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FISCAL YEAR 2018 BUDGET PROPOSALS FOR THE DEPARTMENT OF THE TREASURY AND TAX REFORM

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FISCAL YEAR 2018 BUDGET PROPOSALS FOR THE DEPARTMENT OF THE TREASURY AND TAX REFORM

THURSDAY, MAY 25, 2017

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

The hearing was convened, pursuant to notice, at 10:05 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Grassley, Crapo, Thune, Isakson, Heller, Scott, Cassidy, Wyden, Stabenow, Nelson, Menendez, Cardin, Brown, Bennet, Casey, Warner, and McCaskill.

Also present: Republican Staff: Chris Campbell, Staff Director; Mark Prater, Deputy Staff Director and Chief Tax Counsel; Chris Armstrong, Deputy Chief Oversight Counsel; and Jeff Wrase, Chief Economist. Democratic Staff: Joshua Sheinkman, Staff Director; Adam Carasso, Senior Tax and Economic Advisor; Michael Evans, Chief General Counsel; Elizabeth Jurinka, Chief Health Counsel; 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. Senator Wyden and members of the committee, I want to briefly comment on the horrific terrorist attack in Manchester. Americans are bound to our British friends by a common language, culture, and many other things such as the common law.

As a boy I remember the strength it brought to us Americans to witness the courage of the British people as they stood strong in the battle of Britain. We know the resolve of the British people will once again vanquish a common foe.

Today I think I can speak for all members of the committee when I say, "God save the Queen, and God save Great Britain." We care a great deal for our friends overseas, and we wish them the best.

Today's hearing has a dual focus. We will discuss the President's budget for fiscal year 2018 as well as ongoing efforts to reform our Nation's tax code.

We are pleased to be joined here today by Treasury Secretary Steven Mnuchin, who will provide the administration's perspective on these important issues. We welcome you back to the committee, Mr. Secretary. As this is your first budget hearing before this committee, let me warn you, these hearings tend to be pretty grueling, but that is a necessary part not only of the budget process but also of the committee's oversight function. But not to worry; I think you are up to the challenge.

Let me begin by saying a few words about the President's budget. Obviously, we are all still absorbing the finer details of this proposed budget. But at this point, I can say definitively I applaud the President for his focus on advancing pro-growth policies to get our economy moving, and I share the administration's concerns about our debt, which ballooned by nearly doubling under the previous administration.

The President's budget envisions increased economic growth that eventually reaches 3 percent. As I understand it, that vision relies on implementation of a number of policies, including pro-growth tax reform, cutting unnecessary regulation, building infrastructure, and some other approaches as well.

I think reforming health care is part of that, boosting energy production, reducing deficits. That would significantly improve the supply side of the economy. Of course, it is not unheard of that an administration places belief in the efficacy of its policy proposals.

For example, in former President Obama's fiscal year 2010 budget, growth was assumed to get to as high as 4.6 percent and was assumed to average 3.8 percent over an extended 8-year period. And that was premised on the administration's belief in its policy prescriptions.

So while critics may want to criticize the optimistic nature of the budget's growth projections, it is, I believe, more realistic than a number of budget proposals that we have seen in the past, particularly some that came from the previous administration.

I also share the overall goal in the budget to reduce deficits without raising taxes, keeping in mind that our Nation's debt nearly doubled during the previous administration. We have a number of difficult choices ahead of us as we work to address inefficiencies and reform wasteful programs and agencies. That difficulty is reflected in the budget.

I look forward to continuing to examine the various proposals and to hearing Secretary Mnuchin's insights about the items in the budget that we are going to discuss today.

I would like to spend just a few minutes discussing the other element of today's hearing, and that is tax reform.

For 6 years now, I have been beating the drum on tax reform. I sought to make the case for reform here in the committee, on the Senate floor, in public forums and events, and in private conversations.

I have not been alone. There has been a bipartisan recognition—one that I think is growing more by the day—that our current tax system does not work. Throughout this endeavor, I have stated numerous times that if we are going to be successful, we will need to see engagement from the President.

Before anyone writes that off as a political statement, let me make it clear that I was not simply advocating for the election of a Republican President. On the contrary, I repeatedly implored President Obama to engage with Congress on tax reform, but to no avail.

The current administration put out a tax reform framework earlier this month, one that I think can serve as an outline as this effort moves forward, keeping in mind that, as with any major undertaking, we will need to be realistic and commit to practicing the art of the doable.

I expect that you will get a number of questions about the tax plan here today, Secretary Mnuchin. In addition, I expect we will hear a lot about the process by which tax reform will move through Congress.

On that point, we have already heard a few demands from my friends on the other side of the aisle, stated as if they were preconditions for any serious engagement on tax reform. My hope is that these are not really preconditions, but still I do want to address one of them briefly here today.

One of the demands we have heard is that Republicans abandon the use of budget reconciliation for tax reform. This, in my view, is an odd demand. Historically speaking, most major tax bills that have moved through reconciliation have had bipartisan support.

In fact, in the past, when Republicans have controlled the House and Senate along with the White House, all of our tax reconciliation bills have enjoyed some Senate Democrat support.

If we can reach agreements on policy, there is absolutely no reason why Democrats could not agree to support a tax reform package moved through the reconciliation process. I cannot image a scenario in which my Democratic colleagues would be more amenable to compromising on tax reform policy if reconciliation is taken off the table.

In fact, the only thing we would accomplish by foreclosing the use of reconciliation would be to ensure that the minority would be able to more easily block any bill from passing, which is a strange demand to make before beginning a good faith negotiation.

In any event, whether this is truly a precondition or simply a rhetorical point on the part of my colleagues, let me be clear: my strong preference is that our tax reform efforts be bipartisan. I have reached out to my colleagues on both sides of the aisle and sincerely hope that both parties can be at the table together.

I think I have more than adequately demonstrated my willingness to work with my Democratic colleagues on this committee and elsewhere. My intention is to continue working with my Democratic colleagues on tax reform so long as they are willing to engage.

I do not want to speak for Secretary Mnuchin today, but I think it is safe to say that he shares this desire and is similarly committed. And I think he is committed to working with our Democratic colleagues on this effort.

With that, let me once again thank the Secretary for being here today. I look forward to a rigorous and thoughtful discussion of these and other issues.

With that, I will turn to my colleague and friend, Senator Wyden, for his opening remarks.

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

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

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

Let me say, also, that on our side, we very much share your view with respect to these despicable acts in Manchester. A number of us serve also on the Intelligence Committee: Chairman Burr, Vice Chairman Warner, and myself. So we understand that your points are very well-taken, and we share them.

The CHAIRMAN. Thank you.

Senator WYDEN. Mr. Chairman and colleagues, what the American people demand of us is bipartisan cooperation on taxes, health care, and the many other issues that affect their daily lives. Yet, what the new administration has offered is a one-page tax cut proposal that is shorter than the typical drugstore receipt, and a budget that looks like it was written by people who believe working families and seniors—who are walking on an economic tightrope—have life too easy.

The one-pager puts forward numbers that do not come close to adding up. The math behind this plan would make Bernie Madoff blush. So without realistic tax numbers to analyze, I am going to focus my remarks in two areas.

First, the administration's economic team says that the President's focus is on a middle-class tax cut. If this Trump plan was built for a middle-class tax cut, then Trump Tower was built for middle-class housing.

On one side of the ledger, there is not a lot of detail on how the Trump tax plan would help working families or the middle class, just vague open-ended promises.

Contrast that with how it treats the very fortunate, very few. Eliminating the estate tax and opening a new mile-wide loophole for the wealthy to exploit pass-through status is a prescription for more inequality in America.

Right here in this room, Mr. Mnuchin and I agreed on the now-legendary Mnuchin Rule of "no absolute tax cut for the rich." But after what we have seen in the tax plan and the budget, I guess we have to throw that in the waste bin alongside the Trump plan not to cut Medicare.

Their health plan makes it harder for us to keep the trust fund solvent. There is the trillion dollars in Medicaid cuts, and there is the $70 billion in cuts to Social Security Disability.

So the promise not to cut Medicare, not to cut Medicaid, and not to cut Social Security Disability also has not rung true.

Now, to the second point. The Trump economic team is dusting off the old disproven idea that tax cuts completely pay for themselves. There is not a reputable economist out there who agrees with that.

But you do not have to take my word for it. Look back at history. Just in the last few years, Governor Brownback of Kansas slashed rates for the wealthy and businesses, zeroing them out in some cases. He sold the plan by saying it would launch the State's economy into the stratosphere. Instead its revenues have cratered. Kansas is struggling to keep schools open and basic services running.

Go back a little further to the early 2000s and the Bush tax cuts. Those tax cuts did not pay for themselves either. And then look back to the late President Reagan. He passed a big regressive tax cut in 1981. But lo and behold, in 1982 and 1984, he had to raise revenue to make up for the deficits that were caused.

Bottom line, the pay-for-itself argument behind this tax plan holds up as well as the flat-Earth theory, except people still try to defend it.

Now I want to respond briefly to my friend, the chairman's point with respect to the process going forward, because I think he knows that I very much share his view that to pass lasting, job-creating tax reform that is more than an economic sugar high, it has to be bipartisan. It is not a haphazard exercise, just throwing a bunch of bullet points together because you have an op-ed article written by some campaign advisors.

