the committee, I want to thank Secretary Lew for appearing today. I also want to thank all the Senators who participated. It has been a good hearing.

Any questions for the record should be submitted by no later than Thursday, February 12th.

The hearing is adjourned. Thank you, Secretary Lew.

Secretary LEW. Thank you, Senator.

[Whereupon, at 12:04 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Senator Chuck Grassley
Statement for the Record
The President's Budget for Fiscal Year 2016
February 5, 2015

Secretary Lew, I would like to take this time to discuss what you and the Administration have come accustomed to calling the "Trust Fund Loophole."

Referring to the President's proposal to eliminate step-up in basis for bequests as a trust fund loophole is ironic for at least two reasons. First, the President's proposal would actually make trust funds a more attractive estate planning tool for the very wealthy and second, the proposal is not eliminating a loophole, but long-standing policy that is a function of the estate tax. The reason for step-up in basis at death is to prevent the double taxation of assets that are subject to the estate tax.

Yes, today with a $5 million exemption, assets of estates under this amount general escape tax on their appreciated value. There are a couple options for addressing this.

One way is to impose a new and punitive tax on top of the estate tax. The other is to eliminate the estate tax and move to a modified carryover basis regime. This was the route Congress sought to take while I was Finance Committee Chairman.

The Administration has decided to go the first route, which could be devastating to family farms and small businesses in Iowa and across the nation.

The President continues to sell his proposal as only impacting the very wealthy. However, this is just not accurate. Len Burman, a former Clinton Treasury official and someone who hardly could be mistaken for a conservative thinker, actually points this out in a recent article for the Tax Policy Center. Mr. Chairman, I ask unanimous consent to submit this article for the record. While it is true that the greatest number of households impacted will be those at the top end of the income distribution, the fact is the proposal will impact households at just about every income level.

The reason for this is that assets may have greatly appreciated over decades making these individuals look wealthy as the result of a one-time realization event. Under the President's proposal, that realization event is generally death.

A great example of this is an Iowa family farm. In Iowa, it is very common for a farm to be held within a family for decades or even over a century with the value of the farmland appreciating greatly. Mr. Secretary, I would love for you to come to Iowa and visit a family farm and tell them that they are wealthy one percenters.

To highlight just what the President's proposal could mean to an Iowa family farm, imagine the President's proposal in the context of a parent or grandparent who purchased a farm in 1970. According to Iowa State University, the average price for an acre of farmland in 1970 was $419

where today that same land fetches about $8,000 per acre. According to the Department of Agriculture, the average farm size in Iowa is 345 acres.

Doing the simple math, a farm with these characteristics purchased in 1970 would have increased in value from $144,555 to more than $2.76 million today. This does not even take into consideration buildings and equipment. Just based on the land, the capital gain exceeds $2.6 million. The President provides a $200,000 exemption for a couple, which still leaves a capital gain exceeding $2.4 million.

When factoring in the President's proposal to increase the top tax rate on capital gains to 28%, the farmer can expect a tax bill topping $600,000 likely payable at death.

Mr. Secretary, this proposal should be referred to as the "Family Farm Elimination" proposal because it could mean the death of family farms across Iowa and in other states.

In all likelihood, it would result in farming becoming concentrated among only the largest and wealthiest operations as the large corporate farms swoop in to buy farmland when the family can't afford the taxes.

Mr. Secretary, I want to know some specifics on how the Administration intends to ensure an average farmer, like the example I just provided, will be shielded from this confiscatory tax. It is not enough to give lip service to protecting small businesses and family owned operations. I want details of how exceptions for small businesses will work.

It also is not enough to say closely held business will be allowed to pay the tax under a 15 year payment plan. Average farmers would still likely have to sell off assets to pay such a hefty bill. Furthermore, it would divert resources that could otherwise be reinvested into the farming operation.

If you cannot give me specifics, or assure me average Iowa farmers will be protected, the Administration should throw this proposal in the trash bin alongside the President's proposal to tax 529 plans.

Are Accrued Capital Gains Income in the Year You Die?

By Len Burman

Tax Policy Center

February 2nd, 2015

The Tax Policy Center's tables showing the distribution of President Obama's new income tax proposals indicate that some middle-class households would pay more tax than under current law. The Administration says they wouldn't. The reason is that TPC and the White House disagree over what counts as income.

The dispute centers on the President's proposal to tax accrued, but unrealized, capital gains at death. We find that some middle-income households would pay this tax; the White House contends that all of the burden would fall on taxpayers with high incomes.

OMB Director Shaun Donovan was quite pointed in his critique of our analysis on *NPR's Morning Edition* today:

> There are some fundamental flaws [in the TPC analysis]. They actually assume that all of this income from capital gains isn't really income. It sort of defies logic to say that a family that has $500,000 of capital gains, that isn't income.

The Administration argues that unrealized capital gains held at the time of death become income in the year the law changes to make them taxable. It is certainly true that *taxable income* on a decedent's tax return would increase under the President's proposal, but our measure of income, called expanded cash income, is intended to track pre-tax economic status. That doesn't change just because a tax is levied on accrued gains.

Treasury Deputy Assistant Secretary Adam Looney proposes a different income measure: adjusted gross income (AGI) plus unrealized capital gains taxed at death. Not surprisingly, using this income measure, nobody with income below $100,000 would be affected by the new capital gains proposals since they allow a $100,000 capital gains exclusion for singles ($200,000 for couples). Treasury's distribution table is reproduced below.

Raise Top Capital Gains and Dividend Rate to 24.2% and Tax Capital Gains Upon Gift and Death*

(Fully Phased-in Law at 2015 Income Levels)

Adjusted Gross Income and Gains Realized at Death	All Families	Families Paying Additional Tax				
	Number (thousands)	Number (thousands)	Percent of All Families	Amount ($ billions)	Percent of Total Tax Change	Average Increase ($)
0 <= 10,000	39,884	0	0.0%	0.0	0.0%	0
10,000 <= 20,000	24,485	0	0.0%	0.0	0.0%	0
20,000 <= 30,000	18,608	0	0.0%	0.0	0.0%	0
30,000 <= 40,000	14,229	0	0.0%	0.0	0.0%	0
40,000 <= 50,000	11,439	0	0.0%	0.0	0.0%	0
50,000 <= 60,000	9,161	0	0.0%	0.0	0.0%	0
60,000 <= 75,000	10,580	0	0.0%	0.0	0.0%	0
75,000 <= 100,000	13,011	0	0.0%	0.0	0.0%	0
100,000 <= 200,000	17,992	4	0.0%	0.0	0.0%	2,240
200,000 <= 300,000	3,599	18	0.5%	0.1	0.2%	3,620
300,000 <= 400,000	1,200	19	1.6%	0.1	0.4%	7,735
400,000 <= 500,000	590	51	8.7%	0.2	0.5%	4,099
500,000 and above**	1,377	994	72.2%	40.9	98.9%	41,155
Total***	167,771	1,087	0.6%	41.4	100.0%	38,054

Department of the Treasury
Office of Tax Analysis

January 19, 2015

*Accrued captial gains exceeding $100,000 (and excluding household furnishings and personal effects) would be subject to income tax upon gift and death. Bequests to spouse receive carryover basis; personal residences receive $250,000 exemption per person; charitable donations exempt. Unlimited deferral of tax for certain family-owned businesses and 15-year payment plan for other illiquid assets provided. The tax is borne by the donor or dedecedent.
**About 99% of the tax is paid by families who have more than $500,000 in income (the top 0.8% of families). About 81% of the tax is paid by families who have more than $2 million in income (the top 0.1% of families).
***Families with negative income are included in the total line only.

The problem is capital gains taxed at death represent a lifetime of accruals, not a single year's income. The whole point of the Administration proposal is that these gains have entirely escaped taxation for years, so levying tax would close a giant loophole in the tax code. (I commented favorably on the merits of the proposal at *http://taxvox.taxpolicycenter.org/2015/01/18/president-obama-targets-angel-death-capital-gains-tax-loophole/*.)

A Treasury Department working paper argued in 1999 (when I was Deputy Assistant Secretary) that the economically correct way to account for capital gains is to include assets' annual increase or decrease in value in each year's "economic income." By that measure, only a fraction of capital gains taxed at death would be included in a decedent's income, with the rest included in years prior to death. By extension, accrued tax liability should also be allocated as asset values increase or decrease. (Accountants use the concept of accrued tax liability to allocate deferred business taxes for company financial statements, so this isn't a radical economic concept.)

If we classify households by counting gains allocated on an accrual basis, the President's proposal would affect some households with moderate income. Data from the Federal Reserve Board's Survey of Consumer Finances show that a small fraction of people with modest incomes have accrued unrealized capital gains large enough to be affected by the tax. (See Table 4 from our report on the distributional effects of the new proposals.)

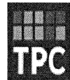


TABLE 4. DISTRIBUTION OF ACCRUED CAPITAL GAINS, BEFORE AND AFTER EXCLUSIONS, BY INCOME PERCENTILE, 2013

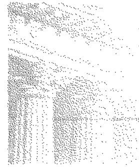
Income Percentile[1]	Before Exclusions			After Housing Exclusion			After Housing Exclusion and General $100,000/$200,000 Exclusion			
	Number (thousands)	Amount ($ billions)	Percent of Total	Number (thousands)	Amount ($ billions)	Percent of Total	Number (thousands)	Percent of Units	Amount ($ billions)	Percent of Total
Lowest Quintile	10,203	700.1	3.9	2,880	270.3	2.0	345	1.4	219.0	1.8
Second Quintile	14,043	834.4	4.6	4,272	233.8	1.7	552	2.2	103.2	0.9
Middle Quintile	15,341	955.8	5.3	6,436	400.3	2.9	838	3.6	213.1	1.8
Fourth Quintile	20,373	2,058.3	11.4	9,682	1,081.6	7.8	1,616	6.6	712.9	5.9
80-90	10,895	1,575.0	8.7	6,285	1,059.1	7.6	1,105	9.4	805.2	6.7
90-95	5,745	1,599.9	8.9	4,110	1,215.3	8.8	1,355	22.6	918.6	7.6
95-99	4,753	4,626.7	25.6	4,127	4,070.7	29.3	2,183	45.1	3,609.7	29.9
Top 1 Percent	1,218	5,719.4	31.7	1,195	5,560.3	40.0	941	77.0	5,495.9	45.5
All	82,570	18,069.6	100.0	38,987	13,891.6	100.0	8,935	7.3	12,077.5	100.0

Source: 2013 Survey of Consumer Finances

[1] Excludes primary economic units with negative income.

The bottom line is that while the President's proposal is targeted at wealthy people, a small fraction of them have modest incomes measured on an annual basis.

There are other reasons why our estimates and Treasury's differ. But reclassifying exceptionally thrifty middle-class families to the top of the income distribution by counting a lifetime of unrealized gains in income when they die clearly overstates their well-being.



Senate Committee on Finance
U.S. Senator Orrin Hatch (R-UT), Chairman
http://finance.senate.gov

Hatch Statement at Finance Hearing on President Obama's 2016 Budget

WASHINGTON – Senate Finance Committee Chairman Orrin Hatch (R-Utah) today delivered the following opening statement at a committee hearing on President Obama's fiscal year 2016 budget:

Today's hearing is on President Obama's budget for Fiscal Year 2016. I want to thank Secretary Lew for appearing before us today.

I'm not going to sugar-coat anything with this budget. Instead, I'm going to cut right to the chase.

The President's latest budget proposes to hike taxes by $2.1 trillion.

Seemingly not content with the $1.7 trillion in new taxes he and his allies in Congress have imposed over the past six years, the President, with this budget, wants to again raise taxes on savings, investment, small business, and more, somehow thinking that it will help the economy.

Sadly, this insatiable desire to raise taxes is not intended to bring our budget into balance. Rather, the President's $2.1 trillion tax hike is accompanied by proposals to further expand the government to an even greater share of our economy.

The proposed budget never balances.

Deficits continue, which means that debt as a share of the economy would remain at levels not seen in our nation's history, outside of a few years surrounding World War II.

That outcome would mean continued risk of what the nonpartisan Congressional Budget Office has labeled a "fiscal crisis."

In fact, CBO has warned us repeatedly about potential fiscal crises under President Obama's tenure. They have also made clear that unsustainable entitlement spending is at the heart of the potential for a fiscal crisis. Yet, the President's budget proposes precious little in the

way of reining in spending on our health care entitlements, and does virtually nothing to address Social Security.

Despite having pledged in 2009 that he would not kick the can down the road on Social Security, that is exactly what the President is now proposing to do with his budget, even while the disability trust fund is projected to be exhausted next year.

Simply put, there are too many shortcomings in the President's budget to adequately address in my opening statement, but they include: higher taxes that would stifle job creation, economic growth, savings, and investment; new wealth taxes; muddled thinking about distributional issues; a lack of significant reforms to our unsustainable entitlements; ongoing deficits and outsized, risky federal debt; and a repackaged bank tax that nods to the ineffectiveness of the Dodd-Frank law.

The budget even puts forward a tax on section 529 education savings, which suggests that the budget's authors are out of touch with the American people. Of course, we have heard that the proposal to tax 529 education savings has been withdrawn and labeled a distraction, but is still supported on policy grounds by the administration.

This is unhelpful, and that's the kindest possible word I can think of to describe that particular proposal and others like it that are apparently founded on the notion that the American people's savings are not their own, but, instead, targets for more redistribution.

Like I said, there is a lot I could complain about when it comes to President Obama's budget. But, let's be honest, rehashing these complaints over and over again is not going to be the best use of the committee's time.

So, Secretary Lew, let's try to look at some areas in the budget where the administration seems willing to go in a positive direction, even if, in my opinion, it falls short on the substance.

In those areas, let's try to work together toward what I believe is the shared goal of everyone here: To help Americans where we can, and get out of the way when we should.

For example, I believe that we share a desire to reform our tax code, which everyone agrees is severely broken, does not help American families, and harms American businesses.

And by businesses, I mean businesses of all types, not just one particular organizational form.

I believe we share a desire to renew Trade Promotion Authority, as you identify in your testimony.

I believe that we share a desire to promote productive investments in infrastructure.

Of course, if we're going to effectively address these issues, the President and his administration owe it to the American people to suspend what often seems like an unending political campaign for enough time to at least explore bipartisan cooperation.

I will close with a question for you, Secretary Lew. It's a question that you did not answer and evaded in testimony earlier this week. The IRS Commissioner evaded a similar question when he was here on Tuesday. Secretary Burwell did the same in our hearing yesterday.

The American people deserve an answer to this question and I hope you'll be willing to give us one today.

The question is: Do you have contingency plans in place in the event the Supreme Court invalidates the current structure of the Affordable Care Act tax subsidies later this year?

I'd like you to address this question in your opening remarks. And, I'll note that it's a simple question, requiring only a one-word answer: yes or no.

Once again, I want to thank Secretary Lew for appearing here today.

With that, I'll turn it over to Ranking Member Wyden for his opening statement.

###

Written Testimony of Treasury Secretary Jacob J. Lew
before the Senate Committee on Finance
on the President's Fiscal Year 2016 Budget Proposal
February 5, 2015

Chairman Hatch, Ranking Member Wyden, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2016 Budget.

The President's Budget invests in the American people and our country by promoting inclusive economic growth, increasing job creation, and expanding opportunity. While our economic recovery is well established, we have more work to do to make sure the gains are shared more broadly — what we call Middle Class Economics.

The President's Budget achieves $1.8 trillion of deficit reduction over 10 years, primarily from much-needed reforms to our health, tax, and immigration systems. Under this Budget, deficits decline to about 2.5 percent of GDP over the 10-year budget window, down 75 percent from the Great Recession peak of 9.8 percent of GDP. At the same time, this Budget shows that investing in growth and opportunity go hand in hand with putting the nation's finances on a strong and sustainable path. The President strongly believes that now is the time to invest in America's future in order to drive inclusive economic growth and opportunity, secure the nation's safety, and put the nation's finances on the road to a more sustainable fiscal outlook. We believe our Budget does just that.

This Budget makes needed investments in key priorities while maintaining a responsible fiscal course. For a stronger economic future, we propose a fully paid-for increase in the discretionary

budget caps to make room for a range of domestic and security investments, including increased investments in education, job training, research, manufacturing, infrastructure and national defense. At the same time, we want to simplify and improve our tax code to make the paychecks of working families go further, ensure the wealthiest pay their fair share, and fix our broken business tax system in order to promote long-term growth and broad-based prosperity while using one-time transition revenue to pay for much needed investments in our nation's infrastructure.

Introduction

When the President took office six years ago, the federal government's fiscal outlook was bleak. The economy was shrinking at its fastest rate in 50 years and shedding more than 800,000 private sector jobs per month. Unemployment peaked at 10 percent in 2009, a level not seen in over 25 years. Health care spending was on an unsustainable path, and the deficit hit a post-World War II high.

Since that time, the policies put in place by this Administration and Congress have helped produce a sustained economic recovery and unprecedented decline in the deficit, putting us on a sustainable fiscal path. In 2014, our economy achieved a number of important milestones. We have seen nearly five years of private sector job growth — a new record. In 2014, we added more jobs than any year since the late 1990s. For the first time in two decades, the United States is producing more oil than it imports, and we are now the world's leading producer of petroleum and natural gas. The manufacturing sector continues the strongest period of job growth since the

1990s. And rising home prices have restored nearly $5 trillion in home equity to homeowners. By virtually any metric, our economy is stronger and continuing to gain strength.

From fiscal year 2009 to 2014, the deficit as a share of GDP fell by two-thirds, a rapid decline by historical standards. Over the past several decades, only the period of demobilization following the end of World War II saw a faster pace of fiscal consolidation. In fact, the deficit for fiscal year 2014 came in almost one percentage point lower than we anticipated in our Budget one year ago. This year's Budget expects that the deficit will decline to 2.5 percent of GDP in fiscal year 2016 and achieve primary balance in 2022.

Strong growth combined with the Administration's policy choices have dramatically improved our fiscal trajectory. Unfortunately, the political environment in Washington in the early part of this decade, governing from crisis to crisis, has held back the recovery that otherwise would have created more jobs for working Americans. When Congress allowed the sequestration cuts to become law, they caused a notable drag on the economy — those that took effect in March 2013 reduced the Gross Domestic Product by 0.6 percentage points and cost 750,000 jobs, according to the Congressional Budget Office. In 2011 and again in 2013, the full faith and credit of the United States was used as a bargaining chip, driving down consumer confidence and driving up uncertainty in the business and international communities. Over the past year, we have seen real progress in returning to regular order in conducting fiscal policy. I am hopeful that the bipartisan progress will continue with the kind of compromise that nurtures growth and preserves our sustainable fiscal path.

The U.S. economy appears to have entered a period of self-sustaining growth. The economy grew 2.5 percent last year. Private sector forecasters expect the economy will grow roughly 3 percent this year, while the International Monetary Fund recently revised its U.S. growth estimate higher, expecting 3.4 percent growth in 2016. This is substantially faster than all of the other advanced economies combined.

Despite significant progress, we have more to do to fully address our nation's ongoing challenges. The benefits of the growth are not being shared by all Americans. While more Americans have jobs than ever before, there are still millions of Americans in search of work as well as millions of part-time workers in search of full-time opportunities. Despite the drop in the unemployment rate, average hourly earnings have been rising only slowly, and the income of the typical American family has not kept up with inflation — in fact it has trended down for the last 15 years.

With the recovery now well-established, we need to ensure that hard working Americans share the gains. The President's Budget encourages growth and opportunity in the short-run and makes investments that will promote broadly shared growth over the longer term, while remaining dedicated to maintaining fiscal responsibility. While the recovery in the U.S. economy has helped to drive global growth, the rest of the world cannot depend on the United States to be the sole engine of growth. At the recent G-20 meeting in Brisbane, there was agreement that more needs to be done to stimulate domestic demand around the world. Our strength allows us to maintain our leadership in the global community, and while we must lead by example, we cannot do it alone.

The Bipartisan Budget Act of 2013 reversed a portion of sequestration and allowed for higher investment levels in 2014 and 2015, but it did nothing to alleviate sequestration in 2016. Sequestration imposed arbitrary spending cuts that are bad for our economy and our security. These across-the-board cuts were never even intended to go into effect; rather, they were purposely unpalatable to create pressure to pass balanced, responsible deficit reduction. Congress should not repeat the mistakes of the past by allowing further sequestration cuts in 2016. In the absence of congressional action, non-defense discretionary funding in 2016 will be at its lowest level since 2006, adjusted for inflation, even as the need for pro-growth investments in infrastructure, education, and innovation has only increased due to the Great Recession and its aftermath. Inflation-adjusted defense funding will also be at its lowest level since 2006.

