

BUSINESS INVESTMENT AND INNOVATION

Senate Finance Committee Staff Tax Reform Options for Discussion

April 11, 2013

This document is the second in a series of papers compiling tax reform options that Finance Committee members may wish to consider as they work towards reforming our nation's tax system. This compilation is a joint product of the majority and minority staffs of the Finance Committee with input from Committee members' staffs. The options described below represent a non-exhaustive list of prominent tax reform options suggested by witnesses at the Committee's 30 hearings on tax reform to date, bipartisan commissions, tax policy experts, and members of Congress. For the sake of brevity, the list does not include options that retain current law. The options listed are not necessarily endorsed by either the Chairman or the Ranking Member.

Members of the Committee have different views about how much revenue the tax system should raise and how tax burdens should be distributed. In particular, Committee members differ on the question of whether any revenues raised by tax reform should be used to lower tax rates, reduce deficits, or some combination of the two. In an effort to facilitate discussion, this document sets this question aside.

CURRENT CHALLENGES AND POTENTIAL GOALS FOR REFORM

Under current law, businesses determine their taxable income using a complex set of rules that, in many cases, differs from the rules they use to calculate their financial or "book" income. Financial income is the measure of income that businesses are required to compute each year for financial accounting purposes, and it follows the generally accepted accounting principles (GAAP) or some other form of financial accounting. Taxable income is the measure of income they must compute in paying their taxes.

These differences between taxable income and financial income reflect the different objectives of tax policy and the accounting rules. Financial accounting rules are designed to paint a picture of a business's absolute and relative financial performance. The tax rules should be designed to equitably and efficiently collect revenue. In addition, while some disagree with this practice, the tax rules are often used to promote other policy objectives, such as incentivizing certain economic behaviors that policymakers consider socially valuable.

As a consequence of these special accounting rules and incentives embedded in the tax code, businesses spend large amounts of time and resources every year trying to calculate their tax liability. Tax reform provides an opportunity to simplify these provisions and, if members of Congress decide tax incentives are desirable, make those tax incentives more effective. This paper discusses options for reforming the rules regarding business investment, tax accounting, and innovation, with special attention to smaller businesses. Following are some potential broad principles for reform in this area:

- Simplify the law in order to reduce the cost to businesses of complying with the tax code
- Make the tax code more neutral by eliminating or reducing differences in effective tax rates across industries and business activities
- If policy makers choose to include incentives in a reformed tax code, ensure that those incentives are effective and efficient
- Provide businesses with greater certainty

Some specific concerns about the taxation of business investment and innovation include the following:

- **Overall complexity:** Current law provides numerous tax expenditures for businesses. Tax expenditures are provisions in the tax code that deviate from a “normal” income tax. While the definition of a tax expenditure is inherently subjective, the Treasury Department and the Joint Committee on Taxation (JCT) have both published different lists of what they define as tax expenditures since 1968 and 1972, respectively. According to JCT, there are over 140 business tax expenditures in the tax code today. Among businesses with 20 employees or less, tax compliance costs \$1,584 per employee, according to a 2011 Small Business Administration study. ([JCS-1-13; Small Business Association, Frequently Asked Questions](#))
- **Large differences in effective tax rates by industry:** Tax expenditures create large disparities in the tax treatment of different types of business investment, which may distort investment choices. According to the Treasury Department, the average federal corporate tax rate varies from a low of 14% for utilities to 31% for construction. Other studies have shown wide disparities in the taxation of different asset types. ([President’s Framework for Business Tax Reform, February 2012](#); CRS, Corporate Tax Reform: Issues for Congress, Dec. 26, 2012)
- **Uncertainty created by temporary provisions:** The tax code has been amended more than 15,000 times since 1986 ([President’s Economic Recovery Advisory Board’s Report on Tax Reform Options, August 2010](#)). Over 60 tax provisions expire in 2013. The temporary nature of expiring tax provisions makes it difficult for business taxpayers to

plan. For example, the research and development (R&D) credit has been extended at least 15 times since 1981. The Section 179 limitations on the amount of property that can be immediately expensed, which were increased retroactively at the beginning of this year, have changed at least 7 times since 2002.