It takes a lot of careful consideration to write a bipartisan tax reform bill, and I know something about it, because I wrote two of them: one with our former colleague, Senator Coats, and one with one of our colleagues that all of you remember, Senator Gregg.

The focus has to be on writing an economically responsible proposal that will create good-paying red, white, and blue jobs without heaping a new burden on the middle class. That is the kind of reform that will win the support of both sides and will last.

But the point with respect to reconciliation, and I think—this is not a debate about the desire of my friend, the chairman, Orrin Hatch, wanting to work in a bipartisan way, because he and I have done that on a lot of occasions. This is not a question of the chairman's intent, but the fact is, as the chairman himself noted, reconciliation is inherently a partisan process. That is what it is all about.

It is a process that, in effect, puts a gun to the head of one side. So that is why there is such strong feeling on our side about not using reconciliation. And I want, in making that comment, to not diminish (a) my affection for the chairman, and (b) my desire to have a bipartisan bill, having written two of them. I would very much like, in accord with some of these principles that I have outlined—and I know some of my colleagues have said that too: they do not think the tax system works. It is a dysfunctional, rotting economic carcass. We understand that.

But we have to ensure that we have a bipartisan process, and for that reason I just wanted to comment briefly on my friend's remarks.

The CHAIRMAN. Well thank you, Senator.

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

The CHAIRMAN. Today, I would like to extend a warm welcome to Secretary Steven Mnuchin. We are really grateful to have you here.

Secretary Mnuchin was sworn in as the 77th Secretary of the United States Treasury on February 13, 2017. Prior to his confirmation, Secretary Mnuchin was the finance chairman for Donald J. Trump for President. In addition to traveling with the President around the country in that role, Secretary Mnuchin also served as a senior economic advisor to the President in crafting the President's economic positions and economic speeches.

Before those activities, though, Secretary Mnuchin served as founder, chairman, and chief executive officer of Dune Capital Management. He also founded OneWest Bank Group LLC and served as its chairman and chief executive officer until its sale to CIT Group Inc.

Earlier in his career, Secretary Mnuchin worked at the Goldman Sachs Group, Inc. where he was a partner and served as chief information officer. He has extensive experience in global financial markets and oversaw training in U.S. Government securities, mortgages, money markets, and municipal bonds.

Secretary Mnuchin is committed to philanthropic activities and previously served as a member of the boards of the Museum of Contemporary Art Los Angeles, the Whitney Museum of Art, the Hirshhorn Museum and Sculpture Garden on the Mall, the UCLA Health Systems board, the New York Presbyterian Hospital board, and the Los Angeles Police Foundation.

He was born and raised in New York City and earned a bachelor's degree from Yale University.

Secretary Mnuchin, we are grateful to have you here. I appreciate your willingness to serve your country, and please proceed with your opening statement.

STATEMENT OF HON. STEVEN T. MNUCHIN, SECRETARY, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary MNUCHIN. Thank you. It is a pleasure to be here.

Chairman Hatch, Ranking Member Wyden, and members of the committee, it is an honor to be here today. I am looking forward to working with members of Congress and this committee on passing important legislation for the American people.

My number-one priority as Treasury Secretary is creating sustainable economic growth for all Americans. The best way to achieve this is through a combination of tax reform, regulatory relief, and protecting taxpayers. This also includes making some difficult decisions with respect to our budget.

We are currently bearing the costs of excessive government commitments of previous years, and this has forced us into making hard choices. But the remarkable thing about economic growth is, it builds on itself.

If we develop the right policies today, our children and grandchildren will reap the benefits of an ever-growing economy. Indeed, in the next 10 years, if we return to the modern historic average of above 3 percent annual GDP growth, our economy will grow by trillions of dollars. This will be meaningful to every man, woman, and child in this country and future generations.

Tax reform will play a major role in our campaign for growth. It has been more than 30 years since we have had comprehensive tax reform in this country. This administration is committed to changing that.

We have over 100 people working at Treasury on this issue. We are working diligently to bring tax relief to lower- and middle-income Americans, as well as make American business competitive again. All this comes as we simplify the tax code and make it easier for hardworking Americans to file their returns.

Finally, I would like to speak about the importance of free and fair international trade. Few doubt that free trade is a crucial component of economic growth, but trade deals that disadvantage American workers and businesses can hardly be considered either free or fair.

In meetings with my international counterparts, I have stressed this dual importance. Just 2 weeks ago, I had productive meetings with the finance ministers of the G7, and earlier I met with the members of the IMF and World Bank. They understood our concerns, and we have approached our international dialogue with a renewed spirit of mutual understanding.

In the President's address to the joint session of Congress, he spoke about the marvels this country is capable of when its citizens are set free to pursue their visions. Fundamental to that freedom is removing imprudent regulation and uncompetitive taxes from blocking their way.

This has been a significant few months at Treasury. We have been studying, developing, and implementing policies that will put this country on the path towards sustained economic growth. In the coming months, we will work with this committee and the Congress in what we will look back on as an important time for this Nation's economy and our history.

Thank you, and I look forward to answering your questions today.

The CHAIRMAN. Thank you so much.

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

The CHAIRMAN. We are glad to have you here, and I appreciate the way you have taken over and are doing your work.

Mr. Secretary, an op-ed was written by then-Senator Obama's senior economic advisors, Drs. Furman and Goolsbee, in the August 14, 2008, edition of the *The Wall Street Journal.* I will put that op-ed in the record here at this point.

[The article appears in the appendix on p. 40.]

The CHAIRMAN. In that op-ed, Drs. Goolsbee and Furman stated that then-Senator Obama's tax proposal would reduce revenues to less than 18.2 percent of GDP. That would be a revenue-to-GDP target that they apparently thought was desirable.

That target certainly exceeded the Nation's long-run average for revenue to GDP, which the non-partisan CBO tells us has been about 17 percent over the last 50 years. Interestingly, the current administration's budget has revenues averaging 18.2 percent of GDP over a 10-year budget window, exactly what then-Senator Obama was advocating.

Secretary Mnuchin, considering that taxes as a share of our economy are already heading higher and are projected to continue to rise above the historic average, and considering that the President's budget projects an average of 18.2 percent in revenues as a share of the economy, how do you respond to the critics who have argued that the President's budget does not raise enough revenues?

Secretary MNUCHIN. Mr. Chairman, thank you for pointing that out, and I look forward to reading that op-ed that you are putting in the record.

I believe that, as you have pointed out, we have a significant amount of revenues relative to GDP, and particularly with economic growth, we think the critical issue is that we have tax reform that simplifies personal taxes, provides a middle-income tax cut, and makes our businesses competitive again.

The CHAIRMAN. Well, some of my friends on the other side have argued that Congress should not pass tax reform under the budget reconciliation process. In fact, some have stated that the administration and leaders in the House and Senate should categorically take that option off the table before beginning any bipartisan talks on tax reform.

Yet 4 years ago, the Democratic Senate had adopted a budget that included a reconciled tax increase of almost $1 trillion. That tax increase instructions' purpose was tax reform.

Despite my objections to increasing taxes at that time, I agreed to work with then-Chairman Baucus on an intense bipartisan tax reform process. There were no preconditions or demands made that the Democrats abandon their reconciled tax instruction.

There are other relevant examples from recent history that played out the same way. In fact, I think it is fairly safe to say that requiring that type of precondition, the categorical abandonment of reconciliation prior to negotiating, is without any substantive precedent.

What are your thoughts on that, Mr. Secretary? Are there any process-related demands that you would like to make before you will be willing to work with both sides up here on Capitol Hill on bipartisan tax legislation?

Secretary MNUCHIN. Mr. Chairman, I have no process demands from my standpoint. I am hopeful that we can work with both Republicans and Democrats.

I know we have had the opportunity to work with your staff. I know that my staff is going to be sitting down with Senator Wyden's staff and your staff later in the week, and we are hopeful that we can find common ground, particularly on the issue of making our business taxes competitive.

We have a system that is highly uncompetitive. We need to put our workers back to work.

The CHAIRMAN. Well, Mr. Secretary, the President's budget envisions increased economic growth that eventually reaches 3 percent. As I understand it, that vision relies on an implementation of a number of policies, including pro-growth tax reform, cutting unnecessary regulations, building infrastructure, reforming health care, boosting energy production, and reducing deficits that would significantly improve the supply side of the economy.

Of course, it is not unheard of that an administration places belief in the efficacy of its policy proposals. For example, in former President Obama's fiscal year 2010 budget, growth was assumed to get to as high as 4.6 percent, and it was assumed to average 3.8 percent over an extended 8-year period. And that was premised on the administration's belief in its policy prescriptions, particularly the impact of a so-called "stimulus."

Now, Mr. Secretary, could you spend a little bit of time explaining why the administration believes that its policy proposals, including but not limited to tax reform, can generate sustained higher economic growth?

Secretary MNUCHIN. Mr. Chairman, we firmly believe that a combination of tax reform, regulatory relief, and trade policies will return us to levels of 3-percent sustained economic growth with GDP. And I believe our long-term projection is actually 2.9 percent in the budget. It takes several years to get to 3 percent.

I have heard lots of economists tell us why that is not going to be the case, but we are committed to have policies to get us back to what are appropriate growth rates in this country.