The President's Budget makes needed investments in key priorities, even while setting the nation on a fiscally responsible course. The Budget proposes increasing the discretionary caps in the context of a balanced fiscal plan, while making room for a range of domestic investments that will help move the nation forward. These include investments to strengthen the economy by improving the education and skills of the U.S. workforce, accelerating scientific discovery, and continuing to bolster manufacturing.

The proposals in the President's Budget aim to strike a balance between achieving long-run fiscal responsibility and helping working families get ahead. Among the proposals to help families, this Budget simplifies and expands child care tax benefits; enhances educational opportunities by partnering with states to make community college and career and technical schools free for responsible students and consolidating and expanding education tax incentives;

makes it easy and automatic for workers to save for retirement; and reforms the tax system and raises the minimum wage to better support and reward work. These investments in the middle class are fully paid for by repealing perhaps the single largest income tax loophole, called "stepped-up basis," raising the top capital gains and dividends rate back to 28 percent — the same rate during the Reagan Administration — and reforming financial sector taxation to discourage excessive borrowing by the largest financial institutions.

The President's trade agenda is another important component of our strategy to grow the economy and strengthen the middle class. Exports account for a significant portion of our economic growth over the course of the last four years and ninety-eight percent of our exporters are small businesses. Expanding the reach of America's exports will create new opportunities for our small businesses to grow. I look forward to working with all of you to pass trade promotion authority legislation that creates a level playing field for our businesses and workers.

The Budget calls for business tax reform that will be revenue-neutral in the long run, make our companies more competitive, and directly benefit the middle class by paying for a plan to repair and expand our existing infrastructure to support our economy for the next generation with a one-time tax on previously untaxed foreign income. We know that investing in our nation's physical and human capital will provide the best long-run return for the economy. Moreover, Congress should address the so-called tax extenders in a fiscally responsible manner, including preventing a tax increase for 26 million working families and students by making permanent the expiring tax credits that benefit them. The Budget increases the resources we are putting toward

national security both at home and abroad because economic prosperity and fiscal responsibility cannot come at the expense of our safety.

Taking the right steps today will make our fiscal challenges easier tomorrow. A stronger economy today will ease those fiscal challenges and improve the lives of working Americans. A credible plan, built on the bipartisan cooperation that we have seen recently, is the best way to secure long-run growth.

Reforming the Tax Code

Our framework for business tax reform will simplify compliance for and provide tax relief to small businesses, while tightening our international tax system to close loopholes that strip the U.S. tax base by allowing multinational corporations to avoid paying U.S. taxes.

I continue to believe the best way to achieve reform today is to start with pro-growth business tax reform that protects and strengthens the middle class, lowers rates, simplifies the system, levels the playing field, and eliminates unfair and inefficient loopholes. When we make the switch to a smarter business tax system, there also will be one-time revenue during the transition, and we can use some of that revenue to create jobs rebuilding our roads and bridges, repairing our tunnels, and investing in our transit systems.

It has been almost three years since the President laid out his framework for sweeping business tax reform. Making sure the system works for everybody is as urgent today as it was then. This

year, business tax reform represents an opportunity for members of both parties and the Administration to work together to make progress for the American people.

Small businesses are a source of innovations, but their growth can be discouraged by the high costs of complying with complex tax laws. Over 80 percent of all tax compliance costs are borne by small businesses, and the burdens are heaviest on the smallest of the small businesses. While the largest, most complex businesses spend less than one-tenth of one percent of their receipts on the costs of complying with the tax code, a small business with less than $100,000 in receipts on average spends well more than 10 percent of its receipts on compliance costs. This is unacceptable. While the current tax code contains a number of provisions intended to simplify compliance for small businesses, more can be done. For example, small business expensing allows small businesses to deduct the cost of their investments in equipment and avoid the complexity of depreciation accounting. While the expensing limit had been $500,000 for a number of years, it recently reverted to $25,000 for 2015. As part of tax reform that is revenue neutral in the long-run, the President proposes to extend permanently expensing up to $1 million. This provides significant tax relief to America's small businesses and would allow small business to avoid the complexity of tracking depreciation. The President also proposes to dramatically simplify taxes for small businesses, by allowing all businesses with less than $25 million in gross receipts to use cash accounting and dispense with an array of other complicated accounting rules. In addition, there are proposals to increase the deductibility of start-up expenses for new businesses and to eliminate capital gains taxation on investments in small business stock. These changes will reduce compliance costs of small businesses and encourage investment and entrepreneurship.

On the international side, we are proposing reforms that would fix the current broken and inefficient system for taxing the foreign income of U.S. multinational corporations. The current system rewards U.S. companies that locate their operations and shift profits abroad and keep them outside the United States. In fact, as indicated in the President's Framework for Business Tax Reform, certain small countries with very low tax rates have attracted profits of U.S. multinational companies that exceed multiples of the GDP of those countries. Much of the manipulation comes from the ability to defer U.S. tax on certain earnings of foreign subsidiaries until that income is repatriated.

Tax reform must seek to balance the need to reduce tax incentives to locate overseas with the need for U.S. companies to be able to compete overseas for the investments and operations absolutely necessary to serve and expand into foreign markets in ways that benefit U.S. jobs and economic growth. The core of the President's tax plan, which is detailed in this year's Budget, is a global minimum tax. The global minimum tax would ensure that U.S. multinational firms pay at least a 19-percent tax on their foreign earnings as they are earned — rather than deferring the tax for years or forever — while exempting from the minimum tax a return to real activities performed abroad. After this initial payment, foreign earnings could be reinvested in the U.S. without additional tax, which would level the playing field and encourage firms to create jobs here at home.

In addition to the global minimum tax, our international tax reform proposals would address the ability under current law for multinational firms to erode the U.S. base with excessive interest

deductions and take further steps to stem corporate tax inversions, building on the Treasury Department's first, targeted action last September.

As we have consistently said, business tax reform together with anti-inversion legislation is the only way to fully address these transactions. Our business tax reform will help make inversions less attractive by making the United States a more competitive location from which to do business. Specific anti-inversion measures are also needed even after the business tax system has been reformed, as there will always be other countries with lower tax rates and less stringent rules for taxing foreign earnings.

In addition to these new detailed proposals in the reserve fund for business tax reform, this year's Budget includes new details on the President's plan to simplify our complex tax code for individuals, to make it fairer by eliminating some of the biggest loopholes, and to use the savings from closing loopholes to invest in helping middle class families get ahead and growing the economy. One of the largest loopholes in the individual income tax code is a provision known as stepped-up basis. Stepped-up basis refers to the fact that capital gains on assets held until death are never subject to income taxes. Hundreds of billions of dollars escape capital gains taxation each year because of this loophole that lets the wealthy pass appreciated assets onto their heirs tax-free. Stepped-up basis perpetuates wealth disparities and inequality of opportunity, particularly given that retirement accounts such as 401(k)s and IRAs — which often represent a middle class taxpayer's only major capital asset beyond a home — do not receive this special treatment. The budget closes the stepped-up basis loophole by treating bequests and gifts other than to charitable organizations as realization events, like other cases where assets change hands.

By closing this loophole, we unlock resources that could be reinvested more productively elsewhere, making our proposal a pro-growth way to raise revenue. The budget also increases the total top capital gains and dividend rate to 28 percent, the rate under President Reagan.

Since the 2008 financial crisis, the President and Congress have taken major steps to make the financial system safer and the broader economy more resilient, including enacting legislation that ensures taxpayers will not be on the hook to bail out financial firms perceived to be "too big to fail." Recognizing that excessive leverage undertaken by major financial firms was a significant cause of the financial crisis, the Budget builds on the reforms we have already put in place by proposing a financial fee that would further discourage excessive borrowing by large financial institutions.

Building a 21st Century Infrastructure

Transportation is critical to the nation's economy, allowing Americans to travel safely and conveniently, and enabling our businesses — in particular small businesses — to move goods to market at competitive prices. As part of transitioning to a reformed international tax system, the President's business tax reform plan would impose a one-time transition toll charge of 14 percent on the up to $2 trillion of untaxed foreign earnings that U.S. companies have accumulated overseas — raising enough revenue to fill the projected shortfall in the Highway Trust Fund and make new investments as part of the President's six-year surface transportation reauthorization. Unlike a voluntary repatriation holiday — which would lose revenue — the President's proposed toll charge is a one-time, mandatory tax on previously untaxed foreign earnings, regardless of whether the earnings are repatriated.

To spur economic growth and allow states and localities to initiate sound multi-year investments, the FY 2016 President's Budget request includes a 6-year expanded surface transportation reauthorization proposal to improve safety, support critical infrastructure projects, and create jobs while improving America's roads, bridges, transit systems, and railways. This builds on the Administration's 4-year proposal, the Generating Renewal, Opportunity, and Work with Accelerated Mobility, Efficiency, and Rebuilding of Infrastructure and Communities throughout America — or the GROW AMERICA Act — which was submitted to Congress last year.

Our Build America Investment Initiative has taken a series of new steps by federal agencies to support the efforts of state and local governments to access federal financing programs, structure public-private collaboration, and attract private investment to build and improve roads, bridges, ports, broadband, and water systems in metropolitan and rural areas in ways that boost economic growth and resilience, while protecting the interests of taxpayers and workers. As part of that initiative we are proposing the creation of an innovative new kind of municipal bond, Qualified Public Infrastructure Bonds (QPIB), an idea we have worked on with Senator Wyden. Today, public-private partnerships that combine public ownership with private sector management and operations expertise are limited in their use of municipal bonds. QPIBs will extend the benefits of municipal bonds to public-private partnerships, like partnerships that involve long-term leasing and management contracts, lowering the cost of borrowing and attracting new capital.

Providing Opportunity Through Education

The single greatest resource that our economy has is our people, and it is critical that Americans have the skills and knowledge to compete in the global economy. Research has shown that the

value of a postsecondary education is higher now than ever before. Therefore, the President has proposed programs that will make community college and career and technical school free for every responsible student as well as improve programs that provide education tax incentives for those who attend college.

The higher education benefits we provide through our tax system, including the American Opportunity Tax Credit created in 2009, are making college more affordable for millions of students and their families. But families have difficulty choosing among overlapping benefits and navigating complicated rules, and schools may not provide the information families need to claim tax benefits for which they are eligible. Building on bipartisan reform proposals, the President's education tax reform plan would simplify, consolidate, and expand education tax credits. The plan would cut taxes for 8.5 million families and students, simplify taxes for the more than 25 million families and students that claim education tax benefits, and provide students working toward a college degree with up to $2,500 of assistance each year for five years. These education tax reforms would complement our other proposals to make college more affordable, including continuing historic increases in the Pell scholarship program and simplifying financial aid forms. Together with free community college and career and technical schools, these proposals would benefit students, families, and the broader economy by helping more students earn a postsecondary credential, making them, and by extension our country, more competitive in the global marketplace.

Reforming the Tax System to Better Support and Reward Work

This year's Budget proposes a number of new policies to reduce taxes on working families. Together, these policies will benefit over 44 million families, providing an average tax cut of nearly $600.

In today's economy, having both parents in the workforce is a necessity for many families, yet dual-earner couples can face high penalties for working. When both spouses work, the family incurs additional costs in the form of commuting costs, professional expenses, child care, and, increasingly, elder care. When layered on top of other costs, including federal and local taxes, these work-related costs can contribute to a sense that work is not worth it, especially for parents of young children and couples caring for aging parents. While women, including married women, are increasingly the breadwinners of the family, they are still much more likely than their male counterparts to withdraw from the labor force in these circumstances, taking a toll on their future job options and earnings, and hurting overall economic growth. Building on congressional proposals from members of both parties, the Budget proposes to address these challenges with a new second-earner credit that recognizes the additional costs faced by families in which both spouses work. A total of 24 million couples would benefit from this proposal, which would provide a new, simple second-earner tax credit of up to $500.

The Earned Income Tax Credit is among the nation's most effective tools for reducing poverty and encouraging people to enter the workforce. However, low-wage workers without children and non-custodial parents miss out on the anti-poverty and employment effects of the EITC because the credit available to them is small and phases out at very low incomes. Our plan to

help working families get ahead incorporates the proposed childless worker EITC expansion — an idea that has bipartisan support in this Congress — reducing poverty and hardship for 13.2 million low-income workers struggling to make ends meet while boosting employment. This proposal would double the EITC for workers without qualifying children, increase the income level at which the credit phases out, and make it available to workers age 21 through 66.

The Budget also makes permanent improvements to the EITC and Child Tax Credit that augment wages for 16 million families with 29 million children each year. These improvements provide additional benefits to low-income working parents, families with three or more children, and married families, but they are currently scheduled to expire at the end of 2017. As we made clear during the extenders debate at the end of 2014, we cannot apply a double standard where we address extenders for business but not working families. Finally, the President continues to call on Congress to raise the federal minimum wage and to index it to inflation. No American who works full time should have to live in poverty, and the proposed new minimum wage would both help working families make ends meet and add spending to the economy.

Providing Child Care for Working Families

Over 60 percent of families with children have either two working parents or a single parent who works. That is why access to high-quality, affordable child care is critical for working families and for the broader economy; it helps parents continue working or join the workforce and supports healthy child development and late successes in school. But with the cost of infant and toddler care rivaling the cost of college in many states, many families struggle to afford quality care for their children, and the average child care tax benefit of $550 falls well short of what is

needed to provide meaningful help. The Child and Dependent Care Tax Credit and child care flexible spending accounts are also unnecessarily complex, often requiring significant paperwork and advanced planning for families to receive the full benefits.

This year's Budget streamlines child care tax benefits and triples the maximum child care credit for middle-class families with young children, increasing it to $3,000 per child. The child care tax proposals would benefit 5.1 million families, helping them cover child care costs for 6.7 million children. These tax proposals complement proposals to ensure that quality, affordable care is available to all eligible low- and moderate-income working families with young children, as opposed to the small share of children who receive this help today. In addition, this year's Budget makes critical investments that expand access to comprehensive early learning

Encouraging Retirement Savings

As many as 78 million working Americans — about half the workforce — do not have a retirement savings plan at work. Fewer than 10 percent of those without plans at work contribute to a plan of their own. The Budget proposes additional tax relief to small businesses that start offering a retirement plan, such as a 401(k), or that start automatically enrolling workers in their plan. The President's retirement proposals would give 30 million additional workers access to a workplace savings opportunity and would complement the Administration's efforts over the past year to make saving for retirement easier by creating the simple, risk-free, and no-fee *my*RA starter savings vehicle.

Innovation

One of the major strengths of our country remains our ability to innovate. The United States competes in a global economy, and to continue to provide jobs and opportunity for Americans, we need to invest in American innovation, bolster our manufacturing base, and keep our nation at the forefront of technology.

After a decade of decline, the manufacturing sector is adding jobs for the first time since the 1990s and is poised for growth in the years ahead. The Budget takes steps to build on recent bipartisan legislation and the nine manufacturing institutes funded to date to support 16 institutes by the end of 2016 and put us on pace to build 45 institutes over a decade; equip small and medium manufacturers with the capabilities and access to technologies they need to improve their innovation and productivity; and, through a new $10 billion public-private Scale-Up Manufacturing Investment Fund for American manufacturing start-ups, ensure that what is invented in America can be made in America.

The Budget calls for investing in a wide array of research and development, from the President's signature BRAIN Initiative (Brain Research Through Advancing Innovative Neurotechnologies), the Precision Medicine Initiative, and combatting antibiotic resistance to advanced manufacturing, clean energy technology, and agriculture.

To secure America's energy future and to protect the planet for future generations, the Budget helps increase American low-carbon energy production while improving energy efficiency. The Administration has made combatting climate change a high priority by working hard to reduce

carbon pollution here in the United States and by bringing other countries along to forge an effective global effort to combat this problem. In the United States, our carbon pollution is near its lowest levels in almost two decades. We set higher standards for fuel economy, so that our cars will go twice as far on a gallon of gas, and we are setting a new standard for trucks that will propel American manufacturing and spur the development of new technologies. This strategy has already borne fruit — thanks to lower gas prices and higher fuel standards, the typical family should save $750 at the pump this year.

Ensuring Our Nation's Safety and Security

The Budget recognizes that while America is a world leader in domestic economic growth, it must also continue to promote U.S. national security interests while mobilizing the international community to address global challenges to the nation's safety and security. That is why the Budget advances national security priorities by proposing the funding increases above current law needed to execute the President's defense strategy. The Budget includes $612 billion of total national defense discretionary funds, a $26 billion, or 4.5 percent, increase from the 2015 enacted level. This reverses the decline in national defense spending of the past five years and proposes to transition enduring overseas contingency operations costs to the base budget, to fully fund and account for the costs of keeping the nation secure.

Health Care Reform

With the Affordable Care Act in place, millions of Americans no longer have to worry that an unexpected illness will throw them into bankruptcy, and people with preexisting conditions are now guaranteed access to health insurance. We have reduced the share of uninsured Americans

by almost one quarter, as about 10 million people gained the financial security of health coverage in the past year alone. And since the Affordable Care Act became law, health care prices have risen at their lowest rates in decades. Had health insurance premiums kept growing at the rate they did in the last decade, the average annual premium for a family with an employer plan would be $1,800 higher than it is today.

The health care cost slowdown is already yielding substantial fiscal dividends. Compared with the 2011 Mid-Session Review, aggregate projected federal health care spending for 2020 has decreased by $216 billion based on current budget estimates, savings above and beyond the deficit reduction directly attributable to the Affordable Care Act. Including related interest savings, the savings totals $262 billion.

Comprehensive, Pro-growth Immigration Reform

The President believes that we need to fix our broken immigration system by continuing to strengthen border security, by cracking down on employers who hire undocumented workers, and by providing a pathway to citizenship for hardworking men and women who are already here and contribute to our nation every day.

Immigration reform will encourage economic growth and help achieve better fiscal policy. The President has laid out principles for immigration reform but wants to work with Congress to craft specific legislation. The Congressional Budget Office estimates that the immigration bill that passed with bipartisan support in the Senate in 2013 — and which is largely consistent with the President's vision — would increase the size of the economy by over 3 percent in the next

decade and more than 5 percent over 20 years. Meanwhile, the immigration bill would reduce the deficit by about $160 billion in the first decade and by almost $1 trillion over 20 years. Similarly, the Social Security actuaries have found that the Senate bill would reduce the Social Security shortfall by $300 billion over the first 10 years. The Administration supports the Senate approach and calls on the House of Representatives to act on comprehensive immigration reform this year.

Conclusion

In summary, this budget puts forward a series of proposals to keep America's economic resurgence on track, build on the progress we have made, and help more Americans share in our economic gains through rising wages, higher incomes, and a growing middle class. The roadmap laid out in this budget includes strategies for students to begin school prepared for success, graduate from high-school, and attend college without amassing unaffordable debt; for workers to find good jobs in high-tech manufacturing; for working families to care for a sick child or an aging parent; and for states and cities to rebuild their infrastructure and expand their broadband networks.

This Budget is practical, not partisan, and it provides a comprehensive and balanced approach to the realities we face. It invests in long-term growth, while also building on the progress that has already been made to ensure a sustainable path for the debt and deficit. The Budget is a credible, common-sense plan that makes hard choices. It focuses on middle class economics that will help drive growth, create jobs, and expand opportunity for all Americans, unlocking a brighter future for future generations. I believe, as does the President, that there is plenty of opportunity for

bipartisan cooperation and a number of areas where we can find common ground to move our country forward, starting with business tax reform. I look forward to working with the members of this Committee to make progress on tax reform this year. Together, we can achieve meaningful reform that will help America's families, boost our economy, and enable U.S. businesses expand and be more competitive.

Questions for the Record for Secretary Jacob Lew
Senate Committee on Finance
"The President's Budget for Fiscal Year 2016"
Hearing Date: February 5, 2015

Questions from Chairman Hatch

Question 1:

Various officials have made clear that the administration does not support a voluntary repatriation holiday. Administration officials have recently called it "bad policy," and have said that it "costs a lot of money." Rather, the administration desires to impose a one-time, 14 percent so-called toll charge on un-repatriated earnings and wants to transition to a hybrid international tax system with a 19 percent tax rate on foreign earnings moving forward. I understand that the 14 percent rate, which would generate $270 billion over 10 years, was selected to hit a revenue target for infrastructure spending. While I believe that those proposed rates are far, far too high, it could be useful to work together to reform our international tax system, as well as promote infrastructure. Meanwhile, I have two questions on the budget's proposal. First, I wonder if you could elaborate on why the administration does not support a voluntary repatriation holiday. And, second, I wonder whether you could explain why you picked 14 percent as your toll charge—is it just to hit a revenue and spending target?

Answer:

The Administration opposes a voluntary repatriation proposal because the proposal introduces problematic economic incentives, encourages future profit shifting, and increases Federal budget deficits. A repatriation holiday would not raise additional revenue to pay for infrastructure or other proposals. According to a recent JCT estimate of legislation introduced by Senators Paul and Boxer, a voluntary repatriation holiday reduces Federal tax revenue by $118 billion over the ten-year budget window.