- **Increasing international competition in innovation:** The U.S. faces increasing competition in maintaining its R&D base. Some are also concerned about increasing international competition in specific industries, such as manufacturing. Others believe the tax code should not favor one business sector over another. Most of our major trading partners are enhancing the benefits they offer for R&D to entice companies to locate R&D centers in their countries, with the associated high paying jobs. For example, China, India, Brazil, the UK, Ireland, Singapore, Australia, Russia, and France have recently increased their tax incentives for R&D. According to the Organisation for Economic Cooperation and Development (OECD), in 2008, U.S. R&D tax incentives ranked 24th out of 38 developed countries surveyed. ([OECD Science, Technology, and Industry Scoreboard 2009](#)) On the other hand, the OECD found that for 2009, the United States was second in total government subsidies for R&D as a percentage of GDP, looking at both direct subsidies and tax incentives. ([OECD Science, Technology, and Industry Scoreboard 2011](#))
- **Limited business effect of tax incentives that defer tax liability:** Some tax incentives allow businesses to pay tax later than it would otherwise be due. Such timing changes do not affect the nominal amount of taxes due, although they can be very valuable due to the time value of money. For example, accelerating depreciation deductions means that a business pays less tax in the years immediately following the purchase of an asset, but pays correspondingly more tax later in the useful life of the asset. Many publicly-traded corporations and certain private businesses often plan with a focus on financial income. In general, changes in the timing of paying a tax do not impact financial income and, as a result, may not significantly affect business behavior. Therefore, to incentivize business behavior, it may be more effective to provide tax incentives that are not timing-based, but instead are, for example, rate reductions or credits.

REFORM OPTIONS

I. SMALLER BUSINESSES

There is no agreed-upon definition of what constitutes a small business. For example, JCT has identified at least 42 different definitions of a small business or small employer in the tax code.

Nevertheless, there are several provisions of current law that could be targeted for reform as they apply to small businesses (although some think the definition of a small business in these rules is overinclusive or underinclusive):

- **Section 179 expensing:** Under Section 179, businesses can immediately expense certain property, such as equipment or machinery, instead of depreciating the property. The maximum amount that can be expensed is \$500,000 for 2013. This amount is phased out once qualifying property exceeds \$2,000,000. In 2014, the maximum amount will become \$25,000, phasing out at \$200,000.
- **Cash method of accounting:** Under current law, generally certain businesses with average annual gross receipts under \$5 million can report their income and expenses (other than inventory) using a cash method rather than an accrual method. The same is true of certain farming businesses and personal service businesses. Taxpayers using a cash method generally report income when they receive it and deduct expenses when paid. Taxpayers using an accrual method generally report income when all events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. Accrual method taxpayers deduct expenses when all events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has taken place.
- **Inventory accounting:** If the production, purchase or sale of goods is an income-producing factor for a business, then the business is required to use inventory accounting for the goods. The rules for deducting the costs of inventory vary depending on whether the costs are direct or indirect. For direct costs, businesses that earn income from inventory are required to “capitalize” (meaning not immediately deduct) the costs of inventory that they produce or purchase, and then recover the costs when the goods are sold. In addition, with very few exceptions, businesses with inventory are required to use the accrual method of accounting for inventory. For indirect costs of inventory, businesses that produce their own inventory are typically subject to an additional set of rules—the so-called uniform capitalization (“uni-cap”) rules—which require them to capitalize indirect costs associated with producing inventory. In contrast, businesses that purchase their inventory for resale are not subject to the uni-cap rules unless they have average annual gross receipts exceeding \$10 million.
- **Research and development credits:** As an incentive to encourage innovation, businesses can claim a credit for incremental spending on labor and supplies used for research. This credit is non-refundable. This means that businesses are only entitled to

claim the credit to the extent that they have sufficient income tax liability to offset. If they do not, such credits may be carried back one year and carried forward 20 years.