The CHAIRMAN. Well, thank you.

Senator Wyden?

Senator WYDEN. Thank you very much, and welcome, Mr. Secretary.

Secretary MNUCHIN. Thank you.

Senator WYDEN. Mr. Secretary, nothing shows tax unfairness more clearly than your proposal to let the fortunate few convert their ordinary income into business income without strings attached, pay the lowest 15-percent tax rate, and also avoid Social Security and Medicare payroll taxes. In my view, it is a prescription for more inequality in America.

So you are creating a massive new tax loophole. My reason for asking the question is especially because you cannot enforce the tax laws on the books now. Your current budget proposal asks for even deeper cuts to tax enforcement. How do you expect the American people to believe you can prevent the fortunate few from exploiting this new loophole when you cannot even stop the current tax cheats?

Secretary MNUCHIN. Senator Wyden, thank you. That is a very good question. And first, let me assure you that I have said repeatedly—I said this the other day at the Banking Committee—that we are absolutely committed to making sure that pass-throughs, that small and medium-sized businesses have the benefit of the business rate, that this is not just something for large corporations.

Small and medium-sized businesses are the engine of growth in this economy, but we will absolutely make sure that rich people cannot use this as a loophole where they should be paying 35-percent taxes on wages, and that they pay 15 percent instead. I assure you that will be in the code, and we will have very clear ways to enforce that.

Senator WYDEN. Mr. Secretary, respectfully, I just do not think that cuts it. I mean, I do not doubt that you believe that you can absolutely make it happen, you are absolutely sure it is only going to go for the little guy, the small business.

But the reality is the tax cheats thrive, they thrive in the absence of clear, tough enforcement principles. And I just did not hear that now. What you said was you are interested, you are absolutely going to assure it, but this proposal has been out there, and we have not gotten any specifics about how this is actually going to be done. And if anything, since we talked about it last, the problem is even more serious because the budget proposal, again, cuts the enforcement budget. So I think the sooner you get that to us, the better.

Now, your budget assumes 3-percent growth, which you claim adds $2 trillion to revenues. That is kind of a dubious proposition to me.

You told us last week that this economic growth is what pays for tax reform, but the Trump budget does not include tax reform. So unless you make this clear to us, are you not double-counting the same $2 trillion to pay down deficits that you claim will pay for tax reform? I mean, this is kind of Bernie Madoff math, but maybe I am missing something. Tell me how it works.

Secretary MNUCHIN. No, we are absolutely not double-counting. When the President's budget was done, we were not ready to have a full-blown tax reform plan that we could model into the budget. So we have not put that in.

We have put in the economic impact, as you have pointed out. There are other areas that are extremely conservative, but I assure you, when we present a tax plan, we will not be double-counting the growth.

Senator WYDEN. So again, we are told that sometime down the road, you will not double-count. I would surely like to see, as we have talked about, more specifics, because I do not see how your plan does not blow a multi-trillion-dollar hole in the deficit. And that is going to harm the ability to generate more high-skill, high-wage jobs and the innovation we want to see.

I will have more questions on the second round, Mr. Chairman.

The CHAIRMAN. Well, thank you, Senator.

Senator Grassley?

Senator GRASSLEY. Secretary Mnuchin, mine are more of a rifled type of questions that I have, not so general.

I would like to bring your attention to a proposal that I have introduced with Senator Cantwell that is very much aligned with the President's "America first" agenda. The American Renewable Fuel and Job Creation Act is what it is called.

It would convert the current biodiesel blender's credit to a producer's credit. The switch ensures that the tax credit incentivizes domestic production and taxpayers are not subsidizing imported fuel like we are doing now.

With biofuel imports nearly doubling from 510 million gallons to almost 1 billion gallons in 2016, this change is critical to ensure the credit is supporting the domestic industry rather than subsidizing foreign imports that often already receive favorable treatment from their home country. So it is not really a question, but for you to understand that from Argentina, we are getting all this biofuel, and the taxpayers of the United States are subsidizing that import just like we are attempting to incentivize domestic production.

So we want to change it so we do not subsidize that import. I would like to hear if you, kind of—I would like to hear you say you agree with me.

Secretary MNUCHIN. It sounds like a good plan, and I look forward to working with you on the details of that.

Senator GRASSLEY. Okay. Question number two—I appreciate your and the President's dedication to pro-growth tax reform.

A key aspect of that is jumpstarting by reducing corporate tax rates 35 percent to 15 percent. This makes sense given that, according to the OECD, the corporate tax is the most harmful form of taxation to economic growth. However, the devil is in the details.

For instance, the Camp tax reform proposal sought to lower the tax rate to 25 percent, in part, by slowing depreciation. However, as evidenced by the Joint Committee on Taxation's dynamic revenue estimate of the Camp proposal, the slowing of depreciation undid much, if not all, of the positive growth effects of the lower rate.

So, question: the President's tax reform outline is silent on depreciation. Could you shed some light on where the administration stands on depreciation? Would the administration favor slowing depreciation, accelerating depreciation, or fully expensing it?

Secretary MNUCHIN. Thank you, Senator. That is a very good question, and we fully support the idea that capital goods and investment in capital are what fuel the growth of this economy. So no, we do not support slowing depreciation, and we are looking at various different alternatives as we build the tax plan.

Senator GRASSLEY. Okay. I am not going along the lines of the same question that Senator Wyden asked about the 15 percent for small business. It is a little more directed to how wide of a coverage that would be. Will the 15-percent rate on pass-through business income be applicable whether we are talking about a simple family farmer sole proprietorship, a small family partnership, a subchapter S corporation, or any other pass-through entity?

Secretary MNUCHIN. It will be, but as I said, we want to make sure that we put rules around this that can be easily managed by the IRS with technology, so that wages are not abused in that system, and that large private companies cannot abuse this system and use it for getting around the personal tax system.

Senator GRASSLEY. Yes, and I appreciate that, and that is what you should try to do. My question is more related—would there be any part of small business that would be treated differently than another part of the small business——

Secretary MNUCHIN. No; they will all have the benefit of that.

Senator GRASSLEY. Okay.

This will be my last question.

While the Camp tax reform approach slowed depreciable lives, the House tax reform blueprint takes the opposite approach and goes for full expensing. However, part of the tradeoff for full expensing is that the House plan would generally eliminate interest as a deductible business expense.

Do you view this as an acceptable tradeoff, and do you support any limitation on the deductibility of interest?

Secretary MNUCHIN. Again, I think that is a very good question, and something we are looking at carefully. We are also reaching out to lots of different groups.

I have heard some very strong concerns from small and medium-sized businesses that interest is an important part of what they need to be able to deduct, and our preference is to keep the interest deductibility, but that is one of the issues we are looking at.

Senator GRASSLEY. Thank you.

The CHAIRMAN. Thank you.

Senator Nelson?

Senator NELSON. Thank you, Mr. Chairman.

Mr. Secretary, good morning. This is very encouraging to hear the commentary about wanting to make things fair for small business. Were your commentary not to become a part of the overall agreement at the end of the day—in which you would get the small business tax way down—I would like for you to look at a bill that Senator Collins and I filed which makes sure small businesses do not have a higher tax rate than corporations; in other words, if you just changed the existing tax code, instead of them paying a rate much higher at an individual rate, that they would pay a rate no higher than the corporate rate.

I hope you will take a look at that as a backstop. But you are proposing something even further. Is that correct?

Secretary MNUCHIN. That is. I hope we do not need your backstop, but we do look forward to working with you.

Senator NELSON. All right. Well there is one bipartisan suggestion——

Secretary MNUCHIN. Thank you.

Senator NELSON [continuing]. From Senator Collins and me.

Now, in the President's budget, there are large cuts to the Children's Health Insurance Program, Medicaid, food stamps, medical research at NIH, housing assistance for the low-income, especially with disabilities, and you eliminate subsidized student loans. You eliminate the Community Development Block Grant program, and of course, for example, the city of Miami uses that to serve poor seniors on Meals on Wheels.

And there is not a full offset for tax reform, the overall tax reform. I am afraid that what is going to happen is, you are going to starve these programs of their resources. So without a full offset, how can we have confidence in the President's tax reform plan, that it is not just what looks like: a veiled attempt to transfer wealth from the least privileged to the most privileged?

Secretary MNUCHIN. Senator, first of all, we look forward to working with you as we develop more details of the tax plan. We are not ready to release more details. We are working on—obviously, there are lots of different issues for base broadeners that are critical to pay for the tax reforms, and we look forward to working with you.

On the President's overall budget, I think as you know, the President's priority in the budget reflects a large increase in military spending, because the President believes that we have underinvested in the military, and national security is incredibly important. And across the board there were very difficult decisions on many good programs, and I know that we look forward to working with Congress on the budget as it moves forward.

Senator NELSON. Well, I appreciate your attitude. You know, I support a big increase in defense spending too. But what are we to think when we see these programs—NIH being savaged—there has to be balance in the budget. And that is what I want you to consider.

Now, I would just point out that Florida is the State that has on its license tag the orange. The citrus industry is under threat of extinction because of an imported bacteria from Asia that gets into the tree's phloem or sap and kills the tree in 5 years.

We have the research. Senator Cornyn has a lot of citrus as well. They are making progress, but as we make this progress, we have not found the magic cure yet. But what we have done is to hold off the effect of the killing of the tree for a couple of years. But there are a lot of groves that are dead.