The 14 percent rate for the "toll charge" was chosen because it was reasonably related to the 28 percent corporate tax rate envisioned in the Administration's business tax reform plan, and not so high as to be viewed as unfairly treating multinational firms that had accumulated earnings abroad. Clearly, a "toll charge" of some kind makes good sense in a transition to a new tax system for multinational firms.

Question 2:

Related to question 1, the 14 percent toll charge, as I understand it, represents some sort of tax so that, in a transition to a different set of tax rules governing foreign earnings, windfall gains are eliminated or attenuated. The notion behind those gains, also as I understand it, is that under the law governing earnings of U.S.-based multinationals, earnings in past periods were made with the understanding that, once repatriated, they would be subject to the internationally high 35 percent rate, after accounting for credits and the like. Therefore, the notion goes, those earnings should not now be allowed to be repatriated at some fresh lower rate, such as 19 percent, because that would effectively grant a windfall gain to holders of those earnings. If we accept that, then some, including the administration if I am correct, argue that the toll charge revenues accruing to the

government represent only transitional revenues that will not accrue indefinitely into the future. Therefore, the argument goes, those revenues ought not be used in a corporate tax reform exercise because, given short-term budget windows used to "score" reform, if those revenues were to be devoted to corporate tax rate reductions, we could end up engineering a tax reform that looks "revenue neutral" in the short-term (i.e., over a typical 10-year budget window), but would leave a long-run revenue outlook that would in some sense be "too low." Such an argument seems to suggest that scoring of tax policy reforms ought not be done with a budget window of only, say, 10 years, but should be done with a view toward long-run revenue neutrality, if revenue neutrality is a goal of reform. Does the administration believe that tax reform should be scored on the basis of a budget window longer than 10 years, akin to analyzing changes to a pension plan or the Social Security system, in order to attain some sense of long-run sustainability? If not, why would we not utilize toll-charge revenue to lower corporate rates utilizing the traditional 10-year budget window? If so, why would we not utilize toll-charge revenue to lower corporate rates utilizing some measure of long-run sustainability, such as revenue neutrality in present-value terms over a 75-year or some other long-term projection horizon? In any case, why would it necessarily follow from a tax reform exercise that anything viewed as transitional revenue ought to be devoted to a particular category of outlays, rather than tax relief?

Answer

It would be very difficult for companies and the IRS to work indefinitely under two separate tax systems, one for old earnings and one for newly generated earnings. The "toll charge" is intended to represent an appropriate settling of accounts when switching to a new tax system. The transition eliminates the need to account for deferred tax liabilities on profits that accrued under the old tax system.

You are correct in your analysis of why the Administration would not count the transition charge in the measurement of revenues from business tax reform. It is to avoid anticipatable revenue losses in the long run. We and the Joint Tax Committee agree that the so-called "toll charge" represents a temporary, one-time source of revenue, while a cut in the corporate tax rate entails a permanent reduction in revenue. Indeed, under typical budget accounting procedures, the one-time revenue from the toll charge cannot fully cover the long run costs of any permanent cut in the corporate tax rate, whether considered over a long budget period or a representative year in which tax reform is fully phased in, because the toll charge raises no additional revenue as time passes while the corporate tax rate cut lowers revenue every year after enactment.

The toll charge is but one example of a temporary source of tax revenue. There are others that are potentially important in business tax reform.

Because of the size of temporary revenue gains, the Administration believes that some type of longer-term accounting is appropriate in assessing whether business tax reform achieves a goal of revenue neutrality. Otherwise, the result could be a tax system claimed to be part of a revenue neutral reform that would be well short of revenue once fully phased in, in the long run.

There are several useful ways to characterize long-term revenue neutrality. One could look at future time periods, such as the second decade after enactment. One could also consider approaches that moved away from traditional undiscounted cash flow accounting, and towards a discounted present value measure. A discounted present value measure, however, would be a large change from current practice and would involve overcoming many difficult conceptual and practical problems.

We do not believe that all transitional revenues must be allocated to outlays. We do believe, however, that transitional revenue (as typically measured) should not be allowed to fund permanent tax cuts that entail revenue losses well outside the budget period. The Administration strongly believes that shoring up America's deteriorating transportation infrastructure is one very appropriate use of transitional revenue.

Question 3:

The budget proposes to do virtually nothing to confront financial challenges facing Social Security. The President came into office promising not to kick entitlement cans down the road, yet the President's budget now proposes to do just that. When asked about this, administration officials have said that Social Security is not ignored, because immigration reform is in the budget. Unfortunately, even with the budget benefits from immigration reform-that are realized through dynamic scoring which the administration embraces in this case-there would still be unfunded liabilities in Social Security of nine to ten trillion dollars over the next 75 years. In both the short run and long run, immigration reform doesn't come close to solving the problem. On the impending exhaustion of the disability insurance (DI) trust fund in 2016, the administration wants a stand-alone payroll tax reallocation, moving funds from one Social Security trust fund to another with no structural changes to the program. However, a stand-alone reallocation from the retirement (or Old Age Survivors Insurance-OASI) trust fund to the DI trust fund has never occurred in the past, according to officials at the Social Security Administration (SSA). I have three questions. First, why has the administration, including SSA, been unwilling to engage with Congress to work on Social Security's financial challenges? Second, do you acknowledge that the administration's preferred approach to deal with the DI trust fund - a stand-alone reallocation - has never been done in the past? Third, given numerous past reallocations between trust funds—sometimes from OASI to DI, more often from DI to OASI, sometimes with overall payroll tax rate changes and sometimes not—under circumstances different from the current environment, do you believe the separate DI and OASI "trust funds" are mere accounting devices, where money can be moved from one to the other occasionally? If so, do you advocate merging the two "trust funds" into a single account in order to avoid having to engage in future "reallocations" that some claim are mere technical changes?

Answer:

The President believes that Social Security is critical to ensuring that all Americans have the opportunity to retire with dignity and to protecting families when a worker who paid into the system becomes disabled and needs the benefits he or she has earned. The President believes we

need to work in a bipartisan fashion to strengthen Social Security – just as in 1983, under the leadership of then-President Reagan and House Speaker Tip O'Neill – and has laid out six principles for strengthening Social Security that should be the basis for any bipartisan reform:

- Any reform should strengthen Social Security for future generations and restore long-term solvency.
- The Administration will oppose any measures that privatize or weaken the Social Security system.
- While all measures to strengthen solvency should be on the table, the Administration will not accept an approach that slashes benefits for future generations.
- Current beneficiaries should not see their basic benefits reduced.
- Reform should strengthen retirement security for the most vulnerable, including low-income seniors.
- Reform should maintain robust disability and survivors' benefits.

The Administration stands ready to discuss strengthening Social Security that is based on the President's six principles.

Although there has not been stand-alone legislation that reallocated payroll tax flows from the OASI trust fund to the DI trust fund, there has been stand-alone legislation that reallocated payroll tax flows from the DI trust fund to the OASI trust fund; Public Law 96-403 (1980) amended section 201(h) of the Social Security Act to increase the amount of the payroll tax allocated to the OASI Trust Fund, while decreasing the amount allocated to the DI trust fund. We would note that the most recent reallocation – in the Social Security Domestic Employment Reform Act of 1994 (Public Law 103-387) – included merely a handful of other changes. For instance, the 1994 legislation included a few provisions that simplified the payment of employment taxes on domestic employees, and extended the prisoner nonpayment provisions under title II of the Social Security Act to certain individuals confined by court order to a public institutions.

The President's proposal to reallocate payroll tax funds for five years is similar to reallocations that have occurred many times in the past. For example, as explained in a report of the Senate Finance Committee in considering the bill that eventually became enacted as Public Law 96-403 in 1980, "Reallocation has been the traditional way of redistributing the OASDI tax rates because of changes in benefit provisions and in the experience of the program. The Committee bill would provide for such a reallocation between the OASI and DI funds for two years only, 1980 and 1981. This is expected to maintain sufficient reserves in the OASI fund to pay benefits through the end of 1981, giving Congress time to take further remedial action next year." (Senate Rpt. No. 96-946 (1980)).

In six prior reallocations, the total payroll tax rate did not change. In these reallocations, funds shifted from OASI to DI on three occasions, and funds shifted from DI to OASI on three occasions. In five prior reallocations, the total payroll tax changed. In these reallocations, funds shifted from OASI to DI on three occasions, and funds shifted from DI to OASI on two occasions.

Moreover, the President's budget includes a number of additional provisions designed to strengthen the Social Security program by improving program integrity and developing an evidence base for improving employment outcomes for people with disabilities. For instance, to continue to strengthen the integrity and accuracy of Social Security, the Budget proposes to establish a dependable source of mandatory funding beginning in FY 2017 for CDRs and Redeterminations, which ensures that only those eligible for benefits continue to receive them. This proposal, along with the discretionary funding proposed in FY 2016, would eliminate the backlog of about 900,000 CDRs by the end of 2019 and prevent a new backlog from forming in the Budget window. In addition, building on bipartisan support for early intervention demonstration projects in FY 2015, the FY 2016 President's Budget includes a request for $50 million in research for early intervention demonstrations, as well as a legislative proposal for an additional $350 million for FYs 2017-2020.

Question 4:

The President's budget contains a new proposal to tax certain appreciated property at death. I realize that the proposal contains a carve-out for certain tangible personal property, a $100,000 per-person exclusion, and a $250,000 exclusion for principal residences. However, I'm concerned about the small family-owned businesses and family farms that could be impacted by this proposal- and that is a gentle way to describe the likely effect. Some may dismiss the concern by citing data to suggest that only a small number of small family-owned businesses and family farms would be affected by the President's new death tax proposal, but such a dismissal seems to suggest that those entities must be deemed to be losers in altering tax policy, for some greater good. The administration's vague explanation of the small business and family farm exception - that the proposal would not affect certain small family owned businesses and family farms until they are sold or cease to be family owned concerns me. Would you shed some light on how or whether the President's new approach to the death tax would alleviate in any way the onerous tax and bookkeeping burdens of the President's proposals on these small, family-owned businesses and farms?

Answer:

Under the proposal to tax certain appreciated property at death, the tax payment for small, family-owned business and farms could be deferred until the business is either sold or no longer family owned and operated. Alternatively, the tax on the appreciation of the business, along with the tax on other non-liquid assets, could be paid over 15 years on a fixed-payment basis. These provisions would protect small, family-owned businesses and farms and are in addition to the $100,000 per-person exclusion ($200,000 for a married couple) for certain tangible personal

property, and the $250,000 exclusion for principal residences ($500,000 for a married couple) available to all taxpayers. The President's approach (including the special small-business provisions and the exclusion) is intended to limit changes to the tax and bookkeeping requirements of small, family-owned businesses and farms.

Question 5:

I have several questions pertaining to the proposed 19 percent minimum tax on foreign income proposed in the budget. First: Do any other countries in the world tax foreign income in the way the administration has proposed? Second: Does the 19 percent minimum tax assume that the full U.S. corporate tax would be 28 percent; or, does it assume that the current 35 percent tax rate would continue? Third: With such a high and immediate tax on foreign-source income, which would only apply to U.S.-based companies, the proposal would create significant pressure for U.S. global corporations to invert. It seems that the authors of the budget share this concern, which is why they did not propose to tax foreign earnings at the full corporate rate. Are you at all concerned that this proposal would lead to an increase in inversions? Fourth: What was the thinking behind subjecting past earnings to a 14 percent tax, and the new earnings to a 19 percent tax? Although the proposal has a foreign tax credit mechanism, or 85% of a foreign tax credit, it is not referred to as a foreign tax credit. Can you explain that please? Is that because it is only 85% of a foreign tax credit?

Answer:

Other countries have adopted a wide range of approaches to taxing the foreign income of multinational companies headquartered in their jurisdictions. These systems differ from each other and from the current U.S. system and the Administration's minimum tax proposal, in a variety of ways. However, most generally exempt (partially or fully) some categories of foreign income and tax currently other categories at the full corporate tax rate. The minimum tax proposal would move the U.S. system closer to international norms by eliminating deferral, under which U.S. tax on foreign earnings is generally deferred until the earnings are repatriated, in favor of permanently exempting from U.S. tax certain categories of income (income subject to high foreign tax rates and income representing a risk-free return on the active operations of a foreign subsidiary) and taxing other income immediately at the full corporate tax rate (under subpart F) or at a reduced tax rate (under the minimum tax).

The 19-percent minimum tax proposal is premised on a reduction in the maximum U.S. corporate tax rate to 28 percent. Reducing the corporate tax rate is important for many reasons including reducing incentives for U.S. base-stripping.

The choice of a 19-percent rate represents an attempt to reconcile competing policy goals, including maintaining the attractiveness of the United States as a place for high-quality jobs, minimizing incentives and opportunities for U.S. base-stripping, and reducing disparities among U.S. businesses with varying degrees of foreign operations. This 19 percent rate also helps to ensure that the entire tax reform plan is revenue neutral in the long run.

As noted in the answer to question 1, the 14-percent rate was chosen because it was reasonable in relation to the 28-percent corporate income tax rate contained in the President's plan for business tax reform and not so high as to appear unfair. The 14-percent rate is not conceptually linked to the 19-percent rate in any significant way.

The minimum tax rate is determined in a way that effectively provides an 85-percent foreign tax credit, but the proposal does not include a foreign tax credit per se for foreign taxes associated with income subject to the minimum tax. Instead, the proposal generally provides that the minimum tax will be imposed at a rate of 19 percent less 85 percent of the per-country foreign effective tax rate. The foreign effective tax rate is computed based on the 60-month period that ends on the date on which the domestic corporation's current taxable year ends. This 60-month period dampens variation in the residual U.S. tax that otherwise could result from transitory changes in the foreign effective tax rate.

Question 6:

What is the thinking by authors of the President's budget in the 15 percent "haircut" to the foreign tax credit mechanism? Is it because "it may be difficult for the IRS to verify that a taxpayer has exhausted practical remedies under foreign law to reduce its reasonably expected foreign tax liability over time in a manner consistent with a reasonable interpretation of foreign law?" That is, by having to bear some of the cost of foreign taxes, US companies will take greater steps to exhaust practical remedies to reduce their foreign tax? Why a 15 percent haircut on the foreign tax credit? If such a haircut makes sense, would it also make sense for the foreign tax credit in general, not just as to the 19 percent minimum tax? Should the haircut on the foreign tax credit be 19/28? (And, do you wish for the top corporate tax rate to be 28 percent?) Or should there be an 81 percent haircut on the foreign tax credit?

Answer:

You identify one advantage of the 15-percent foreign tax credit "haircut" as creating an incentive for U.S. taxpayers to exhaust their practical remedies to reduce foreign taxes paid. The 85-percent haircut reflects consideration of the overall effective tax rate imposed on the foreign income of U.S. multinational companies under the 19-percent minimum tax.

Question 7:

The deficit has come down, but remains too high, and the President's latest budget promises endless deficits and leaves debt relative to the size of our economy at levels not seen since a couple of years surrounding World War II. While we have heard many promises in the past about "balanced" deficit reduction, more than 98 percent of the deficit reduction from the high watermark of deficits in fiscal year (FY) 2009 through fiscal year 2014 is accounted for by increased revenue. Only less than two percent comes from spending restraint, hardly something anyone could call mindless austerity. Moreover, the only deficit reduction stemming from spending restraint comes from reduced discretionary outlays; outlays for mandatory programs combined with net interest actually rose over the deficit reduction period. Do you acknowledge those fiscal facts?

Answer:

Spending cuts have accounted for the vast majority of the improvement in our budget balance. Deficit reduction to date on the President's watch has featured a ratio of spending cuts to new revenues that is more than 2.5 to 1 – even with proposed new investments.

Since FY 2009, the deficit has fallen in nominal terms and as a percentage of the economy for a variety of reasons: 1) the phase out of temporary stimulus policy, 2) the phase out of temporary measures to stabilize the financial and housing sectors, 3) the reduction in automatic stabilizers as the economy has recovered from the deepest recession since the Great Depression, 4) the introduction of caps on appropriated programs, 5) sequestration and spending reductions in both mandatory and discretionary programs, and 6) the expiration of temporary tax rates introduced by the George W. Bush administration, partially offset by rate cuts and the extension of tax credits for low- and middle-income taxpayers.

The deficit has fallen from $1.4 trillion in FY2009 to less than $500 billion in FY 2014. Last year's deficit represented 2.8 percent of GDP, a drop of 7.0 percentage points from the FY 2009 peak of 9.8 percent of GDP, as a result of both explicit policy actions and improvement of the economy over the past five years. It is difficult, though, to isolate the deficit reduction from each component, while accurately accounting for any interactive effects.

The President's FY 2016 Budget would build on this progress as it, on net, contains $1.8 trillion in additional deficit reduction, not including savings from reducing expenditures for Overseas Contingency Operations (OCO). These cuts would reduce the deficit to 2.5 percent of GDP by FY2025, 0.2 percentage point of GDP less than the 50-year average (1965-2014).

Question 8:

The President's budget promotes something called "middle class economics." However, it looks like the proposed tax hikes on capital income and death would hit Americans with incomes starting at around $100,000 per year with thousands of new taxes. And, at that income, it looks as though all the promised benefits would not offset the higher taxes. Of course, $100,000 of income may be comfortable. But in some areas, such as Washington D.C. or New York City where you previously worked, Secretary Lew, it would be a stretch to say that a family earning that amount is "rich." Is it now the case that the administration considers that the "middle class" ends somewhere around $100,000 of family income, and everyone above that needs to be taxed significantly more to enable more redistribution that would somehow, according to this administration, fuel economic growth? And, are the proposed tax hikes in the budget consistent with earlier pledges by the President not to raise any tax on the middle class?

Answer:

The proposed application of tax to the amount of gain on appreciated property on an individual's last income tax return is consistent with the President's pledge not to raise taxes on the middle class. The provision would only apply to capital gains in excess of $100,000 per person ($200,000 per couple) and would also exempt gains on all personal effects and gains on personal residences up to $250,000 per person ($500,000 for a married couple). Additional protections would apply for family businesses, spouses, and gifts to charity. As a result, the proposed tax on accrued capital gains income would be very progressive. In 2016, more than 99 percent of the burden of the proposed reform of the taxation of capital income is expected to fall on households with adjusted gross income and gains at death exceeding $500,000.

While the capital gains tax reform proposals have minimal impact on the middle-class and working families, the President's other Budget proposals would provide those families with substantial tax relief. These proposals include a simplified and dramatically expanded child care tax credit (including tripling the credit for families with young children), a new dual-earner tax credit, a permanent and expanded American Opportunity Tax Credit, permanent improvements to the Earned Income Tax Credit and Child Tax Credit, and other proposals. Combined, the President's proposed tax cuts would provide over 44 million working families with an average tax cut of nearly $600.

Question 9:

In your written testimony, you talk about the importance of international trade to our economy and how export expansion will create new opportunities for American companies, including small businesses, to grow. Your testimony also expresses the administration's desire to pass trade promotion authority (TPA). Can you please briefly elaborate on the importance of trade for America and talk about why renewing TPA is so important to helping our economy grow?

Answer:

Bolstering global economic growth and stability remains a priority of the United States, and the U.S. Department of the Treasury has been working hard over the last six years to achieve a high-standard trade and investment agenda that raises income and spurs growth. Our robust trade agenda — the cornerstones of which include the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP) agreements — will expand opportunities for American businesses, foster high-quality jobs, and further unlock the macroeconomic gains from expanded trade and investment.

From a domestic perspective, well-crafted trade agreements boost U.S. and global exports of goods and services and opportunities for American workers, even as they raise the standard of living for consumers, through greater choice and access to quality imports. From an international perspective, lower trade barriers and stronger reforms abroad benefit both U.S. economic competitiveness and global economic prosperity. More than 95 percent of the world's consumers live outside our borders, and agreements like TPP and T-TIP will further integrate the

U.S. economy with its fastest growing and largest consumer markets overseas. Renewing TPA helps us to achieve the best possible negotiating outcome so that we can further open global markets to U.S. goods and services, boost economic growth, and support high-quality jobs.