- **Start-up and organizational expenditures:** The first \$5,000 of start-up and organizational expenditures incurred in the context of starting a new business may generally be expensed, subject to a phase-out of such immediate deduction if such expenses exceed \$50,000. Expenditures that do not qualify to be immediately expensed can be amortized (i.e., deducted) over a period of 15 years.
- **Section 1202 stock:** As an incentive to encourage investment in start-up businesses, non-corporate taxpayers may generally exclude 50% of the gain from selling “qualified small business stock” that was acquired at original issue and held for more than 5 years (100% through 2013). The exclusion is limited to stock of a C corporation whose gross assets do not exceed \$50 million (and that meets certain active business requirements).
- **Passive activity loss rules:** The passive activity loss rules prevent taxpayers from using losses from certain passive investments to offset their taxable income from other sources, such as salary income. If a taxpayer has a net loss from passive investments for the year, that loss is carried forward and is available to offset any income from passive sources that the taxpayer reports in future years.

Following are potential reform options for smaller businesses related to these provisions:

1. **Eliminate the requirement that smaller businesses depreciate and amortize investments**
 - a. Permanently increase the amount of qualifying property that smaller businesses can immediately expense under Section 179 and index the amounts for inflation. For example, allow companies to expense up to \$250,000, phasing out above \$800,000 ([The Ways and Means Committee Discussion Draft to Reform The Taxation of Small Businesses and Passthrough Entities](#); [President’s Framework for Business Tax Reform, February 2012](#) (proposing \$1 million threshold); [S.12, Job Creation Act of 2011, sponsored by Sen. Portman](#))
 - b. Permit smaller businesses to expense an unlimited amount of qualified property under Section 179 ([S.727, Bipartisan Tax Fairness and Simplification Act of 2011, sponsored by Sens. Wyden, Coats, and Begich](#))
 - c. Include certain off-the-shelf computer software and qualified real property in the definition of qualifying property for purposes of Section 179 ([S.12, Job Creation Act of 2011, sponsored by Sen. Portman](#); [The Ways and Means](#)

[Committee Discussion Draft to Reform The Taxation of Small Businesses and Passthrough Entities](#))

2. Simplify tax accounting for smaller businesses

- a. Expand cash method accounting and, potentially, expensing through one of the following options:
 - i. Allow smaller businesses with, for example, up to \$10 million in gross receipts to use a “business cash flow tax” model. In such a system, all business cash receipts are immediately included as income and all business cash disbursements are immediately deductible as expenses. Accordingly, the purchase of inventory, equipment, buildings and even land are immediately deductible. Such a system completely eliminates the need to account for inventories and depreciate business property ([President’s Advisory Panel on Tax Reform, 2005](#))
 - ii. Same as (i), above, except businesses could not immediately expense buildings and land ([President’s Advisory Panel on Tax Reform, 2005](#))
 - iii. Permit businesses with, for example, up to \$10 million in gross receipts to use the existing cash method of accounting for income and expenses unless the business has inventory ([The Ways and Means Committee Discussion Draft to Reform The Taxation of Small Businesses and Passthrough Entities](#))
- b. Simplify the accounting rules for costs of inventory through one of the following options:
 - i. Allow businesses with, for example, up to \$10 million in gross receipts to expense all costs of inventory (including both direct and indirect costs) ([President’s Advisory Panel on Tax Reform, 2005](#))
 - ii. Exempt all businesses with, for example, up to \$10 million in gross receipts from the uni-cap rules though still require those businesses to capitalize direct costs of inventory ([The Ways and Means Committee Discussion Draft to Reform The Taxation of Small Businesses and Passthrough Entities](#))

3. Innovation (R&D)

- a. Allow smaller businesses to use up to, for example, \$250,000 in R&D credits against their payroll tax liability, thereby making the credit partially refundable ([Testimony of Annette Nellen at Senate Finance hearing on Tax Reform Options:](#)

[Incentives for Innovation on September 20, 2011](#); [S.3460 of 112th, Startup Innovation Credit Act of 2012, sponsored by Sen. Coons](#))