What we need, if we are going to have a citrus industry—and the production of oranges is way down. It is less than half what it was 7 years ago. That is how dramatic the decline is. And what we need is the ability for the grower to go in there and plow the abandoned grove and replant, since we now can extend the life of these trees until we find the magic cure.

They need expensing all in the first year, instead of the expenses over a number of years because of the tremendous threat to the industry. I wish you would put that in your calculations.

Secretary MNUCHIN. Senator, I assure you that I love Florida orange juice, and as we look at the tax code, we will look at various different things that promote economic growth there and in other places.

The CHAIRMAN. Okay.

Senator Crapo?

Senator CRAPO. Thanks.

Now I want to know if you love Idaho potatoes.

Secretary MNUCHIN. I do, indeed.

Senator WYDEN. Almost as much as Oregon potatoes. [Laughter.]

Secretary MNUCHIN. I love them both equally. Well said.

The CHAIRMAN. Now, now.

Senator CRAPO. Secretary Mnuchin, first I want to thank you for being here. You have made yourself very available to this Senate in many different contexts as we work through some of the important proposals that the administration is pursuing, and I appreciate that.

I want to use the first part of my time not so much to ask a question but to set the record straight on several items that have come up during the times that you have been here.

When you were here at this committee previously and then last week at the Banking Committee, you and the President were attacked by some who said that your efforts to repeal Obamacare were a tax cut for the wealthy. I just want to set the record straight here about what the Obamacare tax policies are.

When we debated the Affordable Care Act, President Obama made a pledge that there would be no tax increases in the bill on the middle class. I brought an amendment to simply achieve that objective in this committee, and on the floor, and each time we considered Obamacare. It was rejected by the other side each time, even after the Joint Tax Committee clearly explained that the Affordable Care Act contains a number of tax increases on the middle class.

And so I just want to, for you—because you may hear this again in some of your contact with the members of the other side, be hit with that argument—I just want to set the record straight. It is very clear that the Affordable Care Act has multiple taxes on the middle class and its repeal will, in fact, bring significant tax relief to the middle class.

Now, I am going to go on to talk with you about the budget projections. You have already indicated here today that there have been criticisms of the growth rate that has been assumed in the budget by the administration. Could you tell us what the growth rate is that is assumed in the budget?

Secretary MNUCHIN. I believe it is an average of 2.9 percent. It gets up to 3 percent, but I believe over the 10-year period, it is slightly lower.

Senator CRAPO. The information I have in front of me is that President Obama's first budget assumed a 4-percent growth rate, and in fact, that his first 4 budget years assumed at least 4-percent growth rate. Would you be aware of whether that is correct?

Secretary MNUCHIN. I believe that is correct.

Senator CRAPO. And if you look at the 10-year proposal, the 10-year budget that President Obama put forward, they assumed a 3.2-percent growth rate for the entire decade, the previous decade that we have just been through. What is the average rate for the decade that is in the budget? Did you just indicate that it is 2.9 percent?

Secretary MNUCHIN. I believe it is 2.9 percent, yes; below what their projection was.

Senator CRAPO. So the Trump budget proposals are even below, and significantly below, the same types of projections that the Obama administration projected in presenting their budgets?

Secretary MNUCHIN. That is correct.

Senator CRAPO. Now, let us talk about 3-percent growth rate. Is it unreasonable to expect that the United States of America could grow at a rate of 3 percent?

Secretary MNUCHIN. Senator, I know there are lots of economists who will give us reasons why structurally we cannot grow at that rate, but we firmly believe that with the right policies, that the economy can get back to what is more normalized growth rates of 3 percent or higher, and we are committed to do that.

Senator CRAPO. And when you talk about "normal growth rates," what is the average growth rate of the United States for, say, the last 50 years?

Secretary MNUCHIN. It is over 3 percent.

Senator CRAPO. And currently, I think over the last 8 or 9 years, we have seen roughly, well, under 2 percent—1.8 percent or 1.9 percent. Is that correct?

Secretary MNUCHIN. That is correct.

Senator CRAPO. So it seems to me that those who are saying that we cannot get above that threshold are saying that we need to be stuck in a, basically, plodding-along economy that cannot even get back to grow at its historic average. Would that be an accurate perception?

Secretary MNUCHIN. That would be accurate.

Senator CRAPO. Well, I appreciate your unwillingness to accept that, and I want to work with you to develop pro-growth policies for this country, whether it is tax reform, health-care reform, housing and finance reform, regulatory reform, and I want to also thank you for the work you are doing at FSOC and at the Treasury Department.

I look forward to your report coming out on regulatory improvements and statutory improvements that can be made to help reduce the drag on our economy that the Federal Government presents. And so, again, I just want to thank you for working for and fighting for these policies and assure you that I will assist and work with you to try to achieve the growth rates that you hope to see America achieve.

The CHAIRMAN. Thank you, Senator.

Senator Brown?

Senator BROWN. Thank you, Mr. Chairman.

Secretary Mnuchin, welcome again.

Your party has a history of, let us say, less than enthusiastic support for social insurance, for Medicare, or for Social Security, for unemployment insurance.

Let me illustrate with a story. I was in Youngstown one day, and a woman stood up and said, I am 63 years old, I hold two jobs, I don't have insurance, I just want to—my goal is to live until I am 65 until I have Medicare. That was her goal; not to see her grandchildren, not to see the world. I mean, that is what this system has done to her.

I hear your Secretary of HHS, your Cabinet colleague, talk about raising the eligibility age for Medicare to 67—but let me go to tax reform.

The day you came out, the day your administration came out with its very short, not very descriptive tax reform bill, the next day, on the front page of the *Wall Street Journal* was the story about tax reform, but on page A–17, on the op-ed page, was an article by Martin Feldstein who was, by and large, the Godfather, the real thinker behind the Arthur Laffer kind of "tax cuts pay for themselves."

Well, what he said is—I will just read the pullout. "Gradually increasing the Social Security eligibility age can offset revenue loss from Trump's tax cuts." So, in spite of what the administration is saying, that you will grow out of these deficits from tax cuts, Martin Feldstein, the Godfather of thought of supply-side economics, has said, "Well, it really will not work that way, and we should pay for it with Social Security cuts and raising the eligibility age."

And so I want to ask you a series of questions about that to clear it up. I am worried about how you will pay for this tax cut, because no economic theories really say we will grow our economy to the point that we will remake all the revenue, make it all back. But I want to ask—I want to clear this up, because I am worried about cuts to Social Security, Medicare, and Medicaid. It is clear you are going to do it for Medicaid, but here is my series of questions, if you would answer "yes" or "no."

Can you give us your word that the administration will live up to the President's promise that he will not cut, alter, or privatize Social Security and Medicare?

Secretary MNUCHIN. I believe that is the President's intent, yes.

Senator BROWN. Even though, already in your plan, you are cutting $72 billion from disability insurance, which is, in fact, part of Social Security?

Secretary MNUCHIN. Yes, let me just assure you that the President wants to be absolutely clear that anybody who is eligible for disability will get their disability payments. There are some assumed savings in there as a result of, perhaps, people who can get off of disability, but the President absolutely intends to make sure that people who have disability and are on that get their benefits.

Senator BROWN. Well, I do not really believe the President when he also said he would not go after Medicaid and you have two different big hits to Medicaid: the HCA and the budget.

But let me ask the next question. Would you commit to not raising the Social Security retirement age in order to pay for these tax cuts?

Secretary MNUCHIN. Yes.

Senator BROWN. Okay. Thank you.

The administration has been very specific about what, in fact, you want to do on your budget cuts, but much less specific when it comes to tax reform. I mean, you have said you are going to go after children's health care, disability, infrastructure, Medicaid, Meals on Wheels, food stamps, economic aid for Appalachia, legal aid, Lake Superior, Americorps pensions—there is a whole host of things you said you would cut, but you are not at all specific on taxes yet, and it is a single page of bullet points. And I will, in my last couple of minutes, ask some very specific questions, and I want to ask if certain provisions are under consideration in tax reform.

Are you considering changing the Earned Income Tax Credit and the Child Tax Credit?

Secretary MNUCHIN. It is not a focus of ours at the moment.

Senator BROWN. That is a "no"?

Secretary MNUCHIN. Correct.

Senator BROWN. Are you considering changing the deductibility of interest?

Secretary MNUCHIN. Deductibility of mortgage interest?

Senator BROWN. Mortgage interest first.

Secretary MNUCHIN. No, we are not considering that.

Senator BROWN. Are you considering changing like-kind exchanges?

Secretary MNUCHIN. That is one of the many different things that could be looked at, but we have made no decision on it.

Senator BROWN. Are you considering changing the New Markets Tax Credit?

Secretary MNUCHIN. At the current time, we are not.

Senator BROWN. Are you considering changing the treatment of cash accounting?

Secretary MNUCHIN. Again, I would just say we are in the process of developing the overall plan, so we have not gone through all of these.

Senator BROWN. Are you considering changing LIFO—last-in, first-out accounting?

Secretary MNUCHIN. Again, it is not something we are considering at the moment.

Senator BROWN. Are you considering changing the treatment of life insurance companies?