Question 10:

Secretary Lew, the White House press secretary made a statement recently about Social Security, saying "frankly, we've not gotten a lot of serious willingness on the part of Republicans to engage in that conversation." Of course, as you know or should know, I have indicated a serious willingness to engage in conversation about Social Security for a long time now. I've asked questions about it for years, including questions to the Social Security Administration and to Treasury. And I have heard nothing of substance in response. It is not clear to me what planet the White House press secretary lives on, but let me make clear once again my desire for someone, anyone, in the administration to begin dialogue on Social Security. We know that the disability insurance trust fund is projected to be exhausted next year, and we know that the administration's budget proposal to have a stand-alone trust fund reshuffling is untenable. It remains unclear to me how a representative of the administration make can such a false claim about Republicans willingness to have serious discussions about Social Security. The President's budget proposals for Social Security would do nothing even close to significant to address the more than $10.5 *trillion* of unfunded liabilities in the Social Security programs that are projected over the next 75 years. Yet the President came into office pledging not to kick the can further down the road. Is there anything that the administration is willing to discuss with me to at least begin to have dialogue about addressing the financial challenges facing Social Security and modernizing the programs to better fit current needs, and are there any proposal(s) it is willing to put forward beyond the budget's calls for more administrative funding or experiments (pilot programs)? In addition, given that your testimony identifies that the President's budget "invests in the American people," please explain how ignoring promises embedded in Social Security that you in your role as Trustee of the Social Security trust funds, identify as being financially unsustainable, is an investment? Please explain how it is fair to younger generations of workers that they inherit what are currently known to be unsustainable promises that will have to be made sustainable by them, because the budget ignores the unsustainability, in the form of higher taxes and/or reduced benefits? Explain how deferring and saddling younger generations of workers with higher taxes and/or lower benefits is an investment in them?

Answer:

The Administration has endorsed the reallocation of payments between the OASI and DI Trust Funds as a measure to forestall the depletion of the DI Trust Fund reserve because it leaves the overall financial status of the combined OASDI Trust Funds unchanged while averting deep and abrupt cuts in benefits for workers who paid into the system while they worked, became disabled, and now need the Social Security benefits they have earned. We believe that a one-time reallocation of payroll tax revenues, as has been done many times in the past on a bipartisan basis, is a common sense approach, but we would also be happy to discuss alternative

approaches that avoid depletion of the DI Trust Fund reserves and a sharp and sudden reduction in benefits, while also protecting current and future workers who become disabled.

We acknowledge that we have ongoing long-term financing challenges related to Social Security and Medicare, but it is also wrong to ignore the progress we have made over the last few years. In 2009, the 75-year projected unfunded obligations for Medicare and Social Security totaled 5.6 percent of GDP. In 2014, that share was down to 3.9 percent, a 30 percent reduction, largely due to the projected impact on Medicare of the Affordable Care Act. We are confident that the reforms in the Affordable Care Act not only strengthen the finances of Medicare, but are also resulting in better care for beneficiaries.

We look forward to making further progress on strengthening the finances of Social Security and Medicare and are very interested in your ideas.

Question 11:

Secretary Lew, we already have one death tax—it's called the estate tax. Now, the President proposes that we have a second death tax on capital gains. Do you believe that it makes sense to tax the same assets twice under two separate death taxes?

Answer:

It is incorrect to characterize the proposal to repeal the step-up in basis at death provision as taxing the same assets twice. Capital gains realized during an owner's life are taxed and the net proceeds (whether held in cash or reinvested) would form part of the gross estate of that owner at death for estate tax purposes. However, asset appreciation not realized before death escapes income tax altogether. Families with modest resources generally must sell assets to provide for their living expenses in retirement and do not have other sources of financial wealth to enable them to hold assets until death and thereby avoid the income tax on capital gains. Thus, this proposal would achieve consistency in the income taxation of appreciation of assets and provide greater equity between families that need to draw down their assets for retirement income and those that do not. In effect, the proposal ensures that appreciated gains on assets are taxed once, and do not escape taxation altogether. Further, a person who inherits an appreciated asset receives a basis in that asset equal to the fair market value as of the date of death. The current inequality between the income tax treatment of gains realized during life and those held until death, and the step-up in basis at death, produces a strong incentive to retain assets until death solely for the purpose of avoiding capital gains tax.

Question 12:

When the Highway Trust Fund was created in 1956, with the gas tax as a funding mechanism, the idea was that users of highways would pay for them. Since then that user-pays model has come under stress from increased burdens being placed on the trust fund and spending that outpaces revenues. Revenue is only one-half of the Highway Trust Fund ledger, of course. Equally important is the other half- how money is spent. What we spend it on and the accountability for that spending is just as important. It seems to me that by

suggesting that money be taken from changing the tax code in the name of tax reform, while not addressing the imbalanced nature of the Highway Trust Fund simply defers action on an admittedly difficult issue. However, I believe in preserving the user-pays model of funding, that has formed a foundation for infrastructure spending for almost 60 years. I also believe strongly that we need serious discussions about how money is spent and on bringing more accountability to infrastructure spending. Does the administration want to preserve the Highway Trust Fund and the user-pays model of financing that we have relied upon since 1956?

Answer:

The Administration has proposed (in the GROW AMERICA Act) to preserve Highway Trust Fund solvency for six years and increase investments to meet national economic goals. Funding for this initiative would come from existing fuel taxes supplemented by one-time or temporary revenue from long-term revenue neutral business tax reform. The Administration believes that this revenue mix that combines existing fuel taxes, which are partially rooted in a user cost concept, with funds from the one-time tax revenue from business tax reform offers an attractive and appropriate combination of financing sources. The Administration looks forward to working with Congress to address our nation's critical infrastructure needs, over the short and long term.

Question 13:

In a joint address to Congress in February 2009, President Obama pledged: "If your family earns less than $250,000 a year, a quarter million dollars a year, you will not see your taxes increased a single dime. I repeat: not one single dime." Elsewhere, the President stated that individuals with less than $200,000 of income would not have a tax increase. Is that pledge still operative? Is that still a guiding principle for this Administration? Are there any tax increases in this year's Green Book that would increase taxes on couples making less than $250,000, or on singles making less than $200,000?

Answer:

Improving fairness in the tax code is a guiding principal for this Administration. This point is illustrated in the Budget where all income groups below $200,000 would receive net tax cuts from the President's Budget proposals.

Moreover, during his first term in office, the President signed legislation that cut taxes by $3,600 for a typical middle-class family. He created the American Opportunity Tax Credit (AOTC) for college students and strengthened the EITC and child tax credit, helping 16 million working families with children to make ends meet. The President's Budget continues this effort by making these important improvements permanent and would also provide over 44 million middle-class families with an additional average tax cut of nearly $600.

Question 14:

Assume the following:
- A married couple with Adjusted Gross Income of $220,000
- They file jointly
- The couple has two children, ages six and nine
- They have $7,000 per year in eligible child-care expenses
- They claim four personal exemptions of $3,950 each
- They claim the standard deduction of$12,400
- They contribute the maximum amount to their FSA of $5,000
- The 2014 tax tables, personal exemption amounts, and standard deduction are in effect
- The "Reform Child Care Tax Incentives" proposal is in effect for 2014

Do you agree that that their taxable income under current law would be $186,800? (i.e.: 220,000 - ((4 X 3,950) + 12,400 + 5,000)?

Could this married couple filing jointly with AGI of $220,000 have a tax increase if the President's proposal regarding the child-care credit and FSAs gets enacted into law? My staff has calculated that their tax would be $39,551 and that they would be able to claim a child-care credit of $200, and so that their total tax would be $39,351. If President Obama's proposal were enacted, however, then assuming the same facts, their tax liability would be as follows (remember that the child-care FSA would no longer exist): their taxable income would be $220,000 - ((4 x 3,950) + 12,400) = $191,800. The pre-credit tax would be: $40,951. The amount of the credit would be: $1200 (i.e., $6,000 x 20%). So, their total tax would be $39,751 (i.e., $40,951 - $1 ,200). It appears that this couple's taxes would have gone up by $400 (i.e., $39,751 - $39,351) – do you agree?

Next, let's consider a different example. Assume the following:
- A single mother with Adjusted Gross Income of $68,000
- She files as a Head of Household
- She has one five-year-old child
- She spends exactly $5,000 on eligible child-care expenses, all of which come from her FSA
- She claims two personal exemptions of$3,950 each
- She claims the standard deduction of $6,200
- She contributes the maximum amount to her FSA of $5,000
- The 2014 tax tables, personal exemption amounts, and standard deduction are in effect
- The "Reform Child Care Tax Incentives" proposal is in effect for 2014

Do you agree that this single mother's taxable income, under current law, would be $68,000 - ((2 X $3,950) + $6,200 + $5,000) = $48,900?

Do you agree that her current law tax would be: $6,691?

Moreover, do you agree that, if the President's proposal were enacted, her taxable income would be $53,900? And, thus, her pre-credit tax would be: $7,894? Her credit would be: 35% x $3000, or $1050 (remember, the amount eligible for the credit with only one child is $3,000, not $5,000). So, her total tax would be: $7,894 - 1,050, or $6,844. That is, under the President's proposal, this single mother with Adjusted Gross Income of $68,000 would owe $153 (i.e., $6,844 - $6,691) of additional tax as compared with current law. Is this correct?

Answer:

While it is possible to create hypothetical examples of fact patterns where some families might see an increase in income tax under the President's proposal, the President's child care tax reforms invest an additional $50 billion in working, middle-class families with children through a more robust child care tax credit that greatly simplifies compliance with the tax code. For example, we calculate for your example of a single mother with $68,000 of AGI that she would owe less tax compared to current law due to her eligibility for a larger child care tax credit under the President's proposal. She also would avoid the complexity of having to navigate FSA requirements to be reimbursed for child-care expenses. Once the President's proposal is in effect, most middle-class working parents will receive more child care assistance through the tax code for three reasons: (1) they will receive a much larger credit while their children are young, with the maximum credit tripled for children under 5; (2) the level of income at which the credit begins to phase down is increased substantially; and (3) the expense amount and income phase-down thresholds will be indexed for inflation to ensure the credit maintains its value over time.

Question 15:

The President's budget proposes a bank tax, relabeled from what used to be labeled by the administration as a financial crisis responsibility fee, before the administration began boasting about profits from private assets that the federal government took on during the financial crisis. The new labeling comes with a new motivation, as well, to "complement" other administration policies aimed at preventing future financial crises and "making the economy more resilient." The budget states that "Even with the end of 'too big to fail,' excessive leverage still creates risks for the broader economy." Please state clearly whether you agree that "too big to fail'" has ended, without qualifier—that is, not simply as "a matter of law," but unencumbered as in the budget which clearly states "the end of 'too big to fail." Please identify why regulators and the opaque, unresponsive Financial Stability Oversight Council, charged with the overly heroic objective of monitoring and warning of systemic risks, cannot adequately do the job of preventing future financial crises without need for complementary taxes on intermediation?

Answer:

Since the crisis, the Administration and Congress have taken major steps to make the financial system safer and the broader economy more resilient, including enacting legislation that ensures taxpayers will never be on the hook for bailing out failing financial firms.

Consistent with such past actions and recognizing that excessive leverage undertaken by major financial firms was a significant cause of the crisis, the President's comprehensive Business Tax Reform plan includes a financial sector fee that would further discourage large financial institutions from excessive risk-taking through the use of leverage. This fee would be imposed only on the very largest financial institutions and would serve as a disincentive to excessive leverage.

Question 16:

The President's budget request targets completion of 16 million Social Security Numbers (SSNs) for fiscal years 2015 and 2016, unchanged from the number in fiscal year 2014. However, as you know, the President acted unilaterally last year to provide work authorization and abilities to receive Social Security numbers for millions of previously non-work-authorized workers. Even with the Department of Homeland Security concocting some new enumeration (i.e., screening and file compilation for shipment to Social Security to churn out Social Security numbers quickly) process for those millions, how can the President present a budget request with SSN performance targets that the President knows are incorrect because of his unilateral immigration action?

Answer:

We defer to the Social Security Administration (SSA) regarding the SSN performance targets in the President's budget request.

Question 17:

While the President seems to have withdrawn his initial attempt to tax education savings of American families in so-called 529 plans because American families do not like the proposal, I understand that the administration still supports the proposal. Presumably, that means that the proposal will arise again in future budgets, with the notion that the educational savings of American families is deemed to benefit certain families more than others. I am proud to have recently supported the "ABLE Act" which created so-called ABLE accounts, providing tax relief for families to help with individuals facing challenges surrounding disabling conditions. Those ABLE accounts have not yet been set up, but have similarities with 529 education savings accounts—indeed, ABLE's are 529A accounts. Given that the administration still supports the idea behind taxing 529 savings, on the grounds that the tax relief associated with those education saving accounts accrue more to some than others and therefore ought to be "repurposed" or redistributed, it is reasonable to assume that the administrations 529-tax proposal in the budget, subsequently withdrawn, may give those interested in establishing ABLE accounts reason for pause. In my view, it is unfortunate that the administration's 529 tax proposal generates uncertainty

for families saving for education and, now, perhaps to establishment of a robust ABLE account infrastructure. Does the administration intend to pursue restructuring of tax relief associated with ABLE accounts in the future in attempts to repurpose that relief through redistribution from some ABLE account holders to other families in the form of some other tax relief for those other families?

Answer:

The Administration has no plans to propose changes to the statutory requirements of section 529A accounts.

Question 18:

Your testimony identifies that the President's budget proposes to "make community college and career and technical schools free for responsible students." What do you project will be the cost to American taxpayers of "free" community college and career and technical schools?

Answer:

For fiscal year 2016, the Administration requests $1.4 billion in mandatory funding to support America's College Promise. The proposal would cost $60.3 billion over 10 years, and would be funded with mandatory funds. Funds provided under this program would be used to eliminate community college tuition and fees for eligible first-time students, regardless of age or whether they are recent high school graduates. Unlike "last-dollar" scholarship programs, America's College Promise would be a tuition waiver program funded by new Federal and State resources. Therefore, low- and moderate-income students would continue to be eligible for Federal student aid (including Pell Grants) that they can use to cover other costs of attendance, such as books, supplies, housing, and transportation costs.

Question 19:

In the President's proposal to "reform the taxation of capital income," the Green Book states that "payment of tax on the appreciation of certain small family-owned and family operated businesses would not be due until the business is sold or ceases to be family-owned and operated." In testimony before the Committee, you indicated that the threshold for determining whether a business would be considered "small" would be "$1 million." Is this based on revenues, asset values, both, or something else? In another of the President's proposals, "expand simplified accounting for small business and establish a uniform definition of small business for accounting methods," the President proposes to "create a uniform small business threshold at $25 million in average annual gross receipts." Why is a different definition of "small business" being used in the proposals described above? Why does the Administration propose to add more complexity into the tax code by utilizing different definitions of "small business?"

Answer:

The definitions of small business differ between the two proposals because the purposes of the definitions differ. In one case certain family-owned and-operated small businesses are being offered a deferral of income tax due on a one-time tax event – the deemed realization of capital gains on the death of a principal owner.

In the simplified accounting proposal, the definition of a small business is intended to reduce the annual burden of tax accounting for smaller businesses. At present, various accounting provisions provide special or simplified accounting treatment for businesses with less than $1 million, $5 million, $10 million, or $25 million in average annual gross receipts, depending upon the accounting provision involved, and the type of activity or the form of the business. The simplified accounting proposal aims to ease compliance by providing a single and relatively generous definition of "small business" for a number of commonly-used accounting rules.

While no specific definition of a small business is included in the President's proposal to reform the taxation of capital income, the Administration would be willing to work with Congress to identify an appropriate definition for this purpose.

Questions from Senator Roberts

Question 1:

When you testified before this Committee in February 2013, I asked you about the efforts by 11 European States to adopt a financial transaction tax proposal recommended by the European Commission that would be broadly extraterritorial. You responded that the Treasury Department has raised concerns with European counterparts about the possible extraterritorial application of such a law. Now that 10 of the states have committed to introducing an FTT law by January 1, 2016, will you reiterate the concerns you raised in 2013 in order to dispel any uncertainty about the United States opposition to extraterritorial tax laws?

Answer:

Several Member States of the European Union have decided to move forward with a financial transaction tax, but we have decided to pursue a smarter approach that would impose a tax on large financial institutions rather than retail investors. The Administration's FY-2016 budget includes a proposal for a Financial Fee that would be assessed on certain liabilities of the largest financial firms. This proposal reflects the following rationale: the bigger they are, the more leveraged they are, the more risk they pose to the financial system, the more they pay in the form of this financial fee. In addition, our proposal does not give an incentive for financial transactions to be reengineered, or migrate to risky venues, to avoid being subject to the financial transactions tax. We do not support any European financial transaction tax which has the potential to harm U.S. investors in the U.S. who have purchased affected financial products. Treasury has raised these concerns with our European counterparts, and will continue to voice these concerns moving forward.

Question 2:

As you may know the French government is currently imposing a financial transaction tax on trading in American Depositary Receipts (ADR)s of French securities. ADRs are U.S. securities that are traded primarily in the United States and are often owned by U.S. retirees through a mutual fund or other collective investment vehicle. They represent shares in French stock, but they are usually issued by a U.S. bank and traded on a U.S. exchange. There is a long-standing treaty in place between the United States and France that, in Article 29, specifically addresses cross-border application of stock transaction taxes. The securities industry filed a request for competent authority assistance under the US-French Tax Convention in December 2012 arguing that this provision applies, but to my knowledge, there has been no official response from the French Government. In your response to a question I asked you in 2013, you said that the United States opposes extraterritorial FTT laws "because it would harm U.S. investors." I appreciate that response and agree with it, but the French FTT is also extraterritorial and it directly harms U.S. investors in its application to ADRs.

a. **What is the United States' position on the application of Article 29 of the U.S.-French Treaty to the French tax on ADR transactions?**
b. **What is the United States doing to encourage a formal response from the French Government to this request under the dispute resolution provision of the Treaty?**
c. **Would you agree that, in general, the United States and France should not seek to tax stock transactions outside their own territories?**
d. **Would you be willing to ask the French government to disclose to my office how much revenue it has collected from ADR transactions subject to French FTT since the tax was imposed in December 2012 and how much it expects to collect in the next 10 years?**

Answer:

The Treasury Department agrees with the concerns you have raised regarding the cross-border reach of the French financial transactions tax. As you are aware, we have publicly and privately stated that we would not support any tax that has the potential to harm U.S. investors who have purchased affected securities.

The Internal Revenue Service (IRS), which has been delegated authority to interpret and administer U.S. income tax treaties, has taken the position that the Article 29 of the bilateral income tax treaty in force between the United States and France should be interpreted to prevent the application of the tax on transactions executed in the United States. However, after extensive discussions with their French counterparts, the IRS has not been able to achieve a common interpretation of the key tax treaty provisions as they are currently drafted.

The provisions of the bilateral income tax treaty with France, as is the case with almost all U.S. tax treaties, permits the tax authorities of one country to request from its counterpart information that is foreseeably relevant to the application of the tax treaty or the administration of domestic tax laws. It is not clear that a request on behalf of Congress for information about the amounts of revenue that has been collected (or that will be collected) under the French financial transactions tax, would meet the criteria to constitute a valid request for information pursuant to the U.S. – France tax treaty.

Questions from Senator Cornyn

Question 1:

Mr. Secretary, in 2006, then Senator-Obama said on the Senate floor, "The fact that we are here today to debate raising America's debt limit is a sign of leadership failure. It is a sign that the U.S. Government can't pay its own bills. It is a sign that we now depend on ongoing financial assistance from foreign countries to finance our Government's reckless fiscal policies. Over the past 5 years, our federal debt has increased by $3.5 trillion to $8.6 trillion. That is "trillion" with a "T." That is money that we have borrowed from the Social Security trust fund, borrowed from China and Japan, borrowed from American taxpayers." Five years ago, President Obama said before Congress, "Understand if we don't take meaningful steps to rein in our debt, it could damage our markets, increase the cost of borrowing, and jeopardize our recovery." But since 2009, when the President was first sworn into office, the debt has grown by more than $7 trillion to over $18 trillion, a 70 percent increase. And now we know that by 2019 the President is proposing to add almost another $4 trillion to the nation's credit card. In other words, in just ten years, the President wants to add more debt to the backs of America's middle class than all previous Presidents combined. This is astonishing. The take-away is that the President likes making speeches about the need to exercise leadership or the need to take meaningful steps to rein in our debt, but does not like doing either in his budgets.

a. **Do you think doubling the debt in just ten years is an example of exercising leadership? Do you think this is a meaningful step to rein in our debt?**
b. **Do you think doubling the debt in just ten years is a sustainable path?**
c. **Why does it appear the Administration fails to understand that debt is a national security concern? If the Administration does, why doesn't the budget request prioritize balancing our budget and begin to pay down the debt?**

Answer:

Since assuming Office, President Obama has shown strong leadership as a steward of the U.S. government's fiscal position and has enacted numerous policies that have made significant progress in limiting the rise in government debt as a share of GDP, thereby ensuring its sustainability. Under President Obama, the deficit has fallen by more than 70 percent, measured as a share of the economy. Last fiscal year, the federal deficit was 2.8 percent of GDP, less than a third of the 9.8 percent of GDP deficit recorded in 2009 when he assumed the Office. In fact, the fiscal year 2014 deficit as a share of GDP is slightly below the average over the past 40 years. Moreover, the President's policies are contributing to the most rapid deficit reduction since the end of World War II. Indeed, the last time deficits fell at a faster rate as a share of the economy over a comparable period of time was during the post-war demobilization from 1945-1950.