4. Start-up and organizational business expenditures

- a. Consolidate the rules for deducting start-up expenditures and organizational expenditures into a single rule, and increase the \$5,000 threshold to \$10,000 subject to a phase-out beginning at \$60,000 ([The Ways and Means Committee Discussion Draft to Reform The Taxation of Small Businesses and Passthrough Entities](#))

5. Exclusion for sale of qualified small business stock

- a. Make 100% exclusion permanent and eliminate corresponding AMT preference item ([Kauffman Foundation, A Market-Based Approach for Crossing the Valley of Death, January 2012](#))
- b. Expand eligibility for Section 1202 by, for example, increasing the size restriction of the business to \$75 million ([S.1381, Small Business Tax Relief Act of 2009, sponsored by Sen. Grassley](#))
- c. Expand eligibility for Section 1202 to limited liability companies and S corporations ([Testimony of Annette Nellen at Senate Finance hearing on Tax Reform Options: Incentives for Innovation on September 20, 2011](#))

6. Exemption from passive activity loss rules for R&D-focused start-up businesses

- a. Exempt R&D-focused pass-through entities from the passive activity loss rules to help them raise capital ([S.3595](#) and [H.R.6559](#), ...to provide an exception from the passive loss rules for investments in high technology research small business pass-thru entities, sponsored by Sen. Menendez and Rep. Gerlach)

7. Provide a pass-through business deduction

- a. Allow some or all pass-through businesses to deduct a certain percentage of their business income ([S.1381, Sen. Grassley's 2009 Small Business Tax Relief Act](#); [S.1960, 2011 Jobs Creation Act, cosponsored by Sens. Collins and McCaskill](#); and [H.R.9, 2012 Small Business Tax Cut Act, sponsored by Rep. Cantor](#))

II. DEPRECIATION AND AMORTIZATION

Under current law, businesses generally cannot immediately expense the cost of tangible property used in their business, but rather must “capitalize” the cost of such property and recover it over time through depreciation deductions. The same is true of intangible property, although deductions in that case are called “amortization.”

The Tax Reform Act of 1986 introduced the current modified accelerated cost recovery system (MACRS) for computing depreciation. The cost of property is depreciated over its applicable recovery period, which is based on designated “class lives”. Such recovery periods are generally shorter than the economic life of the asset. Some assets, such as buildings, are depreciated in equal amounts over the recovery period of the asset (straight-line depreciation). Other assets, such as equipment, are depreciated more quickly over the recovery period of the asset (e.g., the double declining balance method). In general, intangible assets (for example, goodwill and patents) are amortized on a straight-line basis over 15 years. However, certain expenditures for intangible assets, such as advertising, are deducted in the year paid or incurred even though they may create value that lasts beyond the current year.

In addition to the normal MACRS rules, an alternative depreciation system (ADS) was also enacted in 1986 for certain limited purposes. Taxpayers can elect to use ADS, in place of MACRS, as their regular depreciation method. Under ADS, property is depreciated over longer periods than MACRS using the straight-line method. Many of the class lives and asset classifications for MACRS and ADS have not been updated since the 1980s.

Following are potential reform options for depreciation and amortization:

1. Revise the depreciation rules for tangible assets to more closely track their economic lives through one of the following reforms:

- a. Require companies to use the ADS rules ([S.727, Bipartisan Tax Fairness and Simplification Act of 2011, sponsored by Sens. Wyden, Coats, and Begich; President’s Economic Recovery Advisory Board’s Report on Tax Reform Options, August 2010; estimated in 2011 to raise \\$724 billion over 10 years](#))
- b. Require companies to use the ADS rules with updated lives and modifications for new technologies; possible sources for updated lives include the Treasury Department and the Bureau of Economic Analysis ([S.2100, Tax Depreciation, Modernization, and Simplification Act of 2005, sponsored by Sen. Smith](#))
- c. Extend the recovery period of equipment under MACRS to reflect the decline in inflation since 1986 but keep the existing depreciation methods ([CBO, Reducing](#)

[the Deficit: Spending and Revenue Options, March 2011; estimated to raise \\$241 billion over 10 years\)](#)