Secretary MNUCHIN. Again, as I have said, we are developing the overall plan. So we are looking at many, many different ways of broadening the base. So, that specific one, I have not seen, but again, I just want to emphasize we are looking at things across the board.

Senator BROWN. Are you considering changing the treatment of State and local bonds?

Secretary MNUCHIN. Again, I have said our preference is strongly to keep the interest deductibility of State and local bonds.

Senator BROWN. Are you considering changing the Low-Income Housing Tax Credit, considering the sharp, deep cuts to housing programs generally. Are you considering changing the Low-Income Housing Tax Credit?

Secretary MNUCHIN. Again, at the moment, that is not something that I have seen.

Senator BROWN. Okay.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Casey?

Senator CASEY. Mr. Secretary, thank you for being here.

Secretary MNUCHIN. Thank you.

Senator CASEY. I have a couple of questions on tax cuts, or at least the proposal that we would anticipate.

The Census Bureau tells us that the average American salary is just about $52,000 a year. And I know that both in previous testimony, but also in our conversation last week with members of the Finance Committee, you were careful about what you could guarantee in the final outcome versus what you would be proposing or the administration would be proposing. So in light of that average American salary of $52,000, can you guarantee, in terms of the administration's proposals, that millionaires and up will not receive a tax cut greater than that average American salary of $52,000 a year?

Secretary MNUCHIN. Again, we are going through a process across the House, the Senate, the administration, taking in lots of input. I have said that our intent is to have a middle-income tax cut.

I want to be careful in not guaranteeing anything, since I am not the ultimate—this is a——

Senator CASEY. But all I——

Secretary MNUCHIN [continuing]. This is a process that goes through multiple, different areas.

Senator CASEY. Mr. Secretary, all I am asking for is what will be the proposal of the administration. I realize the House and Senate could change things down the road.

I am just asking, in your tax reform proposal, when it is finalized and presented, will that be the case that millionaires and up will not receive a greater tax cut than that $52,000?

Secretary MNUCHIN. Our intent is that, as opposed to the administration coming out with its own proposal, our intent is we are working with the House and Senate, that we will come up with a combined proposal that can pass the House and Senate and be signed by the President. And I have said before, when we come out with all the details, we will obviously have all the distribution, and people will be able to make whatever comments and whatever changes as it goes through the legislative process.

Senator CASEY. I will take that as a "no," that there is not a guarantee.

Secretary MNUCHIN. Again, I am not personally guaranteeing anything at the moment.

Senator CASEY. Well, you ought to be able to guarantee what you can propose, what the administration can propose.

Secretary MNUCHIN. Again, I can guarantee you our proposal has been and will be a middle-income tax cut, and that is our priority.

Senator CASEY. I understand that, but that is not what we are looking for here, so I will take that as a "no."

Also, we have in Pennsylvania almost 2 million people who earn less than $23,000 a year. So, if—let me ask a similar question. For someone making $1 million a year or more, they would get—or at $1 million, they would be getting a tax cut of about $23,000 based upon what we have heard so far. So what is your answer to those Pennsylvanians?

Secretary MNUCHIN. I am sorry, those Pennsylvanians who make $23,000? Is that your question?

Senator CASEY. Right.

Secretary MNUCHIN. I believe with the standard deductions, they will not be paying taxes.

Senator CASEY. Well, but that is what some of them make in a year. What I am asking you is, if the President's priority, as has been stated, has been not cutting taxes for the high end, then why would you include a tax cut for people at the high end of the income scale in terms of the proposal released in April? Because that is what we have read in that proposal.

Secretary MNUCHIN. Again, in that proposal, the idea was to eliminate almost all deductions with the exception of mortgage interest and charitable donations, which we think are important, and offset almost all those deductions with a reduction in taxes that is pro-growth, will grow the economy, and will create jobs. And we look forward to working with you and others as we work through the details.

Senator CASEY. Well, let us go through those deductions. Does the administration, in the tax plan that will be presented, plan to repeal the deduction for student loan interest?

Secretary MNUCHIN. Again, let me just state that we are looking at everything——

Senator CASEY. I understand that, but——

Secretary MNUCHIN [continuing]. So I do not have all the details, and I am not prepared to go through them on a line item.

Senator CASEY. You answered some questions before.

Secretary MNUCHIN. Yes.

Senator CASEY. Let us try it again. So you are not going to answer on student loan interest. How about higher education expenses?

Secretary MNUCHIN. Again, I do not expect those to change, but let me be clear. We are going through base broadening. So I am just not prepared—I am more than happy to come back when we release a plan and go through it on a line-item basis with you and have it marked up. So I am more than happy to do that. And I am also more than happy to seek input from you and your staff on what the priorities are, so that if we can try to do this on a bipartisan basis, we have your input.

Senator CASEY. That would be wonderful.

Let me conclude with this. We have two letters that we are waiting on answers for. These are from January.

The first is a letter I sent you regarding—based upon your statement in your testimony that you allege you sent a letter to HUD on reverse mortgages. So I would ask you to find that letter and respond to it, preferably by close of business tomorrow.

And secondly, there is a letter that Senator Brown and I sent regarding foreclosure data for OneWest Bank, both nationally and State-by-State. So I would hope we could get an answer to both of those letters now that it is the end of May.

Secretary MNUCHIN. Let me be clear. I am no longer associated with CIT, which purchased OneWest Bank. I do not have access.

Yes, I stand behind my comment that there was a letter to HUD, but I do not have access to that letter. I am sure HUD has it, and you could request it from HUD.

The CHAIRMAN. Senator Warner?

Senator WARNER. Thank you, Mr. Chairman.

Mr. Secretary, it is good to see you again.

Secretary MNUCHIN. Nice to see you, Senator.

Senator WARNER. Let me do one thing that I do not expect you to respond to since you do not have the budget here, but first of all, Director Mulvaney—I was just up at Budget—has said the administration's policy is to make tax reform revenue-neutral, and that is the administration's proposal.

Secretary MNUCHIN. Again, I have repeatedly said that it would be paid for with economic growth and base broadening.

Senator WARNER. Well, I am going to come back to that in a moment, because that could mean also cooking the books.

In your budget on page 13, one of the proposals that you bake into your assumptions is repeal of the estate tax, which would benefit folks like you and me—I am not sure anybody else on the panel. But then curiously enough, back on page 27 of the budget—and again, you do not have it here, so I do not expect you to respond—you have a line item here that says estate and gift tax revenues are still coming in.

To me, that appears to be double-counting, and maybe we can get that cleared up. As you know, when we talked in your confirmation hearings—you know, I applaud your effort to try to make our tax code more rational and try to lower corporate rates, do repatriation. I spent a couple years in this process and took some arrows from my own team in terms of entitlements, but also looking at net new revenues.

I just have to tell you, sir, the nonpartisan CRFB, Committee for a Responsible Federal Budget, has estimated that your tax cuts and your outline would add about $5 trillion to the deficit over the coming decade. And with what you have answered to Senator Casey and Senator Brown, when you take charitable, home mortgage, retirement account deduction, and some of these others off the table, you cannot get $5 trillion in savings. As a matter of fact, you would have to take on at least one—I am not going to go through the whole list, but the largest remaining tax expenditure, when you take the big ones off, to go where the money is, is the deductibility of employer health care plans. Is that on the table? That is north of $200 billion a year. That could get you some real revenues, but that would dramatically disrupt the health-care system.

Secretary MNUCHIN. Let me first assure you that our plan is not going to add $5 trillion, and I do not understand why they would have scored it, since they do not have the details.

People like the Tax Foundation and others have not scored it, and I assure you, when we come out with all the details, there will be full transparency. This will be scored by Joint Tax as well as lots of outside groups, and we will provide our own view of the scoring. We have over 100 people in the tax department looking at lots of different scenarios, and we are working hard on that. We have no intention of doing something that would add trillions of dollars to the debt.

Senator WARNER. Well, right now at $20 trillion, as interest rates go up, for 100 basis points—again, we discussed this before—that just adds an additional debt service, $140 billion a year in additional payments, right off the top. So, you know, I would argue you balloon the debt and whatever benefit you get from the tax cut is going to be erased by the additional deficit payments.

Secretary MNUCHIN. Senator Warner, I assure you that we appreciate the significance of the debt having gone up to $20 trillion.

Senator WARNER. And again, both sides bear responsibility. All I would say, sir, is I have spent a couple years looking through these numbers pretty closely.

I think based on reasonable, normal assumptions, with anything close to traditional scoring, even if you do get a little bit of a bump on dynamic scoring, you cannot get to $5 trillion of tax expenditures without going after the largest ones like employer-based health care.

I really fear that—you know, this becomes a lot harder than it looks, and I am worried about the 3-percent growth rate assumptions. I will look more. I am worried, as well, about dynamic scoring that has to include the tax cut assumptions and yet you are then saying they are not counted in the budget, so there does seem to be, again, double-counting.

I am also very worried that we are taking domestic discretionary spending down to 3 percent of GDP. That is the lowest it has ever been, and we were both business guys. You invest in a business—business invests in education, plant and equipment, and staying ahead of the competition.

A government does that by investing in education, infrastructure, and research and development. And unfortunately, your budget slashes investments in education, infrastructure, and research and development.

That is not going to lead, I believe, to the kind of growth that you have in your underlying assumptions. I have only 3 seconds left.