The President's FY16 budget would continue this recent progress, while implementing policies to accelerate growth and expand opportunity. Under the President's policies, the Administration estimates that deficits would decline to around 2.5 percent of GDP starting in 2016 and that debt would stabilize and decline each year after 2015, reaching 73.3 percent of GDP in 2025.

Question 2:

The Administration likes to take credit for the recent job creation even though more Americans have given up looking for a job since the 1970s. The President also likes to acknowledge that no area holds more promise than our investments in American energy, and that Americans have benefitted from lower energy prices due to more domestic production. He has been quick to note the growth in oil and gas production - although this growth has been primarily on private lands in states, like my own. Furthermore, between December 2007 and 2014, Texas has been an engine for job creation for the U.S. In fact, without Texas, job growth across the country would have essentially been flat over this time period. For these reasons, my constituents are perplexed that on one hand the President likes to take credit for job creation and talks up the need to increase domestic energy production, but then he proposes a budget that would kill the goose that lays the golden egg by taking aim at an important sector of the Texas economy. I think Washington has a lot to learn from Texas when it comes to job creation. Texas does not have an individual income or a corporate income tax; it is a right-to-work state, which makes the Texas labor market free and flexible; and we have common-sense regulatory framework that does not punish job creators.

a. **How will the tax increases in the President's budget help create jobs in my home state of Texas?**
b. **How do the President's tax increases on American energy manufacturers and producers make my state more competitive?**
c. **How would the President's tax increases impact the energy bills of Americans?**
d. **How does raising taxes on energy producers help increase domestic production?**

Answer:

The oil, gas, and coal tax preferences the Administration proposes to repeal distort markets by encouraging more investment in the fossil fuel sector than would occur under a neutral system. This distortion is detrimental to long-term energy security and is also inconsistent with the Administration's policy of supporting a clean energy economy and reducing greenhouse gas emissions. Moreover, the subsidies for oil, natural gas and coal must ultimately be financed with taxes that cause further economic distortions including underinvestment in other, potentially more productive, areas of the economy. The benefits that would come from a less distortionary tax system and from a clean energy economy would be realized across, and would benefit, the entire country, including Texas.

<u>Question 3:</u>

Mr. Secretary, I know this issue may not be in your direct purview, but as Treasury Secretary you are one of the President's most important budget and economic advisors. The President's budget is proposing to take $3 billion in future oil and gas revenues from several Gulf of Mexico states, including Texas, for more Washington priorities. The President's proposal would tear up the promise the federal government made to Gulf Coast states, including Texas, when we enacted the 2006 Gulf of Mexico Energy Security Act. This legislation, which eventually passed the Senate with the support of then-Senator Obama, provides my state a share of the lease revenues from oil and gas exploration in the Gulf.

a. **I find this proposal disturbing as these funds are meant to be used for coastal conservation, restoration and hurricane protection, why does the Administration want to pull the rug from under the feet of the Gulf States, including Texas?**
b. **Interior Secretary Jewell said of the proposal: "The outer continental shelf is owned by all Americans. We believe that needs to be re-examined to look at what is a fair return to taxpayers across the whole United States." Based on the Administration's statement of commitment that taxpayers benefit from the development of offshore energy resources owned by all Americans, how is it that federal resources are kept off-limits from development or lease sales? And how is deference given to states that do not want federal resources developed off of their coastline, but states that do, like Texas and other Gulf states, which greatly benefit the nation's energy security, are singled out in this proposal?**
c. **Offshore actually provides much less revenue sharing for coastal states compared with onshore minerals. Why has the Administration decided to target this revenue sharing for states bearing the burden of offshore production?**

<u>Answer:</u>

Lands on the Outer Continental Shelf lie beyond and outside state boundaries. These lands are owned by all Americans and the federal government is responsible for the full cost of their management, safety, and environmental protection. The Administration is committed to ensuring that American taxpayers receive a fair return from the sale of public resources, regardless of whether those resources are on public lands within state boundaries or offshore on the Federal Outer Continental Shelf.

For additional background on these issues, you may wish to contact the Department of the Interior directly.

<u>Question 4:</u>

Mr. Secretary, estimates are that about a quarter of all Earned Income Tax Credit payments (EITC) in Fiscal Year 2013 were paid in error. This means that about $15 billion was wrongly paid. In fact, between 2003 and 2013, about $150 billion in improper EITC payments were made. It appears that the EITC improper payment rate has remained

relatively unchanged and the amount of EITC claims paid in error has grown despite your agency's efforts. Nonetheless, the Administration is proposing to expand the EITC.

a. **Why does it make sense to propose expanding the EITC before eliminating or at least reducing the improper payment rate? Why is the Administration proposing to put more taxpayers' money in a program that has such a high improper payment rate?**
b. **Additionally, the IRS, which is part of the Treasury Department, wastes tens of millions of dollars on union activity, employee bonuses, and other spending that has only come to light through congressional oversight. The IRS has proven it cannot be trusted with taxpayer money, yet at a time when American's wages are stagnant, here you are asking for billions more of their hard earned tax dollars. Do you really think this is fair? Given the record I just laid out, why should Americans trust the IRS with an 18 percent increase in its budget?**

Answer:

We all believe that compliance by taxpayers claiming the EITC should be improved. To that end, IRS works continuously on ways to improve compliance through audit, paid preparer strategies, improved screening, and education. EITC-related audits protect $3 to $4 billion in revenue per year. Efforts to prevent identity theft and fraud prevent another $3 billion in erroneous EITC claims.

The EITC compliance problems that are most difficult to address are related to complicated family circumstances and to eligibility criteria related to qualifying children that IRS cannot readily observe and for which there is no third party reporting. To a large extent, these issues do not apply to the EITC for workers without children, which is the focus of the Administration's proposal in the FY 2016 Budget. Workers without qualifying children currently account for about 3 percent of EITC claims (in dollar terms) and about a quarter of total returns claiming the EITC.

Under the Administration's proposal, the expanded EITC would provide tax relief to 13.2 million low-income workers struggling to make ends meet. All workers currently receiving the EITC for childless workers would receive a larger EITC and 5.7 million additional workers would be newly eligible. The increase would lift about half a million people above the poverty line, and reduce the depth of poverty for 10 million more. A worker at the poverty line would receive more than $600 in additional EITC.

An expanded EITC would encourage work among young adults living independently from their families by helping to establish patterns of behavior that include work. This in turn could lead to more on-the-job experience, more hours of employment and ultimately higher earnings. The proposal also would also harmonize the upper age limit with recent and scheduled increases in the Social Security full retirement age ensuring that older workers continue to benefit from the EITC until they retire.

You also asked about the IRS Budget. The IRS estimates that for every $1 invested in the IRS budget, it produces at least $4 in enforcement revenue. Yet, despite this high return to investment ratio, the IRS budget level for Fiscal Year 2015 was cut to its lowest level of funding since 2008. Adjusting for inflation, the IRS's budget for Fiscal Year 2015 is comparable to where it was in 1998, when IRS operations and the economy and Tax Code were less complex. Enacting the Administration's proposed budget for IRS for Fiscal Year 2016 is necessary to ensure that the IRS has the resources to meet its mission and to stem the decline in taxpayer service and tax collections that has resulted from previous budget cuts.

Since 75 percent of the IRS budget is personnel, the agency has been absorbing most of these budget reductions through workforce contraction. As a result of attrition and a four-year hiring freeze, the IRS ended Fiscal Year 2014 with 13,000 fewer permanent full-time employees compared with 2010. The IRS expects to lose another 3,000 or more through attrition by the end of this fiscal year.

Given the severe budget constraints that the IRS is under and the dramatic impact that the workforce reduction has had, it is necessary for the IRS to continue to recognize high performance and provide training to maintain a high quality workforce. The IRS has tightened its policies to restrict eligibility for performance awards and reduce payments, as well as ensure that spending on training is done in a responsible manner consistent with current law.

Question 5:

Secretary Lew, it is disappointing that the President's budget kicks the can down the road with respect to the Social Security Disability Trust Fund, which will be exhausted in 2016. In November 2014, the Social Security Administration Inspector General reported that billions were used to pay for improperly approved disability claims. Please explain how shuffling money from one part of Social Security to the Disability Trust Fund, as the President's budget proposes to do, solves the problem identified by the Inspector General.

Answer:

Reallocation of payroll taxes between the OASI and DI Trust Funds is to ensure the workers who paid into Social Security and then become disabled do not face a catastrophic reduction in the benefits they need and have earned. Social Security can afford to pay full benefits in both the disability and retirement program through 2033. So, while there is need to address the overall long term challenges in the Trust Fund, an immediate large reduction in DI benefits is unnecessary and would cause significant harm to millions of families.

While the shortfall of the DI Trust Fund is significantly larger than the total amount of improper payments, the Administration takes DI program integrity seriously and has included important proposals in the budget to improve program accuracy. To continue to strengthen the integrity and accuracy of Social Security, the Budget proposes to establish a dependable source of mandatory funding in 2017 for Continuing Disability Reviews (CDRs) and Supplemental Security Income (SSI) Redeterminations, which ensure that only those eligible for benefits continue to receive them. CDRs and SSI redeterminations are highly effective at detecting

improper payments and provide an excellent return on the taxpayers' investment. This proposal, together with discretionary funding proposed for 2016, is projected to produce net savings of $32 billion over 10 years, to reduce the current backlog of around 900,000 CDRs by the end of 2019, and to prevent a new backlog from developing during the budget window.

Moreover, the President's FY 2016 Budget contains several, SSA-related legislative proposals to help prevent and improve the recovery of improper payments in the DI program, our other programs, and programs across the federal government:

- **Allow SSA to Use Commercial Databases to Verify Wages in the SSI Program**. The SSI program is means-tested, and the correct benefit amount can vary monthly based on changes in a beneficiary's income, such as wages. SSI recipients are required to report changes in a timely manner, but some do not, which results in improper payments. This proposal would reduce improper payments by authorizing SSA to conduct data matches with private commercial databases and use that information to automatically increase or decrease benefits accordingly, after proper notification. New beneficiaries would be required to consent to allow SSA to access these databases as a condition of benefit receipt. All other current due process and appeal rights would be preserved.

- **Expand Authority to Require Authorization to Verify Financial Information for Overpayment Waiver Requests.** SSA uses an automated process to verify the financial institution accounts of SSI recipients to improve payment accuracy. SSA has the authority to require applicants and beneficiaries to authorize the agency to get this information in connection with determining SSI eligibility. However, SSA cannot use this process for other determinations that involve consideration of financial institution account information. One such determination occurs when a beneficiary requests a waiver of recovery of an overpayment (whether an OASDI overpayment or an SSI one) or a change in the rate at which SSA withholds funds from a beneficiary's payment to collect a prior overpayment. Determining whether someone qualifies for a waiver or a different rate of recovery can involve determining whether the person has the financial means to repay. This proposal would require OASDI recipients seeking overpayment waivers to grant SSA authority to certify financial information and thereby improve the accuracy of waivers. Currently, there is no automated method for verifying financial assets for overpayment waiver claims.

- **Government-Wide Use of Customs and Border Patrol Entry and Exit Data to Prevent Improper Payments**. U.S. Customs and Border Protection (CBP) maintains data on when individuals enter and exit the United States. This entry and exit information may be useful in preventing improper payments in Federal programs that require U.S. residency in order to receive benefits. This proposal would provide for the use of CBP Entry/Exit data to prevent improper payments for OASI, DI, and SSI.

- **Improve Collection of Pension Information from States and Localities.** Current law requires SSA to reduce OASDI benefits when someone also receives a pension based on work that was not covered by Social Security. SSA currently has a matching agreement with the Office of Personnel Management (OPM) to obtain information on Federal government retirees who receive a pension from work not covered by Social Security. However, SSA generally lacks a way to receive similar information from state and local governments. As a result, many of these pensions go unreported, leading to improper payments. This proposal would require state and local government pension payers to report information on pensions paid for non-covered work to SSA through an automated data exchange.

- **Establish Workers' Compensation Information Reporting.** Current law requires SSA to reduce an individual's Disability Insurance (DI) benefit if he or she receives workers' compensation (WC) or public disability benefits (PDB). SSA currently relies upon beneficiaries to report when they receive these benefits. This proposal would improve program integrity by requiring states, local governments, and private insurers that administer WC and PDB to provide this information to SSA. Furthermore, this proposal would provide for the development and implementation of a system to collect such information from states, local governments, and insurers.

- **Lower Electronic Wage Reporting Threshold to Five Employees.** SSA processes W-2 forms for Treasury. Currently, Treasury requires businesses that file 250 or more W-2s per calendar year to file electronically. This proposal would modify the Internal Revenue Code so that Treasury can require businesses that employ five or more employees to file electronically. This change would be phased-in over three years and would increase the efficiency and accuracy of this process, because electronic returns are completed more rapidly and are generally more accurate than scanned or keyed returns.

- **Move from Annual to Quarterly Wage Reporting.** Employers report wages annually to SSA. However, from 1939 through 1977, SSA received wage reports on a quarterly basis. Increasing the frequency of wage reporting could enhance tax administration. More frequent reporting also may improve program integrity by identifying work on the part of DI and SSI recipients more quickly and providing timelier wage data for use by Federal, income-tested programs. This proposal would return to quarterly wage reporting. The Administration has pledged to work with the States and employers to minimize any burden as employers already report quarterly to the States.

- **Reconcile Office of Personnel Management and Social Security Retroactive Disability Payments.** OPM must reduce disability payments made to Federal Employee Retirement System (FERS) annuitants who receive DI benefits. In many cases, OPM pays the FERS disability benefit before SSA decides whether the person is eligible for DI benefits. This results in FERS overpayments. This proposal would reduce these improper payments by further automating the coordination between SSA and OPM.

In addition, the budget includes a proposal that would reduce DI benefits for beneficiaries who also receive unemployment benefits for the same time period.

Questions from Senator Portman

Question 1:

Mr. Secretary, these questions relate to the new proposal to create a new category of subpart F income for transactions involving digital goods or services.

I understand that the digital economy is one of the OECD's Action items and that Treasury generally has resisted efforts by other countries to treat profits from digital goods and services any differently than profits from non-digital goods and services. Yet this proposal would clearly make that distinction and treat digital income more harshly than non-digital income by taxing it on a worldwide basis at the full US tax rate. How does this proposal relate to the OECD BEPS project generally, and how is it consistent with Treasury's position with respect to the OECD BEPS action plan for the digital economy?

Why does the President view this income as more appropriately taxed at the full US rate, rather than the proposed minimum tax rate, like other non-digital business income?

The proposal would subject US multinationals that are on the cutting edge of the global digital economy to full US tax. Yet their foreign competitors would not be hit by this tax. I am concerned that this proposal will undermine the competitiveness of US digital goods and service providers and jeopardize America's position of leadership in the global digital economy. Why doesn't the President share this concern?

Answer:

A key policy underlying subpart F is to currently tax passive and other highly-mobile categories of income to counter the incentive that otherwise would exist to shift such income out of the U.S. tax base into low-tax jurisdictions. The proposal would create a new category of subpart F income for transactions involving digital goods and services and reflects the fact that current subpart F rules have not kept up with changes in the economy, including the increasing importance of digital goods and services. Income from digital goods and services is highly mobile income of the kind that subpart F is intended to currently tax but nonetheless may go untaxed in the U.S. under tax current rules. Under the proposal, such highly mobile income would be subject to current U.S. tax if earned by a CFC that did not make a substantial contribution to the development of the property or services it sells and that relies on intangible property developed by a related party.

The proposal should be understood not as singling out the digital economy but, rather, as putting the taxation of foreign earnings of digital companies on par with the taxation of foreign earnings of non-digital companies, which are subject to current taxation at the full U.S. corporate tax rate under subpart F in comparable circumstances. This policy is consistent with the U.S. position in the context of the OECD Base Erosion and Profit Shifting (BEPS) work on the digital economy, which supports tax policies that are neutral between digital and non-digital companies. This

policy is also consistent with an overarching U.S. goal in the BEPS project of eliminating opportunities for any company, U.S.-based or foreign-based, to shift income into low- and no-tax jurisdictions where no or minimal real activity with respect to that income is undertaken.

Under the proposal, digital companies that perform research and development activities in the United States that lead to digital goods and services would continue to enjoy substantial domestic tax benefits from those activities, including for example, the research and experimentation credit and full expensing of key costs of developing these digital goods and services.

Questions from Senator Heller

Question 1:

What steps is the administration taking to ensure that small businesses, specifically pass-through entities, are taken care of should this Committee and Congress move forward with business tax reform? (beyond 179 expensing/cash accounting method) Will you work with this committee on this?

Follow up: Is the administration releasing a more detailed business tax reform framework? Yes/no?

Answer:

A fundamental principle of the Administration's framework for business tax reform is to simplify and cut taxes for America's small businesses and entrepreneurs so that they can focus on growing their businesses rather than filling out tax returns. As you note, the Administration's business tax reform framework includes several provisions in addition to the expansion of Section 179 expensing to $1 million and the expansion of the option to use simplified accounting methods to businesses with gross receipts under $25 million. In particular, the Administration proposes to double start-up expenses for new businesses and to make permanent the 100 percent exclusion of capital gains on investments in qualified small business stock, to promote investment in American's growing businesses.

The Administration remains committed to working with Congress to move forward with business tax reform.

Questions from Ranking Member Wyden

Question 1:

Mr. Secretary, as you know Congress has long been concerned that foreign countries are manipulating their currencies to give their exports an unfair competitive advantage. There have been repeated calls for the administration to seek enforceable rules related to exchange rate manipulation as part of the Transpacific Partnership agreement. Recognizing that other countries may have different views and that this is a negotiation, would the President like to see the TPP partners make meaningful commitments to pursue market-oriented exchange rate policies?

Answer:

The President has been clear that no country should grow its exports based on an undervalued exchange rate, and currency has been at the top of Treasury's international agenda. We have worked intensively through our multilateral and bilateral engagements to press our trading partners on currency practices, and have secured meaningful commitments on currency in the G-7, G-20, and the U.S.-China Strategic and Economic Dialogue (S&ED).

Our TPP partners are aware of our ongoing commitment to move major economies to market-determined exchange rates that are transparent and flexible, and that reflect underlying economic fundamentals. In recent consultations, they have indicated a willingness to discuss constructively our concerns about inappropriate currency policies. We have an opportunity to develop an historic new approach to promote greater accountability in the context of TPP, and I remain committed to working with Congress and our TPP negotiating partners to find ways to address currency disciplines that are consistent with our overall strategy of bilateral and multilateral engagement.

Senator Debbie Stabenow

Question 1:

Once again the President's Budget proposes eliminating "last-in-first-out" (LIFO) accounting, despite criticism of the proposal from members on both sides of the aisle. As I read the proposal, it would repeal LIFO for tax purposes both prospectively and retroactively. As you know, this could have severe consequences for many businesses – including many small businesses that have used LIFO for many years – both in my own state of Michigan and nationwide. Even if they are allowed to pay these taxes over time, small and mid-sized businesses will have trouble doing so, and for many of them, this will be a financial blow that they will have great difficulty recovering from. In the meantime, it will be harder for these businesses to expand, create jobs, and make needed investments. Are you concerned about how repealing LIFO retroactively will affect small and mid-sized businesses?

Answer:

The LIFO accounting method offers deferral, not exemption, of income; non-LIFO taxpayers (including small and mid-sized businesses) have been required to recognize income that LIFO taxpayers may have been able to defer.

Under the Administration's proposal, a taxpayer who had used LIFO would be treated the same as any other taxpayer required to change its method of accounting – the taxpayer must recognize the difference in income between an existing method of accounting and a new method of accounting. The LIFO reserve is this difference, and its inclusion in gross income simply restores parity between LIFO and non-LIFO taxpayers. The Administration's proposal recognizes that an immediate income inclusion of the LIFO reserve could impose a substantial increase in tax liability on some former LIFO taxpayers. Therefore, the Administration's proposal would significantly extend the period over which taxpayers are required to include their LIFO reserves in income (to ten years, or to two-and-a-half times the normal four-year adjustment period). Repealing LIFO without requiring the inclusion of past deferrals could be viewed as imposing an unfair distribution of tax burdens to non-LIFO taxpayers.