- d. Require publicly-traded companies and large, audited companies to compute depreciation under GAAP (i.e., “book depreciation”) ([Murray, Tax Executives Institute \(TEI\), Comments of TEI on Tax Simplification and Reform, March 25, 1997](#); [Whitaker, Bridging the Book-Tax Gap, Yale Law Review, 2005](#))
- 2. Revise the amortization rules for intangible assets to more closely track the economic lives of intangible assets**
 - a. Extend the useful life of intangibles to, for example, 20 years ([Johnson, Extend the Tax Life for Acquired Intangibles to 75 Years, Tax Notes, May 21, 2012](#))
 - b. Require companies to amortize certain expenditures currently permitted to be expensed, such as advertising expenses ([The Committee for a Responsible Federal Budget, Sept 2012](#); [CBO, Options for Reducing the Deficit, 1997](#))
 - 3. Allow 100% expensing** ([President’s Advisory Panel on Tax Reform, 2005](#))
 - a. Allow businesses otherwise eligible for 100% expensing to elect to accelerate alternative minimum tax (AMT) credits instead ([S.2240, a bill to amend the Internal Revenue Code of 1986 to extend the allowance for bonus depreciation for certain business assets, a proposal tying AMT in lieu of bonus to 100% expensing by Sens. Stabenow, Blunt, Brown and Roberts](#))

III. MANUFACTURING

Under current law, businesses can deduct up to 9% (6% for oil and gas businesses) of their income from domestic manufacturing and production (Section 199). By its nature, this provision reduces the marginal and average tax rate of certain businesses.

- 1. Repeal the domestic production deduction (Section 199)** ([CBO, Reducing the Deficit: Spending and Revenue Options, March 2011](#); [President’s Economic Recovery Advisory Board’s Report on Tax Reform Options, August 2010](#); [H.R.3970, Tax Reduction and Reform Act of 2007, sponsored by Rep. Rangel](#); [Robert Shapiro, Progressive Policy Institute Policy Memo, Anatomy of a Special Tax Break & The Case for Broad Corporate Tax Reform, March 2013; estimated in 2011 to raise \\$164 billion over 10 years](#))

2. Target or simplify the domestic production deduction through some or all of the following reforms:

- a. Limit the deduction to manufacturing and industries that can relocate abroad, for example by disallowing the deduction for some or all of the following: film, utilities, construction, engineering and architectural services, natural resource extraction and agriculture ([President's Framework for Business Tax Reform, February 2012](#))
- b. Provide a larger deduction (or increased R&D credit) on income from products where the related R&D is performed within the U.S. ([Testimony of Michael Rashkin at Senate Finance hearing on Tax Reform Options: Incentives for Innovation on September 20, 2011](#); [S.1866 of 112th, AGREE Act, Sen. Coons](#); CRS, The Section 199 Production Activities Deduction: Background and Analysis)
- c. Provide a larger deduction for income from advanced manufacturing activities, such as activities that depend on information, automation, computation, software, sensing, or networking, or for cutting-edge technology ([President's Framework for Business Tax Reform, February 2012](#); [proposal by Sen. Brown](#))
- d. Provide the same percentage deduction for all domestic production activities, including oil and gas (Merrill Matthews, About Those Tax Breaks for Big Oil . . . , Wall St. J. A17, April 3, 2013)

IV. INNOVATION

Under current law, businesses can choose to immediately expense R&D costs or amortize such costs over 5 years or more. In addition, businesses can claim a nonrefundable credit for incremental spending on labor and supplies used for research. Businesses can choose between two forms of the R&D credit: (1) the "traditional" credit, which is calculated by comparing current research expenses to those between 1984 and 1988, and (2) the "alternative simplified credit," which is calculated by comparing current research expenses from the past three years. The R&D credit has always been temporary and currently expires at the end of 2013. It is often difficult for businesses to successfully claim the credit for all their research activities because of the complex rules regarding what activities or costs qualify for the credit.