One of the things that you said that I applauded during your confirmation hearings was that you felt that the IRS, to do its job, needed appropriate staff and resources, yet your budget cuts the IRS. Do you want to address that?

Secretary MNUCHIN. Sure. Let me first say I know you have tremendous business expertise, and we hope we can work with you and your staff on suggestions for the business tax. I know you appreciate that the system we have is just very complicated. The concept of worldwide income and deferral leaves trillions of dollars offshore, which makes no sense, and we need to get that money back to build jobs, so we very much hope that you will work with us on ideas to move forward on that.

On the IRS, as I did say, I have spent now a bunch of time with the IRS, looking at things. I will tell you one of my biggest focuses—and I do have a technology background—is upgrading the technology at the IRS.

We are very, very focused on the fact that we have underinvested in technology, and I am pleased to report that within the budget, we will protect what are big increases in technology in the IRS, and we will offset them in what we hope are savings in other areas. And obviously, we were looking to cut government spending, and I am pleased that we protected the IRS. There were other people who wanted to cut it more, and we are very comfortable with the spending level and some savings and big technology investments there.

The CHAIRMAN. Senator Isakson?

Senator ISAKSON. Mr. Mnuchin, I want to associate myself with the comments that Mr. Crapo made about your willingness to come to this committee and testify. And the job that you have done so far has been a real breath of fresh air, and we appreciate it.

I also want to acknowledge that Sherrod Brown is the best one-question, "yes" or "no" asker I have ever seen in my life. And one of his questions was about Social Security, and I just want to follow it up, not by challenging Mr. Brown but by making a point.

We have a $20-trillion debt today, is that correct?

Secretary MNUCHIN. Yes.

Senator ISAKSON. Under most math, which is conservative, 10 years from now it is going to be $134 trillion, principally because of the growth in the obligation of Social Security and other measures that are benefit programs; is that not correct?

Secretary MNUCHIN. I do not have the exact numbers, but directionally, I understand what you are saying.

Senator ISAKSON. My only point is this: none of us in here wants to raise the cost of Social Security to anyone. However, if you look at 1983, when Reagan and Tip O'Neill, a Democrat, raised the eligibility age for Social Security from 65 to 66, they raised—I lost a year of Social Security, because I was 39 years old in 1983 and did not turn 66 until 26 years later.

But my point is, by recalibrating the formula in the out-years, you can recover that debt over time and amortize it under the time value of money, which is good for everybody. So I just wanted to point out, none of us wants to raise the cost to anyone or prevent people from being eligible, but recalibrating the formula at a time out in the future for those who will be beneficiaries in the future can go a long way toward beginning to lower the obligation we are going to have as soon as a decade from now. So, I just wanted to make that point.

Second, the budget documents, the messaging instrument—I want to message on three things really quickly.

One, we were disappointed that there was no inclusion in the Corps of Engineers for any funding for the Savannah Port. The State of Georgia has put $248 million of its own money into that port in a joint-venture partnership with the United States Federal Government.

We are in the process of deepening it now, and all of a sudden there is no additional money in there for this year's budget. Without that additional money in there, it puts out a higher cost in future years.

I would appreciate your working with me to look at that to see if there is not some way we can reprioritize capital apportionment for this year to see to it the Port of Savannah gets additional funding. That is a parochial issue, and a selfish one, but it is important.

Secretary MNUCHIN. I will be more than happy to follow up with you and your staff.

Senator ISAKSON. Third, also a parochial issue for myself and Senator Scott—I think I am correct, Senator Scott—is section 45 of the tax code, Production Tax Credits for Nuclear. Is that not correct?

The Southern Company is building two nuclear reactors in Georgia, also in South Carolina. They are the only two nuclear reactors in the United States under construction now.

Because of a problem with finances at Westinghouse and a bankruptcy, the ability of those plants to be finished is not as soon as we thought it would be. The Production Tax Credit section 45 ends at 2020; is that not right?

We are asking you to take a look at an extension of that eligibility from 2020 out a few years. It does not cost you any more money, but the Federal involvement gives us the ability to borrow and leverage in such a way that you have cheap, affordable energy and can finish those plants. Otherwise, we lose the money that has been put into them and lose the opportunity to do so. So I do not expect an answer.

Secretary MNUCHIN. We will be happy to look at it with you.

Senator ISAKSON. I would really appreciate it, and time is of the essence in doing so. I would love to talk to you about it.

And lastly, for low- and moderate-income people, I have worked on the Free File Program for a long time. Are you familiar with Free File?

Secretary MNUCHIN. I am.

Senator ISAKSON. I think it is very important we continue that. I think it ends in 2020 or some out-year. I would appreciate your taking the time when you get the chance to look at that and see if we cannot make that a permanent program for the American taxpayer, where they get free assistance in filing their income taxes to the United States of America. It is a good program.

IRS should always be forward, and the Secretary of Treasury should be forward as well.

Secretary MNUCHIN. We have looked at that, and we agree with you and look forward to working with you on that.

Senator ISAKSON. Again, thank you very much for the job that you are doing, Mr. Secretary.

The CHAIRMAN. Okay. Senator Scott, and then Senator Bennet, and then we are going to close this down. The Democratic leader will have a couple of questions.

Senator SCOTT. Thank you very much.

The CHAIRMAN. You will have to excuse me. I have to leave, but I think you will be treated fairly. I expect you to be treated fairly.

Secretary MNUCHIN. Thank you, Mr. Chairman.

Senator WYDEN. Mr. Chairman, with your indulgence, if we have any Finance members, either on the Democratic side or the Republican side, who have not had their 5 minutes, I assume it would be acceptable to let them ask questions.

The CHAIRMAN. That is right. Okay.

Senator WYDEN [presiding]. Senator Scott?

Senator SCOTT. Thank you, Mr. Chairman and Ranking Member.

Mr. Secretary, good to see you——

Secretary MNUCHIN. Nice to see you.

Senator SCOTT [continuing]. So often in these chambers. God bless you. A couple of questions. I do want to associate myself with Senator Isakson's comments about the importance of 45J, the Nuclear Production Tax Credits.

Really, what it comes down to is a commitment the country made to encourage States to look at ways to get back in the nuclear energy business. South Carolina and Georgia both said "yes." It seems like the Federal Government is not honoring its commitment to those projects, and that is what it boils down to, and there seems to be a suggestion that the administration, through Treasury and the IRS, may be able to provide a bridge from 2020 to 2022 or a couple of years longer in that process.

But if I were an average person, and I am, sitting back at home, taking a look at the conversation that we are currently having around tax reform, it would be difficult to discern where that average person finds benefit in the conversation around tax reform, because we have done such a poor job of having a conversation that seems to get back home.

The only real comment that was glossed over that I thought was really important was when you answered Senator Casey from Pennsylvania, when you answered his question. Senator Casey asked you a question about the impact of your tax reform package on that person earning about $23,000 a year, and your answer was, that person would essentially pay no taxes.

There was a moment of silence there. I think it is really important to note that, as we have a discussion about tax reform, the direction we are heading in is that the person who is at the lowest end of the economic ladder really would have no tax liability in your tax reform package. Is that correct?

Secretary MNUCHIN. That is correct. By increasing the standard deductions, a huge chunk of people who cannot afford to pay taxes, will not, and 95 percent of Americans, we think, will be able to file their taxes on a simple large postcard without having to itemize.

Senator SCOTT. Simplification.

Secretary MNUCHIN. Yes.

Senator SCOTT. The second part of the conversation that I think the average person at home would really enjoy understanding and appreciating, because it takes a little time for us to get there in this committee—folks at home are a lot smarter than we give them credit for being, but we simply do not talk to them. We talk about them.

So, when we have a conversation about the corporate tax rate, both Republicans and Democrats, both conservative and liberal economists, all come to the same conclusion, that the corporate tax rate is borne, essentially, by three groups of individuals.

One group would be the employees who experience lower wages. So, if we are looking for a way to have a conversation with middle America about getting a raise at work, the corporate tax rate is one of the fastest ways for us to get to that higher income for the folks whom we care about. If we were to lower that rate, we could assume that some of the benefits, some of the savings, would go to employees.

The second group that would benefit from a lower corporate tax rate would be the consumers who are buying that product, because, embedded in the actual price of it, is the tax for it.

And then the third group are those folks who are in a position to make further investments so as to create more economic activity, or those folks who are shareholders in companies.

Those three groups of individuals are the folks who actually bear the burden of corporate taxes. Is that about right?

Secretary MNUCHIN. It is. And multiple economic studies have shown that over 70 percent of the cost of corporate taxes is actually borne by the worker. So a major part of reforming the corporate tax system is an effort to increase wages and opportunities for workers.

Senator SCOTT. My final point relates to the folks whom I care most about, folks back in South Carolina and around the country who are like my mother was, a hardworking single mom who struggled to make her ends meet, worked 16 hours a day, and needed more opportunities.

And one of the things that we see in this conversation about reform is that, if we lower the corporate tax rate, we allow for repatriation. We go from a global system to a territorial system, and we include in that the pass-through entities, and we create some kind of a mechanism to make sure that there is not a perverse incentive to move the income in that pass-through entity from income to profit, which was the question of our ranking member. We can figure out how to have a mechanism to stop that.