Questions from Senator Cantwell

Question 1:

The EPA recently approved a request to allow biodiesel from Argentina to satisfy the Renewable Fuel Standard requirements for biodiesel. In addition, this imported biodiesel also qualifies for a $1 dollar per gallon "blenders" tax credit. So, U.S. taxpayers are now subsidizing foreign biofuel producers, while hurting biofuel producers here at home. Current law allows refiners and blenders to receive the biodiesel credit for blends that include foreign-imported biodiesel. Last Congress, I introduced bipartisan legislation with Senator Grassley to reform this important tax credit to help ensure domestic production of biodiesel. Our legislation ensures the credit benefits domestic producers by changing the credit to a producers' credit and does not use taxpayer money to support foreign renewable fuel production. Why should we continue to provide this tax credit for imported fuels and wouldn't it cost less if we changed this from a "blenders' credit" to a "producers' credit"?

Answer:

Although the biodiesel tax credit expired at the end of 2014, the Administration looks forward to working with Congress to evaluate and rationalize all tax incentives in the context of business tax reform. The Administration believes that business tax incentives should have positive economic spillover effects across the economy and be designed to reduce administrative burden and that the best way to address these issues is in the context of business tax reform.

Question 2:

The production tax credit (PTC) remains the most important federal policy tool used to deploy alternative and renewable forms of power, but, unfortunately, is not a permanent part of the tax code. For example, the wind production tax credit has been extended numerous times since 1992, but in each of the years during which the wind PTC completely lapsed, in 1999, 2001, and 2003, the levels of additional wind capacity lowed or collapsed when compared to the previous year's total. How will making renewable energy tax credits permanent impact the renewable energy industry and how many new clean energy projects would be created from permanent renewable energy tax credits?

Answer:

This Administration has been focused on building an energy economy in the United States that is cleaner as well as more efficient and more secure. As part of that effort, the Administration has taken action to support the development and deployment of renewable energy sources that will create new jobs and jumpstart new industries in America. As part of our commitment to clean energy, the Administration has proposed to permanently extend the PTC and make it refundable. It would also make the credit available to otherwise eligible renewable electricity consumed directly by the producer rather than sold to an unrelated third party as is currently required. We believe these features will enhance the production of renewable energy by reducing the

uncertainty that comes from periodic expiration of the tax credit and by expanding the set of projects that can benefit from the PTC.

Question 3:

In 2012, the most recent year for which official data is available, taxpayers deducted less than $16 and half billion in state and local sales taxes, a small fraction compared to the more than $282 billion in state and local income taxes deducted on federal returns. Each Congress, the very first bill I introduce is to make the state and local sales tax deduction permanent, to provide certainty to the almost 900,000 citizens of my state who rely on the deduction for tax fairness. Yet the deduction is now expired and we are waiting to see if this provision will be extended. As the President has chosen again not to extend the state and local sales tax deduction in his budget, what is the justification for treating my constituents differently by maintaining the permanent deduction for state and local income taxes and not extending the deduction for state and local sales taxes?

Answer:

We look forward to working with Congress to address all the expired provisions and to ensure that the Federal tax system fairly and efficiently raises sufficient revenue to support the goods and services demanded by our citizens.

Questions from Senator Menendez

Question 1:

Secretary Lew, as you know the current tax code has a loophole in it that allows foreign-controlled insurance companies to exploit tax havens and strip earnings from the country for the sole purpose of avoiding U.S. taxes. As a result, U.S. companies like Chubb, which employs nearly 2,100 people in my home state of New Jersey alone are put at a competitive disadvantage. And on top of this, U.S. taxpayers are duped out of billions of dollars by these questionable practices. I plan to reintroduce legislation that would close this loophole and level the playing field for American companies so they can outcompete their foreign competitors. And I was glad to see the President's Budget included a proposal to address this issue that mirrors my legislation. Do you agree that the current system puts American insurance companies at a competitive disadvantage? Do you agree that this inequity should be addressed in the context of business tax reform?

Answer:

The Administration has addressed the issue of related party reinsurance as part of the FY 2016 Budget in the Business Tax Reform section. The Administration's proposal would deny a deduction for reinsurance premiums paid to foreign affiliates to the extent that the foreign affiliate (or its parent company) is not subject to U.S. tax with respect to the premiums received. It would permit the U.S. ceding company to exclude from income ceding commissions and indemnity payments received with respect to reinsurance policies that were previously denied deductions for premiums paid. Alternatively, the proposal would permit a foreign reinsurer receiving premiums from an affiliate that otherwise would be denied a deduction to elect to be taxed like a U.S. company with respect to the income associated with those premiums (and to avoid the excise tax on foreign reinsurance contracts). This solution for creating greater tax parity between foreign and domestic reinsurance companies is not punitive, as it simply ignores, for purposes of taxation, cross-border reinsurance transactions between affiliated companies (or allows the foreign affiliated reinsurer to choose to be taxed on the same basis as domestic companies). The Administration believes this proposal should be part of any business tax reform effort.

Question 2:

Mr. Secretary, as you know, the island of Puerto Rico is home to 3.5 million Americans. Over the last several years, Puerto Rico has faced significant economic challenges. Despite the measures Puerto Rico has been taking to address its challenges, the island is still facing a very difficult situation. What steps is Treasury taking to help the 3.5 million Americans who live there? And what more can be done?

Answer:

The Commonwealth's financial challenges did not develop overnight, and they will not be solved overnight. Despite the difficult measures spearheaded by the Governor and Puerto

Rican legislature to date, substantial work lies ahead to manage Puerto Rico's difficult fiscal outlook, including a debt load that nearly tripled over the past decade. Treasury has encouraged the Commonwealth to develop and execute a long-term fiscal plan that provides a sustainable fiscal path forward for the citizens of Puerto Rico. In addition, effective economic development measures are critical to turning around an economy that has been in recession for the past ten years.

More broadly, Treasury and the Administration want Puerto Rico to succeed in its efforts and continue to assist Puerto Rico by supporting its economic development efforts and ensuring that the Commonwealth can access all existing and available federal resources. For example, the Commerce Department and SelectUSA helped attract Lufthansa Technique to build a Maintenance, Repair, and Operations facility in Puerto Rico; the Department of Energy is partnering with PREPA, the local power authority, to develop long-term sustainable energy infrastructure; and the Department of Transportation is currently working with the local highway authority to help it access millions of federal dollars for road and other infrastructure projects. Additionally, the U.S. Treasury Department has a team of financial experts monitoring the situation who are also sharing their expertise with the Commonwealth during these challenging times.

Question 3:

Secretary Lew, as you know, the President's Budget includes a new proposal to change the tax treatment of deferred foreign earnings in order to reduce incentives companies might face to shelter income abroad or avoid bringing earnings back home to the United States. Some critics of the President's proposal, however, have called for a different approach, known as a "repatriation holiday." This alternative proposal would allow multinational corporations that have been sheltering income abroad to get a free, or close to free ride when they finally bring the money home. The argument for this proposal is that it will somehow "set free" earnings that are supposedly "trapped" abroad for investment in the United States. That all of our roads and bridges would be fixed, businesses would expand and hire more workers, and the economy would complete its recovery. The problem with this fantasy is it's exactly that – a fantasy. And we know this won't work because we tried this already in 2004. Can you discuss some of the lessons we learned from the 2004 repatriation holiday, and why the President is proposing a different approach in the Budget?

Answer:

The Administration has consistently opposed a voluntary repatriation holiday because it is a particularly regressive tax reduction that has little positive effect on growth or jobs in the short-run, and is likely to depress both in the long-run.

Reduction in Tax Revenue: A voluntary repatriation holiday as a standalone revenue provision would lower, not raise, tax revenue. This is because taxes paid on earnings that are repatriated under the holiday are lower than taxes that otherwise would have been paid on the earnings in later years and because the holiday reduces repatriations (and hence tax revenue) in the future by

creating the expectation of additional voluntary holidays. According to a recent JCT estimate of legislation introduced by Senators Paul and Boxer, a voluntary repatriation holiday reduces tax revenue by $118 billion over the ten-year budget window.

Regressive Tax Reduction: The tax reduction associated with a repatriation holiday flow to just a few firms and ultimately benefit wealthy households who own the majority of corporate equity capital. In 2004, just 15 companies claimed more than half of the tax benefits, worth more than $1 billion each on average. These companies had aggressively used profit-shifting techniques to move earnings to tax havens, with more than 75 percent of the repatriated foreign earnings coming back from countries commonly viewed tax havens. These gains flow to current shareholders who are mostly wealthy; more than 50 percent of the benefits of a repatriation holiday accrue to the top 1 percent of households (as measured by income).

Little Positive Effect on Growth or Jobs: Most of the firms with large stockpiles of foreign earnings have substantial domestic cash along with cheap access to the capital markets. As a result, it is unlikely that there are high-return investment projects that depend on a low rate repatriation "holiday" for funding. In many cases, the "foreign" earnings are sitting in a U.S. bank and are already invested in Treasuries or U.S. equity markets. Indeed, most of the funds remitted under the 2004 holiday were used for share buybacks, dividends, and acquisitions rather than for new greenfield investments. And some of the firms repatriating earnings also cut their U.S. labor force around the same time.

Negative Effects in the Long- Run: Repatriation holidays cut taxes retrospectively, so that the government loses revenue without any corresponding gains in efficiency going forward. Repatriation holidays also reduce the expected effective tax rate on foreign investment because firms come to expect future holidays, thereby encouraging firms to shift both profits and real investments overseas and making them less willing to repatriate earnings to the U.S. at regular tax rates going forward.

The President proposes a one-time mandatory (not voluntary) 'toll charge' at 14 percent on the stock of untaxed and unrepatriated foreign profits, as a transition to a new hybrid tax system for multinational firms that would be part of more wide reaching business tax reform. The one-time revenues would be dedicated to infrastructure spending. The mandatory tax raises revenue because its tax rate is sufficiently high and would apply to the entire stock of unrepatriated, untaxed foreign profits, not just those that companies would chose to bring back voluntarily or that they would have brought back otherwise. In addition, the mandatory toll charge would be part of a business tax reform package which would also eliminate deferral by imposing a minimum tax and including other measures to combat profit shifting.

Question 4:

Mr. Secretary, as you know, a lot of us feel strongly about the need to put protection against currency manipulation in our trade deals. This is important for both the question of Trade Promotion Authority and for the substance of deals like the Trans-Pacific Partnership. When I raised this issue with Ambassador Froman, he responded that the Administration wants Treasury to take the lead on this. First, I want you to know that is not good enough for me. Currency manipulation to get an advantage in trade has to be addressed in our trade deals. Can you give us your specific plan of action to address these practices that cost us American jobs and suppress American wages through unfair competition?

Answer:

Since day one, the President has been clear that no country should grow its exports based on an undervalued exchange rate and currency has been at the top of Treasury's international agenda. Our goal is to move major economies to market-determined exchange rate systems with transparent and flexible exchange rates that reflect underlying economic fundamentals.

Our strategy has been to press hard on our trading partners through our multilateral engagement in the G-7, G-20, and the IMF, and through bilateral channels such as the U.S.-China Strategic and Economic Dialogue. Those efforts have yielded progress, to the benefit of American workers and firms, and we continue to press for more. I strongly agree with Members of Congress that unfair currency practices need to be addressed and that more can be done on currency issues. The currency objective in the 2015 Trade Promotion Authority bill significantly strengthens Treasury's hand in dealing with unfair currency practices, and I am committed to working with Congress on how best to accomplish this in the context of our trade agreements, consistent with our overall strategy of bilateral and multilateral engagement.

Questions from Senator Brown

Question 1:

Last year, the Administration launched an exciting new program designed to provide access to retirement savings accounts for low-income workers without access to an employer provided plan. Can you provide us with an update of the progress Treasury has made implementing MyRa and tell us what we can do legislatively to expand the program?

Answer:

In early 2014, President Obama announced plans to create a new myRA retirement account program aimed at helping millions of Americans without access to an employer-provided plan to start building retirement security, and issued a presidential memo directing the Department of the Treasury to create the myRA program. Since then, Treasury has been working to create and implement the myRA program, including development of a new Treasury retirement savings bond to be held in myRA accounts.

In December 2014, Treasury issued final regulations establishing the new retirement savings bond and began to administer myRA accounts for employees who elect to begin making myRA contributions through payroll deductions facilitated by their participating employers. Initially, Treasury has been working with a limited number of participating employers to ensure that the myRA program functions efficiently and smoothly. Treasury anticipates taking additional steps in the near future to sign up more employers and to increase public messaging to encourage eligible employees to enroll in myRA.

At this point, Treasury is not looking for any particular legislation to expand the reach of the myRA program. However, we appreciate efforts to highlight this important program to get individuals started saving for retirement – including the program's safety, simplicity, and affordability. In addition, we emphasize that the myRA program is not the entire retirement security solution for Americans. It is only one good starting point. We view the "automatic IRA" program outlined in the President's revenue proposal for fiscal year 2016, as an important next step to increase Americans' retirement security by encouraging saving and increasing participation in retirement savings arrangements by requiring employers that do not currently offer a retirement plan to their employees to provide automatic enrollment in an IRA.

Question 2: Senator Brown

There have been reports that some Administrative Law Judges are being given quotas for how many cases they must adjudicate in a given month. What is Treasury doing to ensure that the ALJs are allowed to preserve their independence and administer their cases according to best practice?

Answer:

The U.S. Department of the Treasury does not employ Administrative Law Judges.

Question 3:

I am deeply concerned about the implementation of the changes to the law regarding multiemployer pensions. In particular, I am concerned about the process for deeply troubled and declining plans. What steps has Treasury taken to implement the new law? What is Treasury's timetable for issuing guidance to administer elections for plans that are eligible to submit proposal to Treasury?

Answer:

Under Kline-Miller (the Multi-Employer Pension Reform Act), Congress established new options for trustees of multiemployer plans that are projected to run out of money. This includes an option for trustees of these plans to apply for a temporary or permanent reduction of pension benefits.

In Kline-Miller, Congress also tasked Treasury with new responsibilities with respect to applications to reduce benefits by trustees of plans that are projected to run out of money. Treasury is committed to implementing Kline-Miller in a fair and transparent way. To that end, Treasury published a Request for Information in February in order to receive public input. Kline-Miller requires Treasury to issue guidance within 180-days of its enactment, and we are working hard to meet that deadline.

Question 4:

Last year the Senate Finance Committee passed a proposal to allow debts the IRS considered uncollectable to be collected by private debt collectors. Would this proposal be an efficient use of IRS resources? Why or why not?

Answer:

We do not believe that this proposal would be an efficient use of IRS resources. Previous experience with private debt collectors, discussed below, has shown that the IRS has a much higher return on investment than private debt collectors, making this proposal an ineffective use of taxpayer dollars. In addition, we are concerned that the proposal would risk taxpayer rights and protections applicable to IRS collection activities that would not apply to private debt collectors, and unfairly affect low-income taxpayers.

Section 6306 of the Internal Revenue Code, added to the Code in 2004, permits, but does not require, the Secretary to enter into a "qualified tax collection contract." From 2006 to 2009, an initiative to permit private debt collection was undertaken pursuant to this authority. The initiative lost money overall because it imposed significant administrative costs on the IRS and resulted in the IRS' resources being diverted from higher priority collection cases to lower priority collection cases. For instance, to prepare for the 2006 to 2009 initiative, the IRS

expended more than $55 million in start-up costs. Although the Internal Revenue Code permits the IRS to retain 25 percent of the amount collected by private debt collectors, this 25 percent holdback was insufficient to cover the costs of the 2006 to 2009 initiative and the IRS needed to use appropriated funds to maintain the initiative, decreasing the resources available to the IRS to collect taxes from higher priority cases. Furthermore, during the 2006 to 2009 initiative, a majority of the cases initially assigned to the private debt collectors were unresolved. In addition, the Taxpayer Advocate Service handled more than 3,700 cases involving taxpayers that private debt collectors attempted to collect taxes from during the 2006 to 2009 initiative. Thus, assigning cases to private debt collectors was not only ineffective, but it diverted Taxpayer Advocate resources that could have been used to resolve other issues with the IRS.

In addition, taxpayers are not entitled to the same protections when private debt collectors collect tax debts as they are when the IRS collects a tax debt. For example, the IRS is required to make its processes and procedures public, which it does by issuing the Internal Revenue Manual (IRM). IRS employees are required to follow the IRM, which prohibits aggressive collection practices. Private debt collectors are not required to make their processes public, nor are they required to follow the IRM. During the 2006 to 2009 initiative, at least some private debt collectors used aggressive collection practices on taxpayers. In addition, IRS employees can be fired for committing certain offenses identified in the Internal Revenue Service Restructuring and Reform Act of 1998 (commonly referred to as the "10 Deadly Sins"); private debt collectors are not subject to these rules and cannot be fired for committing similar offenses. Finally, IRS employees can be fired, fined, and/or imprisoned for the improper use or disclosure of tax return information; private debt collectors are not subject to these consequences for the improper use or disclosure of tax return information.

We have additional concerns about the impact of last year's proposal, including that (1) it could result in economic hardship for taxpayers who have an outstanding tax liability that they cannot currently afford to pay in full, and (2) the lack of due process and other taxpayer protections similar to those that apply when the IRS collects a tax liability could lead to potential abuse by private debt collectors and reduce future voluntary compliance by affected taxpayers. We are concerned that low-income taxpayers could be pressured into committing to payment schedules that they cannot afford to keep, which could further damage their credit rating and their ability to remain current with respect to their tax liabilities. Moreover, unlike the IRS, private debt collectors have no incentive to engage in taxpayer outreach and education, which is particularly beneficial to low-income taxpayers and other underserved populations.

<u>Question 5:</u>

Taxpayers who applied for 1603 grants did so in lieu of claiming an IRC Section 45 tax credit and Congress clearly established that Treasury would take the lead with the assistance of the National Renewable Energy Lab. I want to be sure that there still is a thorough Treasury review of these projects so that we are confident that there is consistency in the way the tax rules are being applied in the context of these grants. Can you assure me that Treasury and the IRS are fully participating in the review of these

applications and that there is consistency between the rules that apply to tax credit projects and the way the same rules are applied to the projects seeking a grant?

Answer:

Section 1603 applications are carefully reviewed prior to funds being disbursed, and payments are made to those applicants who meet all of the statutory eligibility requirements. Under an interagency agreement with the Department of Energy (DOE), DOE's National Renewable Energy Laboratory (NREL) assists Treasury in reviewing applications. NREL was selected to assist in the 1603 Program because of its extensive experience with and expertise in renewable energy technologies, as well as its knowledge of developments in the industry. Applications are subjected to two levels of review by NREL personnel, followed by an additional level of review by Treasury personnel prior to issuance of an award. Consultation and coordination with the IRS takes place as needed and as appropriate. The Section 1603 program applies the same rules applicable to the corresponding tax credit where appropriate. Similar to the IRS, the Section 1603 program looks to all of the relevant facts and circumstances in applying those rules.

Question 6:

Last December, when Congress was debating whether to make a collection of expired business tax provisions permanent the President took a very important stand: Tax cuts for businesses must be accompanied by tax cuts for working families. Is it still the President's position that tax cuts for businesses have to be accompanied by tax cuts and investment in working families? What does that investment look like?

Answer:

The Administration wants to work with the Congress to make progress on measures that strengthen the economy and help middle-class families, including pro-growth business tax reform. However, the Administration opposes proposals that would permanently extend the tax provisions that expired at the end of last year without offsetting the cost. Making these traditional tax extenders permanent without offsets would add over $500 billion to deficits over the next ten years, nearly wiping out the deficit reduction achieved through the American Taxpayer Relief Act of 2013. Moreover, the Administration believes that any deal on tax extenders must also ensure the benefits are broadly shared We are committed to working with Congress to address tax extenders in a manner that is fiscally responsible and prevents a tax increase on 25 million working families and students by continuing important improvements to the Earned Income Tax Credit, Child Tax Credit, and education tax credits.

Question 7:

In the President's budget, he supports a routine accounting measure called reallocation. Reallocation does not cost taxpayers any money and has been done 11 times before in a bipartisan fashion. Now some have called for refusing to do this without cuts to the entire program. This seems to me to be akin to when some in Congress wanted to turn the debt limit into leverage to achieve personal political agendas. Can you walk us through the

Administration's support for clean reallocation and tell us what will happen if Congress refuses to reallocate?

Answer:

To address reserve depletion of the Social Security Disability Insurance (DI) Trust Fund, the Budget proposes to reallocate existing payroll tax collections between the Old-Age and Survivors Insurance (OASI) and DI trust funds while a longer-term solution to overall Social Security solvency is developed with the Congress. At various points over the course of Social Security's history, the Congress has passed reallocation legislation as the need arose for reallocating revenue from DI to OASI, and vice versa. This proposed reallocation will have no effect on the overall health of the OASI and DI trust funds on a combined basis. It also ensures we avoid deep and abrupt cuts in benefits for workers who paid into the system while they worked, became disabled, and now need the Social Security benefits they have earned.