- 1. Allow the R&D credit to expire** ([Sullivan, Time to Scrap the Research Credit, Tax Notes, February 16, 2010](#))
- 2. Require companies to amortize R&D costs over, for example, 3 years rather than expensing costs immediately** ([Tyson and Linden, The Corporate R&D Tax Credit and U.S.](#)

[Innovation and Competitiveness, Center for American Progress, 2012; estimated in 2011 to raise \\$160 billion over 10 years\)](#)

3. Make the R&D credit permanent, while simplifying and/or better targeting it through some or all of the following reforms:

- a. Eliminate the traditional credit and increase the alternative simplified credit to, for example, 17-20% ([S.1577 of 112th, GROWTH Act, sponsored by Chairman Baucus and Ranking Member Hatch; Administration's Fiscal Year 2013 Revenue Proposals; Testimony of Annette Nellen at Senate Finance hearing on Tax Reform Options: Incentives for Innovation on September 20, 2011; Administration's proposal estimated in 2012 to cost \\$99 billion over 10 years](#))
- b. Increase the credit amount for certain research activities like breakthrough innovative or life sciences research ([Testimony of Michael Rashkin at Senate Finance hearing on Tax Reform Options: Incentives for Innovation on September 20, 2011; S.1410, Life Sciences Jobs and Investment Act of 2011, sponsored by Sen. Casey](#))
- c. Eliminate the incremental-only aspect of the credit so it applies to all qualified research ([Testimony by Dirk Pilat, the Organisation for Economic Cooperation and Development, discussing other countries' approaches at Senate Finance hearing on Tax Reform Options: Incentives for Innovation on September 20, 2011](#))
- d. Disallow supplies from definition of research expenses (Michael Rashkin in his [addendum to his testimony](#) at Senate Finance hearing on Tax Reform Options: Incentives for Innovation on September 20, 2011)

4. Adopt a patent box

- a. Adopt a "patent box" that taxes business income from the sale of patented products developed in the U.S. at lower rates ([S.2091, United States Job Creation and International Tax Reform Act of 2012, sponsored by Sen. Enzi, Testimony of Robert Atkinson before Senate Finance Hearing on Tax Reform Options: Incentives for Capital Investment and Manufacturing on March 6, 2012; Leveling the Playing Field Act of 2012, Sen. Feinstein](#))

V. OTHER TAX ACCOUNTING

Inventory. Under current law, businesses generally may not deduct the cost of goods in inventory until the inventory is sold. Businesses can elect one of several methods for deciding which specific inventory item is deemed to be sold, which matters when items of the same good were purchased at different prices. Under first-in, first-out (FIFO), the business deducts the cost of goods in the order in which they were acquired. Under last-in, first-out (LIFO), the business deducts the cost of the most recently acquired goods first. Under weighted average, the business deducts the average cost of goods available for sale during the period, while under specific identification, the business deducts the cost of the specific product being sold. If prices rise over time, LIFO accounting results in less taxable income. If a business adopts LIFO accounting for tax purposes, it must also use LIFO for financial accounting purposes. The International Financial Reporting Standards, which are used in many foreign jurisdictions, do not permit LIFO accounting.

In addition to picking the method of calculating inventory (e.g., LIFO, FIFO, etc.), taxpayers must also pick a method of valuing inventory. There are three methods for valuing inventory: cost, the lower of cost or market and retail pricing.

Like-kind exchanges. In some circumstances, taxpayers are allowed to defer gains on business or investment property when it is traded for similar property. In addition to permitting direct swaps of property, current law allows certain “three-cornered transactions” in which taxpayers can use intermediaries to facilitate the acquisition of similar property. If, however, a taxpayer sells property and reinvests the proceeds in similar property outside of the like-kind exchange rules, the taxpayer must pay tax immediately on the sale even though the end result is the same.

Insurance. Insurance companies are generally taxed as corporations, except that the reserves they hold to meet policyholder obligations or pay claims are deductible when established rather than when the claim is paid. The tax code permits this deduction in recognition of the fact that insurance companies take premiums into income when they are received, while the related claim may not be paid for years.