And then with regulatory reform, we should have a robust economic activity that leads to economic growth, perhaps the 2.9 percent over 10 years.

And the final part that would help those folks back home would be some emphasis on the workforce reinvestment. That gig economy, the technology economy, will displace a lot of workers, but if we have that in our sights, through the economic activity we could actually design a workforce readiness program that would marry the workers who are looking for work with the jobs where they lie, if we have that kind of synergy and are focused in our activities. Is that basically accurate?

Secretary MNUCHIN. That is, and we do believe that job training is an important part of economic growth and making sure workers are prepared.

Senator SCOTT. My final question, which will be a question for the record—I appreciate you answering later—is a question about the FATCA. Are you familiar with the FATCA?

Secretary MNUCHIN. I am.

Senator SCOTT. Those regulations, the reporting regulations being imposed on those property and casualty companies that have international exposure, doing international work—they are not trying to escape taxation.

It appears that FACTA is an onerous burden on those companies. I would love to hear your response on how this administration would be in a position to follow up and see if there is something that we can do now.

Secretary MNUCHIN. Yes; my staff has made me aware of this issue, and we will follow up with you.

Senator SCOTT. Thank you.

Senator WYDEN. Very good. Thank you, Senator Scott.

My colleagues have been very patient.

Senator McCaskill is next, and then I hope it will be Senator Bennet.

Senator MCCASKILL. I think Senator Bennet has been here longer.

Senator WYDEN. Aren't you great?

Senator MCCASKILL. I have been trying to make three hearings at one time.

Senator WYDEN. We all are.

Senator MCCASKILL. I think he has been here for a while, so why don't we let Senator Bennet go first?

Senator WYDEN. Size seven halo.

Senator Bennet?

Senator BENNET. Okay, so let me just say, Claire McCaskill is—out of 100 Senators—my favorite Senator. [Laughter.]

She was my favorite Senator before she did that, but the graciousness, I cannot tell you how much I appreciate it.

Senator MCCASKILL. Thank you.

Senator BENNET. Thank you, Claire.

Mr. Mnuchin, thank you so much for your service. We are all grateful that you have taken the job that you have.

Are you aware that we collect in revenue roughly 18 percent of our gross domestic product?

Secretary MNUCHIN. Yes. Chairman Hatch made that comment at the beginning.

Senator BENNET. And are you also aware that we spend a little over 21 percent of our gross domestic product?

Secretary MNUCHIN. Yes.

Senator BENNET. And so what you have presented is a budget that—and I am saying this so the tea party folks in America can hear it—you are presenting a budget that cuts more taxes. So they are now going to be lower than the 18 percent—particularly with the economic growth that you have talked about—lower than 18 percent, and at the same time, we have a budget that actually spends more money.

We are cutting taxes, and we are spending more money. Is that not correct?

Secretary MNUCHIN. Again, the budget does not model in our tax changes because we did not have them ready.

Senator BENNET. Are you not cutting taxes in your budget?

Secretary MNUCHIN. We are cutting taxes.

Senator BENNET. Thank you. So, the difference between the 18 percent of GDP that we are collecting in revenue and the more than 21 percent of GDP that we are spending in this government, all the promises that have been made to the tea party about balancing the budget and all the rest, are broken in this budget because we are going to collect less in taxes and we are going to spend more money. Is that not correct?

Secretary MNUCHIN. I do not think that is correct over the 10-year period of time.

Senator BENNET. Well, over the 10-year period of time, one way you deal with that is by cutting domestic spending—not military, not defense, but domestic spending—by 40 percent. That is the proposal that you have made. Is that not correct?

Secretary MNUCHIN. The President's priority is to grow the military spending and offset that with less domestic spending.

Senator BENNET. We understand the President wants to grow the military. He wants to cut taxes. He said he will not touch Medicare.

By the way, tea party people, listen to this: for every Medicare dollar you pay in, $3 are taken out. So, we are going to continue to have a deficit in Medicare. We are going to have a deficit in the government. We are going to spend more in military spending. We are going to tax rich people less, and we are going to cut domestic discretionary spending by 40 percent. That is the plan. That is our plan.

While the front page of the *New York Times* has tunnels that China is building through seven different countries in Asia, our plan is that we are going to cut our domestic discretionary spending by 40 percent. That is your plan, right? That is what the President told people in Ohio and Wisconsin and Pennsylvania, that he is going to cut that domestic discretionary spending by 40 percent so he can finance tax cuts for the wealthiest Americans.

Secretary MNUCHIN. That is not the case at all. As I have said before, the tax reform—and it is not just tax cuts, it will be tax reform—will pay for itself, and when we have the details, we are more than happy to go——

Senator BENNET. I would love to go through the details, Mr. Secretary.

Secretary MNUCHIN. We are not prepared today to go through the details on that.

Senator BENNET. Well, let me ask you a question about that, because you said you were not prepared to talk about details—and we know you have put out a tax proposal. And I accept the fact that things will be modified and changed in the Congress, and I appreciate that.

But will you say today that the Trump administration will not accept the tax reform bill that cuts taxes on average for high-income taxpayers?

Secretary MNUCHIN. Again, what I said is——

Senator BENNET. Yes, go ahead.

Secretary MNUCHIN. What I have said is, our priority is about a middle-income tax cut and to lower the top tax rate and offset it with a reduction of——

Senator BENNET. Will you tell the American people today that your administration—because, at the end of the day, you get to sign a bill or veto a bill—your administration will not accept a tax reform bill from the Congress that cuts taxes on average for high-income taxpayers?

Secretary MNUCHIN. Again, I had some of these questions earlier, and I will repeat that——

Senator BENNET. You did not answer them earlier. I am asking you to answer them now.

Secretary MNUCHIN. What I have said is, we are working very closely with the House and the Senate on an overall tax reform package. We are taking in lots of input, and when we have the details, we will be happy to go through them with you.

Our objective is to create economic growth, to reduce business taxes——

Senator BENNET. Let me ask it this way, Mr. Secretary.

Secretary MNUCHIN [continuing]. And to create a middle-income tax——

Senator BENNET. Will the President veto a bill, a tax reform bill, that cuts taxes on average for high-income taxpayers, that violates the Mnuchin Rule?

Secretary MNUCHIN. Again, the President will look at the overall package that has been——

Senator BENNET. I just hope—Mr. Chairman, I hope the people who voted for this person are listening to these answers.

The last question I would ask—and I know I am out of time—because Senator McCaskill was so kind, I just want to ask one question about Medicaid, so two questions, I guess.

The health-care bill that you have endorsed and the President has endorsed—it is not a health-care bill in my view—but the bill that has passed the House cuts Medicare by roughly $850 billion. This budget seems to propose—is it another $600 billion in Medicaid cuts? I mean, are we up to $1.4 trillion in Medicaid cuts?

Secretary MNUCHIN. I do not have the numbers in front of me.

Senator BENNET. Okay. Then, those are the numbers as I understand them. That is a cut to Medicaid of over 25 percent.

In my State, 50 percent of the people are children. So I hear people, politicians talk about, go to work. They need to go to work. Children—are the children supposed to go to work? Are the people in nursing homes supposed to go to work? Are the people who are already working at a wage that will not allow them to have private insurance supposed to go to work? Where is the quarter of Medicaid—who is going to cover these people?

Senator WYDEN. As much as I share Senator Bennet's concerns, this has to be the last response. Then Senator Thune and Senator McCaskill.

Senator BENNET. I apologize.

Did you want to respond, Mr. Secretary?

Secretary MNUCHIN. There is a—we are slowing the rate of Medicaid, and I can assure you that children will be taken care of. It is not our intent that they will not have coverage.

Senator WYDEN. The order is Senator Thune and Senator McCaskill.

Senator THUNE. Thank you, Mr. Chairman.

Mr. Secretary, what has the economic growth rate been for the past 8 years under the Obama administration?

Secretary MNUCHIN. It has been between 1.5 and 2 percent.

Senator THUNE. And what is the historic average?

Secretary MNUCHIN. Over 3 percent.

Senator THUNE. So is it fair to say that the policies, the economic policies, of the previous administration have not been conducive or created conditions that are favorable to economic growth, at least what we would consider to be normal economic growth?

Secretary MNUCHIN. Yes, I believe that to be the case.

Senator THUNE. So is it also fair to say, then, that part of the reason for that would be the heavy tax and heavy regulation that have been part of those economic policies?

Secretary MNUCHIN. Yes, I agree with you.

Senator THUNE. So it seems to me, at least, that as we talk about where we want to go for the country, we clearly want to get that growth rate back up to a more normalized rate, hopefully north of 3 percent. Would you agree?

Secretary MNUCHIN. That is our number-one priority.

Senator THUNE. Right. So in order to do that, you know—clearly the tax increases, the heavy regulations of the previous administration, have not worked. It seems to me that simplifying our tax code, reforming our tax code in a way that makes us more competitive in the global marketplace, would certainly be a desirable outcome and result, and something that we ought to be able to work on up here on a bipartisan basis.

I would hope my colleagues on the other side would join with us, and hopefully with you and your team, as we design a tax reform plan that, with any luck, will get us back up to that 3 percent growth. One of the reasons I ask that is because the best way to solve the long-term fiscal problems the country has is faster economic growth.