In the event that the DI Trust Fund reserve were to become depleted and unable to pay scheduled benefits in full on a timely basis, the Social Security Administration would be required to cut disability benefits by an estimated 19 percent.

Question 8:

The President has proposed important changes to the tax of passive income. This remains one of the largest inequities in a tax system that many working families believe is stacked against them. The IRC taxes income from work at nearly double the rate of income from investments. In addition, wealthy taxpayers are able to pass on assets they hold throughout their life without any tax on the accumulated gains. The President's budget has taken some important steps to correct this inequity. How will the President's proposals reduce inequality and create opportunity?

Answer:

There are a number of proposals in the President's budget that address this issue of inequality. For instance, the FY16 budget includes a major new proposal that would impose income tax on accumulated capital gains at death and raise the tax rates that high-income individuals pay on capital gains and dividends. Over the ten-year budget window, this proposal would raise more than $200 billion. It eliminates the ability of wealthy taxpayers to pass on assets to their heirs without paying any tax on accumulated capital gains, which is a principal source of inequality in the current tax code.

Several other proposals would reduce tax preferences and loopholes for high income Americans. These include proposals to limit the value to high-income households of itemized deductions and other tax benefits; to ensure that high-income households pay at least as high an effective tax rate as middle income households (the so-called "Buffett Rule"); and to repeal the tax benefits of carried interest. There also are proposals intended to help lower and middle-income families. These include the permanent extension of the refundability of child tax credits and of the enhanced EITC for married workers and workers with three or more children that otherwise

expire in 2017; an expansion of the EITC to childless workers; the permanent extension and expansion of the American Opportunity Tax Credit (AOTC); an expansion and retargeting of child care tax incentives; and a dual-earner tax credit.

Taken together, all these proposals will improve the fairness of the Federal tax system and provide significant tax benefits to families in or striving to be in the middle class.

The Budget includes a number of other important proposals outside of tax policy that would promote opportunity and reduce inequality. These include reversing sequestration to ensure that important investments – from education to research to our national defense – are adequately funded. These investments are key to the strength of our economy and fund important efforts designed to promote opportunity directly, such as through education or job training. In addition, the Budget calls for expanding access to high quality early education and child care, providing two years of free community college to students who meet certain standards, and ensuring that Pell Grants keep pace with inflation – all efforts that expand access and promote opportunity.

Question 9:

Using the criteria outlined in Part II Paragraph 22 of the 2012 IMF Executive Board Decision on Bilateral and Multilateral Surveillance, please provide the names of the countries that are currently implementing monetary policy that meets any of the IMF criteria. Specifically, please indicate whether any of the parties in the Trans-Pacific Partnership negotiations, including the U.S., meet any of the criteria currently and whether they have in the last 10 years. Please identify the precise criteria that have been observed in each country over that period of time.

Answer:

Part II Paragraph 22 of the 2012 IMF Executive Board Decision on Bilateral and Multilateral Surveillance outlines criteria that are considered together — not individually — to assess members' observance of obligations under Article IV of the IMF's Articles of Agreement, namely that members "shall avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other members." These criteria are:

(i) protracted large-scale intervention in one direction in the exchange market;

(ii) official or quasi-official borrowing that either is unsustainable or brings unduly high liquidity risks, or excessive and prolonged official or quasi-official accumulation of foreign assets, for balance of payments purposes;

(iii) (a) the introduction, substantial intensification, or prolonged maintenance, for balance of payments purposes, of restrictions on, or incentives for, current transactions or payments, or (b) the introduction or substantial modification for balance of payments purposes of restrictions on, or incentives for, the inflow or outflow of capital;

(iv) the pursuit, for balance of payments purposes, of monetary and other financial policies that provide abnormal encouragement or discouragement to capital flows;

(v) fundamental exchange rate misalignment;

(vi) large and prolonged current account deficits or surpluses; and

(vii) large external sector vulnerabilities, including liquidity risks, arising from private capital flows.

The determination of exchange rates reflects the interplay of macroeconomic and microeconomic forces throughout the world. Assessments under Article IV require a comprehensive review of significant international economic developments and an evaluation of the factors that underlie those developments.

These criteria are not applied in a one-size-fits-all manner or with uniform quantifiable thresholds. Rather, in making assessments, the IMF considers a wide range of economic variables, including trading partners' exchange rates; external balances; foreign exchange reserve accumulation; macroeconomic trends; monetary policy developments; financial sector developments; institutional development; financial and exchange restrictions; and capital flows.

Moreover, developments in any one area do not typically provide sufficient grounds to conclude that exchange rates are being manipulated in terms of obligations under Article IV. The IMF has not found any TPP country in violation of the Article IV obligation during the last ten years.

Question 10:

The October 2014 Treasury Report on International Exchange Rates said that Japan has not intervened in its currency in three years, but news reports point to verbal intervention as recently as December 2014. According to purchasing power measures, the yen is undervalued by as much as 35 percent against the dollar. Despite these facts, USTR and Treasury have to date ignored Congress' request to include currency disciplines in the TPP agreement, even though American car companies have pointed to Japan's monetary policy as a trade barrier they cannot overcome. Is the Administration willing to reverse the benefits of the auto industry rescue by excluding currency disciplines from TPP?

Answer:

From day one, the President has been clear that no country should grow its exports based on an undervalued exchange rate, and currency has been at the top of Treasury's international agenda. Our goal is to move major economies to market-determined exchange rate systems with transparent and flexible exchange rates that reflect underlying economic fundamentals. To that end, our strategy has been to press hard on our trading partners through our multilateral engagement in the G-7, G-20, and the IMF, and through bilateral channels such as the S&ED. These efforts have yielded progress, to the benefit of American workers and firms, and we will continue to press for more.

Through our leadership, in February 2013, Japan joined the other G-7 countries in pledging to base economic policies on domestic objectives using domestic instruments, and to avoid targeting exchange rates. Japan was also part of the subsequent G-20 consensus and statement at the February 2013 Finance Ministers and Central Bank Governors meeting in Moscow that countries would not target exchange rates for competitive purposes. These statements were affirmed by G-20 Leaders in September 2013 at the St. Petersburg Summit. Since the G-7 and G-20 statements, Japanese official have ruled out purchases of foreign assets as a monetary policy tool.

Japan's domestic economy continues to show persistent weakness, falling into technical recession in mid-2014 and registering real GDP growth of virtually zero for the year. It is particularly important — for Japan and for the rest of the world — that Japan strengthen domestic demand for recovery and growth. Monetary stimulus is an important tool available to policymakers to stimulate growth, but we have emphasized that it must be accompanied by fiscal policy that supports growth in the near-term, and ambitious structural reforms to strengthen domestic demand and increase potential growth over the medium-term.

I strongly agree with Members of Congress that unfair currency practices need to be addressed and that more can be done on currency issues. The currency objective in the 2015 Trade Promotion Authority bill significantly strengthens Treasury's hand in dealing with unfair currency practices, and I am committed to working with Congress on how best to accomplish this in the context of our trade agreements, consistent with our international obligations and as part of our overall strategy of bilateral and multilateral engagement.

Question 11:

In July 2014 after the Strategic and Economic Dialogue (S&ED), you announced that China had agreed to reduce its interference with the yuan "as conditions permit." You described these and other commitments as "major" policy changes. In December 2014, however, the yuan declined significantly. And over the entire year, the yuan lost over 2.4%, after a gain of 2.8% in 2013.

Can you explain how the policy commitments made by China at the S&ED talks in July qualify as major if the currency fell significantly after those commitments and after any appreciation gains in 20 13 were lost in 2014? Please identify specific steps you expect China to make between now and the next S&ED meeting to implement the commitments to reduce interference. In addition please identify the actions the U.S. will take if these steps are not taken by the Chinese.

Answer:

At the Strategic and Economic Dialogue (S&ED) in July 2014, China committed to continue moving to a market-determined exchange rate, to increase exchange rate flexibility, and, for the first time, to reduce foreign exchange intervention, as conditions permit. China's currency, the

Renminbi (RMB), depreciated by 2.4 percent over 2014 against the dollar, and since the S&ED in July 2014, the RMB has been flat against the dollar. However, on an average trade-weighted basis, China's currency has appreciated by more than 10 percent since the S&ED; adjusted for relative inflation, China's real effective exchange rate appreciated by more than 14 percent. In addition, the RMB is one of the few currencies to remain relatively range-bound against the dollar over the past year.

Since the S&ED, China's intervention to purchase foreign exchange is estimated to have significantly declined. Notwithstanding the 14 percent real effective appreciation since July 2014, fundamental factors point to the need for further RMB appreciation over the medium-term. The real test of China's S&ED commitment will be whether China refrains from intervening even when there is market pressure for RMB appreciation. We will continue to urge China to allow the market to play a greater role in determining the exchange rate and to closely monitor China's activities in the foreign exchange market. We will also continue to leverage U.S. engagement in key multilateral fora, such as the G-7, G-20, and the IMF, as well as bilaterally, and especially with China through the S&ED.

Question 12:

Please outline in detail the monetary policies that would lead to the U.S. Treasury Department labeling a country as a currency manipulator as defined under Section 3004 of the Omnibus Trade and Competitiveness Act of 1988.

Answer:

The determination of exchange rates reflects the interplay of macroeconomic and microeconomic forces throughout every corner of the world. Assessments under Section 3004 require a comprehensive review of significant international economic developments and an evaluation of the factors that underlie those developments.

Although a broad range of economies in all regions of the world is routinely examined, Treasury focuses the analysis under Section 3004 on those countries with concurrently large bilateral surpluses with the United States and large global current account surpluses. The term "material global current account surpluses," used in Section 3004, is taken to mean large current account surpluses, measured as a percent of an economy's GDP. The term "significant bilateral trade surplus," used in Section 3004, is taken to mean a large bilateral trade surplus with the United States, relative to the size of U.S. trade.

Notwithstanding the inherent difficulties in rendering assessments, the authorities of an economy could be said to manipulate the exchange rate if they intentionally act to set the exchange rate at levels, or ranges, to prevent effective balance of payments adjustments or gain unfair competitive advantage in international trade such that for a protracted period the exchange rate differs significantly from the rate that would have prevailed in the absence of action by the authorities.

Analysts examine indicators that could be consistent with official action to manipulate currencies for such purposes. They include, inter alia: (1) protracted large-scale intervention in one

direction; (2) rapid foreign exchange reserve accumulation; (3) capital controls and payments restrictions; and (4) trade and current account balances.

However, though potentially helpful, these indicators are generally not dispositive in and of themselves in determining that a specific economy has manipulated its exchange rate under the terms of Section 3004.

Hence, in making assessments, a wide range of economic data and policies must be reviewed. In this light, one must carefully review (1) trading partners' exchange rates, (2) external balances, (3) foreign exchange reserve accumulation, (4) macroeconomic trends, (5) monetary policy developments, (6) financial sector development (7) state of institutional development, (8) financial and exchange restrictions, and (9) capital flows. Developments in any one area do not typically provide sufficient grounds to conclude that exchange rates are being manipulated in terms of Section 3004.

Question 13:

Treasury announced after the July 2014 S&ED talks that China had made commitments to increase transparency in its monetary policy. Three months later, however, Treasury highlighted ongoing transparency issues in China. Treasury's October 2014 Report on International Exchange Rates identified two ways China could increase the transparency of its activity in the currency market. Did China commit to these two specific ways of increasing transparency in its currency market in the July S&ED meetings? Did China fail to make progress on the S&ED transparency commitment between the July meeting and the October report? When do you expect China to fulfill the S&ED agreement on monetary policy transparency?

Answer:

The October 2014 Report on International Economic and Exchange Rate Policies noted that there are two ways that China could increase transparency of its activity in the currency market: adhere to the IMF's Special Data Dissemination Standard (SDDS); and contribute to the IMF's aggregate Currency Composition of Foreign Exchange Reserves (COFER) database. As noted in the April 2015 Report, President Xi of China announced in November 2014 that China will subscribe to the SDDS for reporting exchange reserves as well as other economic data. China has not announced a timeline for SDDS adoption. China has not yet committed to contribute to the COFER database, which would be a key step toward transparency in reporting foreign reserve holdings.

Question 14:

In the October 2014 Treasury Report on International Exchange Rates, Treasury stated that Korea has continued to intervene in its currency and said that the "won should be allowed to appreciate further." Please quantify the impact the undervalued won has had on the U.S.-Korea trade balance since the trade agreement took effect.

Answer:

The U.S.-Korea Free Trade Agreement ("KORUS") took effect on March 15, 2012. Since the Agreement took effect, the won has appreciated 15 percent in real terms on a broad trade-weighted basis. South Korea is now the United States' sixth largest trading partner, with total merchandise trade reaching a record $116 billion in 2014 as compared with $103 billion in 2011; and total trade in goods and services reaching $147 billion in 2014 versus $129 billion in 2011. Since the Agreement took effect, the United States has continued to run a bilateral merchandise trade deficit and a bilateral services surplus with Korea. Regarding the former, U.S. goods exports to Korea were up 6.1 percent in 2014 (as compared with Korea's 2014 real GDP growth rate of 3.3 percent), and reached a record $46.1 billion. Recovery from drought in the United States also contributed a 31 percent, or $1.6 billion, increase in agricultural exports, making Korea our fifth largest market for agricultural exports.

Question 15:

Will you push for the inclusion of currency disciplines in the China Bilateral Investment Treaty? If not, why not?

Answer:

A high standard U.S.-China Bilateral Investment Treaty (BIT) is a priority for the United States. A successful BIT negotiation would further open up China's highly restrictive system to foreign investment and help create a wide range of opportunities for U.S. firms to participate in the Chinese market. A high standard BIT would address priorities such as greater market access, the removal of investment barriers, protections against forced technology transfer, and increased transparency.

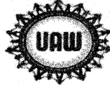
We are pressing China hard on its exchange rate practices, and continue to raise the issue at every opportunity. Our strategy has been to leverage our engagement with China through multilateral and bilateral channels such as the G-7, G-20, IMF, and the U.S.-China Strategic and Economic Dialogue (S&ED) to achieve strong commitments and tangible results.

At the 2014 recent S&ED, we secured a commitment for the first time that China will reduce its foreign exchange intervention as conditions permit, and over the last year, we have seen the amount of intervention decline significantly. On a trade-weighted basis, the RMB has seen a real effective appreciation of nearly 30 percent since China allowed its currency to resume appreciation in mid-2010. RMB appreciation has contributed to a decline in China's current account surplus from a peak of 10 percent of GDP before this Administration took office to just 2 percent of GDP last year.

This strategy of engagement is paying off, and we continue to press for progress in a way that does not undermine the credibility or effectiveness of current efforts or cause the Chinese to dig in their heels at a time when we are making steady progress.

I strongly agree with Members of Congress that unfair currency practices need to be addressed and that more can be done on currency issues. The currency objective in the 2015 Trade Promotion Authority bill significantly strengthens Treasury's hand in dealing with unfair currency practices, and I am committed to working with Congress on how best to accomplish this in the context of our trade agreements, consistent with our overall strategy of bilateral and multilateral engagement.

SUBMITTED BY SENATOR ROB PORTMAN



January 21, 2015

Senator Robert Portman
448 Russell Senate Office Building
Washington, DC 20510

Dear Senator Portman,

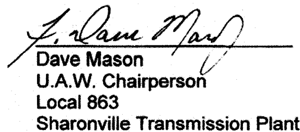
As the new Congress begins debating trade policy, we wanted to thank you for listening to our concerns.

Your early support of strong and enforceable currency rules in trade agreements has helped advance the conversation about currency manipulation as the most critical trade barrier of the 21st century. We clearly remember your visit to our facility on September 13, 2013 when you met with our Union and Plant Leadership Team to discuss this issue. You heard our united voice that currency manipulation hurts U.S. competitiveness here at home and in export markets where we compete around the world.

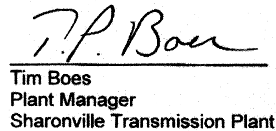
We have worked together to ensure that we are competitive in today's global marketplace and our jobs and our communities are more secure today -- but we must ensure that trade policies do not undermine this progress in the auto industry and U.S. manufacturing.

On behalf of the 1,832 workers at Ford's Sharonville plant where we make world class transmissions and gears that go into virtually every Ford product, we thank you for your continued support and leadership on this issue. It is a top priority for our company, this plant and our workers.

Sincerely,



Dave Mason
U.A.W. Chairperson
Local 863
Sharonville Transmission Plant



Tim Boes
Plant Manager
Sharonville Transmission Plant

3000 Sharon Road, Cincinnati, OH 45241

OHIO ASSEMBLY PLANT
650 Miller Road
Avon Lake, OH 44012

January 27, 2015

Senator Robert Portman
448 Russell Senate Office Building
Washington, DC 20510

Dear Senator Portman,

As the new Congress begins debating trade policy we, on behalf of Ford Motor Company's Ohio Assembly Plant, wanted to thank you for listening to our concerns.

Your early support of strong and enforceable currency rules in trade agreements has helped advance the conversation about currency manipulation as the most critical trade barrier of the 21st century. Currency manipulation hurts U.S. competitiveness here at home and in export markets where we compete around the world.

Ohio Assembly Plant's mission is to provide our customers the highest quality, safest, most reliable automotive products and services while also fostering continuous growth and prosperity for our families and in our surrounding communities. Aligned with that mission, we have worked together to ensure that we are competitive in today's global marketplace and our jobs and our communities are more secure today -- but we must ensure that trade policies do not undermine this progress in the auto industry and U.S. manufacturing.

We thank you for your continued support and leadership on this issue, which is a top priority for our company, this plant and our workers.

Sincerely,

Jeffrey Carrier
Plant Manager, Ohio Assembly

Tim Rowe
Building Chairman, Local 2000

Wyden Statement at Finance Hearing on Treasury FY 2016 Budget

Thank you, Secretary Lew, for being here on day three of budget-palooza at the Finance Committee. While the committee examines the administration's budget proposal today, the underlying issue getting our focus will be the health of the budgets of workers and families struggling to make ends meet.

The middle class in Oregon and across the country is hurting. The job at hand is to put America's middle class on solid economic ground, lift wages, and make sure everyone benefits when the economy grows. The president's budget proposals go after that challenge in a lot of ways, and many of them are designed to improve America's badly broken tax code.

For example, the budget proposes to make incentives for education, child care, and retirement savings more generous. It would take some steps to address the unfair ways our tax system treats wage-earning, middle class workers compared to others. And I was gratified that the proposal would move toward ending the system of deferral that traps the profits of American businesses overseas instead of re-investing them here in the U.S.

All of these are strong ideas, but I see an opportunity to do something even bolder. When it comes to the tax code, why keep bailing water out of the boat instead of fixing the leaks?

The most effective improvements Congress can make to middle-class tax incentives will come through comprehensive tax reform. That's the best route to a modern tax system that's simpler and fairer to everybody. And it's the best way to end the uncertainty caused by our tax code and address its most persistent issues.

Through comprehensive reform, Congress can ensure that incentives provide the biggest help to the people most in need. Too often, that's not how the code works today. Comprehensive reform can do more than piecemeal changes to level the playing field for wage earners and make filing easier to manage. And there's one indisputable fact that's essential for us to recognize: A comprehensive approach to tax reform is the best option for middle class families – not one focused exclusively on business taxes. A lot of people, including in the administration, have advocated a corporate-only or business-only plan for reform.

I would not want to have to explain to a single parent in Oregon why Congress overhauled the tax code for corporations but not for him or her. The corporate side of our tax code undeniably needs improvement; tax reform can and should make American businesses more competitive in the tough global marketplace. But it would be a grave mistake to leave millions of middle class families and small businesses out.

Of course, the Finance Committee will be working with the Treasury Department over the year ahead on a lot more than tax reform. The Treasury fights hard on behalf of American workers and American priorities in tough global marketplaces. So I look forward to hearing about the administration's efforts to address misaligned currencies, particularly with respect to the ongoing Trans-Pacific Partnership negotiations.

And it's important not to forget that the Treasury plays an integral role managing economic sanctions against countries like Russia, Iran and Cuba. This committee welcomes updates on how those sanctions are working and how the administration envisions them changing in the future.

Secretary Lew, there's a lot on your plate. I want to thank you for joining the Finance Committee here today to discuss the administration's budget outline for the year ahead. I'm looking forward to working closely with you and the members of this committee on a bipartisan basis to get America's middle class on solid economic ground.

###

COMMUNICATIONS

---

www.estatetaxrelief.org

SUBMISSION FOR THE RECORD

Senate Committee on Finance

February 19, 2015

Hearing on the President's Budget for Fiscal Year 2016 with U.S. Department of the Treasury Secretary Jacob J. Lew

Chairman Hatch, Ranking Member Wyden, thank you for opportunity to submit a statement for the record regarding the President's fiscal year 2016 budget proposal with Secretary of the Treasury Jacob Lew.