The tax code contains numerous rules regarding the computation of the reserve deduction. While insurance companies use their state-mandated reserves as the starting point for determining the amount of their reserve deduction, they must make adjustments to that starting point. For example, they have to adjust for the time value of money if there is a delay in paying claims, and for the benefit of funding reserves with tax-preferred income. Many aspects of these adjustments are classified by JCT as tax expenditures.

The rules governing insurance taxation have not been significantly reformed since 1986. Since then, many more insurance companies have become publicly traded. The federal government has become more active in overseeing the financial solvency of insurance companies through the Treasury Department's Federal Insurance Office and Dodd-Frank. And technology has enabled insurance actuaries to more accurately predict long-term liabilities. Many of the options listed below involve revisiting insurance taxation in light of these developments.

- 1. Repeal last-in, first-out (LIFO) inventory accounting through one of the following options:**
 - a. Require companies using LIFO accounting to convert to another method of inventory accounting and recognize the gain from recapturing any LIFO reserves into income over a period of time. The effective date can be delayed to give companies time to plan for and minimize the tax consequences of conversion ([CBO, Reducing the Deficit: Spending and Revenue Options, March 2011](#); [Administration's Fiscal Year 2013 Revenue Proposals](#); [Administration's proposal estimated in 2012 to raise \\$67 billion over 10 years](#))
 - b. Require companies using LIFO accounting to switch prospectively for newly acquired inventory to another method of inventory accounting ([CBO, Reducing the Deficit: Spending and Revenue Options, March 2011](#))

- 2. Repeal the lower of cost or market inventory rules** ([S.727, Bipartisan Tax Fairness and Simplification Act of 2011, sponsored by Sens. Wyden, Coats, and Begich](#); [estimated in 2012 to raise \\$3 billion over 10 years](#))

- 3. Repeal, tighten or simplify the like-kind exchange deferral rules**
 - a. Repeal the like-kind exchange rules ([President's Economic Recovery Advisory Board's Report on Tax Reform Options, August 2010](#), [estimated in 2011 to raise \\$18 billion over 10 years](#))
 - b. Tighten the rules, for example, by repealing like-kind exchanges for transactions involving three-cornered exchanges and only allowing tax deferral where exchanges are directly between two parties ([President's Economic Recovery Advisory Board's Report on Tax Reform Options, August 2010](#))
 - c. Replace the like-kind exchange rules with an election to defer paying tax on gains from selling property if the sales proceeds are rolled over into similar

replacement property within a limited timeframe ([President's Economic Recovery Advisory Board's Report on Tax Reform Options, August 2010](#))

4. Update insurance company tax rules to account for industry innovations and to more closely match income and statutory accounting

a. Life insurance companies

- i. Adjust the rules governing the amount of a life insurance company's reserves that are deductible to more closely align with statutory reserves the company is required to hold by state regulators ([DesRochers and Hertz, Treading into the Thicket: Federal Income Tax Implications of Principles-Based Reserves, Society of Actuaries, April 19, 2007](#); [Adney, Taxing Time, The Federal Income Tax Consequences of Adopting a Principles-Based Life Insurance Reserve System, Society of Actuaries, May 2006](#))
- ii. Change the calculation of a life insurance company and policyholder's share of dividends received and tax exempt interest ([General Explanations of the Administration's Fiscal Year 2013 Revenue Proposals](#))
- iii. Adjust current statutory deferred acquisition cost rates that reflect amount of policy acquisition costs that must be amortized ([General Explanations of the Administration's Fiscal Year 2001 Revenue Proposals](#))
- iv. Repeal the small life insurance company deduction ([Landy, Introducing the "Dirty Dozen" Tax Breaks, The Century Foundation, 2012](#))

b. Non-life insurance companies

- i. Adjust current loss reserve discounting rules ([General Explanations of the Administration's Fiscal Year 2001 Revenue Proposals](#))

c. All insurance companies

- i. Repeal some or all of the life-nonlife consolidated return limitations ([H.R.3399, To amend the Internal Revenue Code of 1986 to permit the consolidation of life insurance companies with other companies \(111th Congress\), sponsored by Rep. Larson](#))