The Family Business Estate Tax Coalition (FBETC) is a grassroots coalition of over 60 organizations representing family-owned businesses. The goal of the FBETC has always been full repeal of the estate tax, and the coalition still believes this is the best solution to protect all family-owned businesses from the estate tax. However, the FBETC supported the compromise reached in 2010 between Congress and the President, with a $5 million exemption and the maximum rate of 35 percent, as a bridge to full repeal. The FBETC also strongly supports permanently indexing the exemption level to inflation, providing for spousal transfer, and maintaining stepped-up basis.

The FBETC has serious concerns about a number of proposals in President Obama's fiscal year 2016 budget. Specifically, the FBETC strongly opposes the proposal to reduce the estate tax exemption to $3.5 million, remove the inflation adjustment, and raise the top marginal rate to 45 percent. The FBETC also strongly opposes the proposed repeal of stepped-up basis. The combined effect of these proposals would be the creation of two taxes at death, and would push the combined top tax rate at death to over 60 percent—a level not seen in over three decades. To the contrary, these proposals would instead take a major step backwards in the decades-long movement to provide estate tax relief to family-owned businesses and farms.

Proposed lower estate tax exemption and higher estate tax rate

Since 2001,when the estate tax was put on a glide path to full repeal with the passage of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA), reducing the burden of the estate tax on family-owned businesses and farms has been a Congressional priority. There are many reasons for this.

- The estate tax hurts capital formation and job growth. Prior to 2001, the estate tax reduced capital formation in the economy by an estimated $850 billion.[1]
- Estate tax compliance is time-consuming and expensive. For every $1 of tax revenue raised from the estate tax, $1 is wasted in compliance. For example, in 2006, it is estimated that family businesses spent $27.8 billion just to comply with the law.[2]
- The estate tax forces family businesses to sell their highly illiquid business assets, thereby jeopardizing the health of the business. In addition, the business may be jeopardized when family members leave in anticipation that the business would not survive a death in the family.

---

[1] Joint Economic Committee, United States Congress, *Costs and Consequences of the Federal Estate Tax*, May 2006.
[2] Ibid.

The total cost of the estate tax not only comes from the cost of the tax, but also from the cost of estate tax planning. Family-owned business owners make decisions based on thinking that they may incur the estate tax regardless of whether they ever do. As a result, a large portion of them make unnecessary, even wasteful, expenditures on products and services — such as financial planning and insurance — that they may never require, depriving the business of investment capital that could more productively be used for other purposes, including business growth. Even with a $5 million exemption level, 34 percent of small businesses have incurred expenses in the last five years in order to protect themselves and their heirs from estate tax liability, and another 15 percent expect to do so in the future.[3] Additionally, less than 10 percent of small businesses understand the estate tax, which means they will have to pay for lawyers and accountants to help them understand the law.[4]

Furthermore, because the value of many family-owned businesses is tied to illiquid assets, such as land, buildings, or equipment, this can cause families to lose the viability of their businesses altogether. For example, since 84 percent of a farmer's assets are land based, farmers may be forced to sell their land to pay for the estate tax.[5] Additionally, when a business owner is placed in a situation where they are forced to sell business assets to pay the tax, the result can be assets sold at "fire sale prices," which further hurts the prospects that surviving family members will be able to carry on the business. Protecting these family businesses from the estate tax is important in order to keep these businesses operating for future generations.

With the President's fiscal year 2016 budget proposal calling for a reduction in the estate tax exemption to $3.5 million (not indexed to inflation), and an increase in the top rate to 45 percent, more family-owned businesses would face additional costs associated with tax compliance, and the next generation would face increased risk of having to sell their businesses to pay for the tax.

Creating a New Capital Gains Tax at Death and Repealing Stepped-Up Basis

In addition to the increase in the estate tax, the President's fiscal year 2016 budget also proposes to both repeal stepped-up basis, and create a new capital gains tax at death. The FBETC strongly opposes both of these proposals.

---

[3] Taxes and Spending: Small Business Owner Opinions – NFIB Member Poll, NFIB Research Foundation, See also, testimony of Neil D. Katz, Managing Partner, Katz, Berstein & Katz, LLP, from Committee on Small Business Hearing: *Planning for the Death Tax: Can Small Business Survive?*, May 31,2012: "So while there may only be 3,000 or 4,000 small business owners who die during the year who are impacted by the estate tax, it is impacting a lot of people . . . If there are thousands of lawyers learning about this, there are hundreds of thousands of people that are dealing with this every day."

[4] National Federation of Independent Business, *National Small Business Poll Tax Complexity and the IRS*, Volume 6, Issue 6, 2006

[5] American Farm Bureau Federation, *Estate Tax Reform*, January 2011.

Virtually all of the same difficulties that family-owned businesses and farms face when dealing with the estate tax would be repeated and magnified under the proposed new capital gains tax. It would harm capital formation and economic growth. It would force companies to conduct even more costly estate planning. It would force businesses and farms to sell off illiquid assets to pay the tax, leading to a "mushroom effect"—creating fresh taxes on property sold to pay other taxes. And it would place an unimaginable burden on families, who would be forced to sort through countless records while trying to find an original receipt, bill of sale, or property deed—or worse yet, to face the tax on the entire value of an asset because of the inability to locate documents for property purchased years in the past.

Furthermore, when combined with the proposed increase in the estate tax, the two taxes at death would push the top marginal tax rate to over 60 percent, which is substantially higher than the 55 percent rate in place prior to 2001.

Historically, the tax code has always allowed for a basis adjustment for inherited property for the purposes of calculating capital gains taxes.[6] This means that if inherited property is sold by an heir, capital gains taxes are due on the increase in value since the property was inherited. It is important to note that the basis adjustment moves up as well as down, and if the value of an asset on the date of death is lower than the decedent's basis, the asset's basis is stepped down.

With the passage of the *Tax Reform Act of 1976*, Congress attempted to switch from stepped-up basis to carryover basis for inherited property. In the process, the law also created a $60,000 minimum basis adjustment, which served as a de facto capital gains tax exemption. The proposal was never allowed to go into effect, however. In response to withering criticism, the proposal was postponed for three years with the passage of the *Revenue Act of 1978*. In 1979, as Congress debated whether to repeal the provision or modify it, the Joint Committee on Taxation prepared a background report on carryover basis. The report states:

> "The carryover basis provisions have been criticized as being extremely complex and administratively unworkable. Administrators of estates have testified that compliance with the provisions caused a tremendous increase in the time required to administer an estate and resulted in raising the cost of administration."[7]

Shortly afterwards, carryover basis was repealed entirely with the passage of the *Crude Oil Windfall Profit Tax Act of 1980*.

Additionally, in 2010, when the estate tax was repealed for one year, stepped-up basis was limited to $1.3 million plus an additional $3 million for property passed between spouses. For all other inherited property, carryover basis applied. Once the estate tax was reinstated in 2011, with a $5 million exemption and 35 percent rate, stepped-up basis was reinstated.

---

[6] Joint Committee on Taxation, *Background and Issues Relating to Carryover Basis*, JCS-6-79, March 9, 1979.
[7] Ibid.

With the carryover basis proposal outlined in the fiscal year 2016 budget, the Administration has actually proposed a far more damaging tax regime than was enacted, and ultimately repealed during the Carter Administration. As mentioned earlier, the carryover basis proposal enacted in the *Tax Reform Act of 1976* contained a $60,000 basis adjustment, which, when adjusted for inflation amounts to $249,634 in 2014 dollars.[8] After the tax was delayed for the years during the 95th Congress (1977-1979), the Treasury Department proposed raising this basis adjustment to $175,000,[9] which would translate to $570,644 in 2014 dollars.[10]

The proposal put forth by the Obama Administration would allow for a $100,000 per-person capital gains tax exclusion ($200,000 per couple). When adjusted for inflation, this would affect substantially more family-owned businesses than was originally enacted in the *Tax Reform Act of 1976*, and more than double the number of families affected under the proposal from the Treasury Department in the 95th Congress. Any discussion about this proposal should begin with an explanation as to why, if a plan that was so unworkable that it was never allowed to go into effect in 1976, it should be applied to even more businesses in 2015.

Conclusion

The Administration's proposals related to the estate tax and stepped-up basis are unreasonable and unworkable. They would turn back the clock on decades of progress providing relief to family-owned businesses and farms, force new and repeated trips to the attorney's office, create countless administrative problems, and act as a brake on economic growth and job creation. Congress should reject these proposals and instead build on the bipartisan progress made in recent years to repeal the estate tax once and for all.

---

[8] Calculated using Consumer Price Index Inflation Calculator, Bureau of Labor Statistics, U.S. Department of Labor, available at http://data.bls.gov/cgi-bin/cpicalc.pl

[9] Joint Committee on Taxation, *Background and Issues Relating to Carryover Basis*, JCS-6-79, March 9, 1979.

[10] Calculated using Consumer Price Index Inflation Calculator, Bureau of Labor Statistics, U.S. Department of Labor, available at http://data.bls.gov/cgi-bin/cpicalc.pl

Statement of the Puerto Rico Manufacturers Association
By Mr. Carlos Rivera Vélez, PhD, PE, President

For the Hearing Record
of the
Finance Committee
U.S. Senate

Hearing on
The President's Budget for Fiscal Year 2016

February 5, 2015

Contact:

Carlos Rivera Vélez, PhD, PE
President
Puerto Rico Manufacturers Association
PO Box 195477
San Juan, PR 00919
E Mail- CRIVERAVELEZ@prma.com
Tel: (787) 641-4455
Fax- (787) 641-2535

Thank you Chairman Hatch, Ranking Member Wyden and distinguished Members of the Committee. It is my pleasure to present this statement as President of the Puerto Rico Manufacturers Association (PRMA). The PRMA is a private, voluntary, non-profit organization established in 1928 to serve as the voice of manufacturing in the U.S.'s largest and most important Territory.

As Congress considers moving forward on the issues of reforming the tax code we wish to provide some background on the Federal Tax Code's unique treatment of U.S. companies operating in Puerto Rico as well as the importance of manufacturing to our overall economy. We also ask for your consideration and inclusion of our concerns during your deliberations over Tax Reform.

Puerto Rico has been part of the U.S. since 1898 and today is the home for 3.7 million U.S. Citizens. No jurisdiction of the U.S. is more dependent on manufacturing than Puerto Rico. In fact, manufacturing is currently the leading private sector employer and represents almost one-half of Puerto Rico's economy, far more than any State.

It's important to remember that manufacturing jobs in Puerto Rico are U.S. jobs employing U.S. citizens. Our goal for Tax Reform is simply to "do no harm".

SUMMARY OF KEY POINTS FOR YOUR CONSIDERATION:

- PRMA has taken no official position with respect to the President's Tax Reform measures as described in the Treasury Green Book for FY 2016.
- However, on a personal level, I believe that Treasury's recommended international provisions will harm Puerto Rico and will result in the loss of U.S. / Puerto Rico manufacturing jobs. Puerto Rico is part of the United States and the loss of Puerto Rico jobs directly impacts American Citizens as well as stateside suppliers.
- Historically, Federal tax law has fostered manufacturing and continues to play a pivotal role in attracting and keeping U.S. companies and U.S. jobs in Puerto Rico.
- We urge that Tax Reform should "do no harm" to Puerto Rico's economy by discouraging investment in Puerto Rico.
- Puerto Rico needs a seat at the table during deliberations on Tax Reform.
- Most subsidiaries of U.S. companies operating in Puerto Rico are organized as Controlled Foreign Corporations (CFCs) under the current tax code. However, they are treated as domestic in every other way.
- Puerto Rico is not a tax haven. We believe Puerto Rico is the only jurisdiction in the United States where CFCs employ U.S. Citizens, operating under a hybrid application of U.S. law and on U.S. soil.

TAX POLICY'S HISTORICAL ROLE IN PUERTO RICO'S ECONOMY:

Federal tax policy has traditionally recognized the unique relationship of Puerto Rico to the United States. Initially the provisions adopted as part of the Revenue Act of 1921 and later through the activities of the 1948 Operation Bootstrap (of which PRMA was a major participant) and the creation of IRC Section 936 as part of the Tax Reform Act of 1976, the U.S. Congress has traditionally adopted targeted policies, particularly tax policies, towards Puerto Rico that were "pro-growth" and spurred the conversion of Puerto Rico from an agrarian economy to one based on manufacturing.

Although initially a largely agrarian economy, the decades after World War II saw manufacturing replace agriculture as the driving force of the economy of Puerto Rico. In the 1940's employment by the manufacturing sector was approximately 56,000. That number dramatically increased in the late 1980s after the enactment of IRC Section 936 to approximately 106,000 and to a high of 155,000 by 1995. It was primarily due to the jobs offered by the manufacturing sector that living

standards, wages and educational levels rose dramatically. Today more than 40% of the population has at least 13 years of education. Thanks to Congressionally driven tax policy, the economic miracle that is Puerto Rican manufacturing has grown from labor intensive basic manufacturing to a capital intensive industrialized sector to now a knowledge based advanced manufacturing model.

MANUFACTURING GROWTH AND TRANSITION:

Because of these tax policies and in spite of the recent economic recession impacting our island for the past nine years, Puerto Rico's manufacturing sector has shifted from one based on labor such as the manufacturing of food, tobacco, leather and apparel to the more capital-intensive industries of pharmaceuticals, chemicals, machinery and electronics operating nearly 2,000 plants on our island.

Puerto Rico ranks the fifth in the world for pharmaceutical manufacturing with more than 70 plants. As of 2014, Puerto Rico based plants produced 16 of the top 20 best selling drugs on the U.S. mainland.

Puerto Rico is also the world's third largest biotech manufacturer with more than two million square feet of dedicated plant space and is the seventh largest medical device producer hosting more than 50 plants on the island. Manufacturing accounts for 48. 6 % of Puerto Rico's Gross Domestic Product (GDP) and directly employs 8% of the work force or about 74,000 people. We estimate an additional 80,000 Puerto Rico residents are indirectly employed by our sector. We also estimate an additional 80,000 Stateside jobs supported by Puerto Rico's manufacturing companies (CFCs). Therefore, our manufacturing sector has the multiplier effect of contributing 234,000 jobs (direct, indirect and induced) to the US and Puerto Rico economies. For example, one of our member companies reports that it annually transports over $140 million worth of product from Puerto Rico just through the Port of Jacksonville, Florida.

Manufacturing companies paid $1.4 billion in income taxes in 2009 or 57.9% of all corporate income tax collected. The role of CFCs in Puerto Rico's economy is of such importance that during the current fiscal year, seven (7) of these companies doing business in Puerto Rico represent 20% of the revenues of the Government of Puerto Rico's budget or $2 billion.

Manufacturing offers better wages for U.S. Citizens in Puerto Rico. Unfortunately, while approximately 42% of our population lives below the "poverty line" and the current unemployment rate is at 14%, workers in the manufacturing sector earn an average wage of $39,000, which is actually 30% higher than the per capita average. We are also proud to report that in an economy in which fully 40% of the workers earn minimum wage, manufacturing wages are a major factor in improving the standard of living for all of Puerto Rico's residents.

IRC SECTION 936 FOSTERED MANUFACTURING:

In spite of these positive numbers, the overall economic picture for Puerto Rico generally and for manufacturing specifically must be balanced by the "hard" facts that manufacturing has lost a significant number of jobs particularly since the repeal of IRC Section 936 in 1996.

In it's 1993 Report to the Chairman of the Senate Finance Committee, the General Accounting Office (GAO) summarized the IRC Section 936 credit as follows: *Under section 936, the tax credit equals the full amount of the U.S. income tax liability on possessions source income. Firms qualify for the credit if, over a three year period preceding a taxable year, 80 percent or more of their income was derived from sources within a possession and 75 percent or more of their income was derived from the active conduct of a trade or business within a possession. This provision effectively exempts all possessions source income from U.S. taxation. Dividends repatriated from a U.S. subsidiary to a mainland parent qualify for a dividends-received deduction, thus allowing tax-free repatriation of possessions income. In addition, the provision exempts from U.S. taxation the income earned on qualified investments made by section 936 firms from their profits earned in the possessions. This income is called qualified possessions source investment income, or QPSII. Puerto Rico established rules to ensure that QPSII funds invested through the island's financial intermediaries meet the act's requirements.*

The enactment of IRC Section 936 had a positive and direct impact on Puerto Rico's economy. In 1989, the GAO noted that 13 years after enactment of IRC Section 936, manufacturing firms in Puerto Rico employed 105,500 individuals directly comprising 11% of the total employment of 952,000. By 1997, that number stood at 155,000 Americans directly employed by the Puerto Rico manufacturing sector.

However today, the number of U.S. citizens employed directly by manufacturing has been reduced to approximately 74,000. It's fair to say that this drastic reduction is mostly due to the elimination of IRC Section 936 more than any other single factor. In fact, a number of corporate decision

makers cited the loss of IRC Section 936 as the primary reason for either the closure or relocation of facilities to Mexico, China and the Dominican Republic.

Unfortunately, as manufacturing jobs have disappeared few other local employment opportunities remain. This has caused a sizeable "brain drain" as tens of thousands of skilled workers have left Puerto Rico in search of new employment. Over the past decade, an estimated 300,000 US citizens representing approximately 7% of the total population (mostly the young and those with higher educational levels) left the island for better opportunities on the mainland. This troubling trend suggests greater social consequences if the shrinking manufacturing sector were to continue. Economic circumstances are driving this "brain drain" leaving many of our talented citizens with little choice but to immigrate to the mainland or remain on the island becoming dependent on social programs.

Even in the context of IRC Section 936 repeal, the U.S. Congress recognized the consequences of this repeal and its impact on Puerto Rico and provided for a ten-year transition period. Subsidiaries of U.S. companies were given the opportunity to re-organize as Controlled Foreign Corporations. Although not as generous as IRC Section 936, the CFC mechanism provides a special tax incentive offering a potent financial reason for U.S. companies to remain or expand operations in Puerto Rico.

We believe Puerto Rico is the only jurisdiction in the United States where CFCs employ U.S. Citizens, operating under U.S. law and on U.S. soil. This is truly a unique situation to consider during Congress' deliberations on Tax Reform.

TAX REFORM 2015:

Considering Congress' historical use of the Federal tax code as a tool to foster and support economic growth in the U.S. Territory of Puerto Rico, we urge full consideration of the impact of future Tax Reform on Puerto Rico's economy and job base. We believe Congress shares a bi-partisan goal of fostering manufacturing and encouraging investment in American jobs. Again, we note that Puerto Rico jobs are American jobs.

The GAO's 1993 Report also reviewed the factors that U.S. corporations consider when they contemplate establishing a plant or similar facility in a foreign location. The GAO identified six primary considerations including energy costs, transportation costs, labor costs, stability, infrastructure, and tax structure.

Thankfully, Puerto Rico has a stable government and excellent infrastructure given the millions of dollars invested in recent years on infrastructure improvements. We have world-class seaports, airports and a modern ground transportation network.

Conversely, the Island has a highly skilled and educated workforce but labor costs are the highest in the Caribbean. In addition, local and federal labor laws make Puerto Rico one of the most heavily regulated jurisdictions in the U.S. and certainly much higher than others in the Caribbean basin area.

Puerto Rico is an island and highly dependent on imports of raw materials, food and oil; increasing costs for manufacturing and business operations. While there is a planned conversion over to liquefied natural gas (LNG), currently, energy is generated using imported oil resulting in higher energy costs. A recent comparison with Florida found that energy costs in Puerto Rico are three times that of Florida: on average 27 cents per kilowatt-hour in Puerto Rico versus 9 cents in Florida. The average for the United States is 11 cents per kilowatt-hour.

The bottom line is that we have several factors that must be considered when we compete to foster investment in manufacturing operations in Puerto Rico. Our neighbors in the region as well as our global competitors are aggressively pursuing our manufacturing to re-locate their U.S. operations from Puerto Rico by offering cheaper labor costs, cheaper energy costs, less restrictive regulation and access to the U.S. market.

Therefore, the ability of Puerto Rico to remain economically competitive internationally may well depend on how the U.S. Congress treats U.S. companies operating subsidiaries in Puerto Rico under reforms to the tax code.

We share your goal of giving U.S. manufacturing a competitive edge when Tax Reform is enacted. We also ask for the opportunity to work with you on this task while ensuring no harm to manufacturing jobs in Puerto Rico. Puerto Rico is a vital element of the U.S. manufacturing sector and we wish to continue fostering opportunity for U.S. citizens on our island as well as Stateside.

In conclusion, I would like to thank the Committee for your consideration and ask that we be invited to appear before your Committee during any upcoming hearings on tax reform. I'm looking forward to working with you as Congress deliberates the future of the Federal Tax Code.