If we get back up to north of 3-percent growth, I assume we will see a significant increase in government revenues. Would that be the case?

Secretary MNUCHIN. Yes; it is an over $2-trillion difference.

Senator THUNE. So to me, growth should be the goal. And I appreciate the fact that, although I disagree with aspects of the President's budget, there is an emphasis there on growth and on what tax reform can do to generate a higher rate of growth in the economy.

I introduced a bill last week that is geared toward small and medium-sized businesses that we believe are an engine for economic growth and job creation in this country, and with that sector in mind, the bill focuses on faster cost recovery. The budget proposal that you put forward talks about lowering rates, which is the other lever that we can use to get greater growth in the economy.

Could you tell me how you see faster cost recovery, like immediate expensing, actually playing into the administration's tax reform ideas as well?

Secretary MNUCHIN. Thank you, Senator. That is a very good comment.

So first of all, we absolutely agree with you that small and medium-sized businesses are the engine of growth in this economy, and we need to unleash that growth.

We are very focused on making sure that we have the appropriate policies on expensing capital goods to encourage people to invest, and as I stated earlier, we are looking at a variety of ways to increase depreciation.

Senator THUNE. Okay. I think that ought to be part of any tax plan that we come up with here.

Mr. Secretary, under the President's April 21st executive order, you are in the process of identifying regulations within the Treasury Department that impose undue financial burden and complexity. I believe there are a number of final regulations that were promulgated by the last administration that should be on that list.

What is unclear, however, is how you plan on handling regulations that were proposed but not finalized, ones like the estate tax valuation discount regulations that the Obama administration proposed in August of 2016. These regulations, if finalized, would make it more difficult for owners of family farms and businesses to pass them on to future generations and significantly increase the estate tax burden on family businesses.

Mr. Secretary, as part of your review of regulations, will you include proposed regulations and withdraw those that were not finalized? That would give taxpayers confidence that these proposals will not move forward without at least being reproposed.

Secretary MNUCHIN. I can assure you, we are looking at those, and in particular, I am familiar with the family discount issue that we are reviewing.

Senator THUNE. Final question. I was pleased to see that the administration's tax reform framework seeks to preserve the incentive for charitable giving. Stakeholders have raised concerns, however, that increasing the standard deduction could create disincentives for charitable giving. Could you talk a little bit about whether or not you have looked at that potential interaction and if there are other steps that we could take to encourage charitable giving so that the generosity of Americans can continue to be put to work in our communities and to help those who are most in need?

Secretary MNUCHIN. We do support the need and encouragement for charitable giving, and that is why we wanted to leave that deduction in the tax code. And we are happy to follow up with you and talk to you about ideas for people who use the standard deduction.

Senator THUNE. Thank you. Thank you, Mr. Chairman. I thank the Secretary.

Senator WYDEN. Very good.

Senator McCaskill?

Senator MCCASKILL. Thank you.

Secretary Mnuchin, while I know you have repeatedly said that there are no specifics in the budget, the budget document is full of specifics, including a specific claim that it balances the budget. That is a very specific claim. So, I think it is only fair that we continue to drill down on some of the—a kind way of putting it is "anomalies"—that are in this budget document, just from a financial perspective.

Your budget assumes 3-percent growth, which I am not going to argue about with you here, but I think most economists in the country are vociferously arguing about the notion that 3-percent growth is going to happen.

And you say that contributes $2 trillion in dynamic revenue that goes to deficit reduction, based on the tables in the budget. But then we are told that that $2 trillion pays for the tax cuts. And I see nothing in the budget where the $5 trillion of revenue we are going to lose from the tax cuts is calculated in. So, either you are double-counting and someone is not paying attention to how you do accounting, or you just made a mistake. And I need to know which one it is.

Secretary MNUCHIN. Senator, I appreciate you bringing up that question, and I responded to a similar question earlier. So, first of all, the intent was not to do double-counting. As I have stated earlier, we are not far enough along in tax reform to have modeled in the impact of that. There are other areas of the budget that we think are conservative in our calculation of revenues, but I can assure you, when we have tax reform, there will be full transparency of it, and there is no intent to double-count or anything else along those lines.

Senator MCCASKILL. So it was a mistake?

Secretary MNUCHIN. No, it was not a mistake at all. The budget——

Senator MCCASKILL. Well, you cannot say tax reform is paid for by growth and then count that growth as against the deficit. Either it is paying for the lack of revenue we are getting from the tax reform, or it is going against the deficit. You cannot do both. That is beyond fuzzy math. That is double-counting.

Secretary MNUCHIN. Again, just to be clear, when the budget came out, we overlaid the administration's plans for growth, which are incorporated, and that is what is shown in there. Okay? We do not have tax changes, so we did not model in tax changes. There is full transparency——

Senator MCCASKILL. Is the growth coming from the tax changes?

Secretary MNUCHIN. One of the things is——

Senator MCCASKILL. Is the growth coming from the tax changes?

Secretary MNUCHIN. That is one of them, but there are also plenty of other economic policies——

Senator MCCASKILL. Well, how did you come up with——

Secretary MNUCHIN [continuing]. Our trade policies, or whether it is our regulatory reform policies. There are plenty of other things that will also impact the growth.

Senator MCCASKILL. It just defies understanding that you are going to project what the growth is going to be based on a tax cut, but you cannot put anything in the budget about what the lack of revenue is going to be because of a tax cut. That does not even make sense.

I mean, how can you say you are going to have 3-percent growth and you are going to have all this growth and revenue because of the tax cuts if you never put in the budget what the tax cuts cost—even a ballpark? You did not even say, well, maybe it is going to cost $3 trillion. You did not do any of that in the budget, so how can this document even be taken seriously?

Secretary MNUCHIN. Of course it can be taken seriously, and I am sorry you feel that way. It was completely transparent. Nobody is trying to hide anything.

Senator MCCASKILL. Okay. Well, I think that you cannot say that the growth of $2 trillion is going to pay for tax cuts and say it is going to reduce the deficit at the same time. That just does not make sense, especially when you are not even counting what the tax cut is.

Let me go to something we talked about in your confirmation hearing, and that is the stability of the pension funds. You graciously—and I was impressed, and frankly, it indicated to me that you were willing to listen to folks who have real-life problems that nobody is helping with—you graciously agreed to meet with some of the Missouri truck drivers in your confirmation hearing to hear their plight. These people who have driven trucks 35, 40 years are now being told that they are going to have a mere fraction of the pension that they were promised and their families were going to rely on.

I want to let you know that they are going to be in Washington in a few weeks. I want to save you a trip to Missouri if I can, if we could figure out a time when they are here to have a small group of them. We do not want to overwhelm you. We can ask for one or two representatives to come in and meet with you. I would ask you today if you would be willing to try to make time in your schedule to see some of these truck drivers?

Secretary MNUCHIN. I would. I think we were reaching out to your office about trying to bring people in from multiple states, but if you have people in, we will definitely——

Senator MCCASKILL. We will try to coordinate with you, and maybe we can get multiple States in, because I think the problem is the same—their problem is the same no matter where they drove a truck. Basically, the promises made to them are going to be broken.

Secretary MNUCHIN. And I am much more familiar with this issue than I was at my confirmation. We have spent a lot of time looking at this. Part of it is a function of Treasury, where we oversee certain rules, but we appreciate the issue, and we look forward to working with you on it.

Senator MCCASKILL. Thank you so much, Mr. Secretary.

Thank you, Mr. Chairman.

Senator WYDEN. Senator Heller?

Senator HELLER. Mr. Chairman, thank you.

And to you, Mr. Secretary, thank you for being here today.

Secretary MNUCHIN. Nice to see you.

Senator HELLER. Thanks for taking time to answer our questions. I want to talk about the Border Adjustment Tax here for just a minute, and get your feel on this.

As you are well aware, the House Republican tax reform blueprint includes a 20-percent BAT tax. It is estimated that it would net around $1 trillion of revenue.

You have cast the BAT as unessential to tax reform and said that it is not workable in its current form. Do you still feel the same way?

Secretary MNUCHIN. I do. I testified at the House yesterday. I had several questions on that. We have been working closely with the House on this, and we have expressed concerns and suggested that they should go back and rework it.

Senator HELLER. You also mentioned that there are plenty of other ways to raise that revenue. Can you shine some light on what you mean by these other ways?

Secretary MNUCHIN. I can. I think this is all about base broadening, and we are working hard to look at lots of different alternatives as to how to fill that gap.

Senator HELLER. Can you give us an example?

Secretary MNUCHIN. We are looking at everything, Senator, as you know. Nothing is off the table as far as we are concerned.

Senator HELLER. All right. Let me ask you some questions dealing with debt. I saw a report recently that said that the total U.S. consumer debt is approaching $13 trillion. When you talk of student debt, credit card debt, auto debt, we are looking at $13 trillion. Do you think that that will have any impact on your ability to grow the economy when we see such staggering debt out there?

Secretary MNUCHIN. We are concerned about that, and we are particularly concerned about the burden on students of student debt.

Senator HELLER. Have you guys looked at this and decided how much more debt can grow?

Secretary MNUCHIN. We have not, but we have people who are looking at that.

Senator HELLER. Okay. Well, would we anticipate that there would be answers soon on that?

Secretary MNUCHIN. I would be more than happy to follow up with you.

Senator HELLER. I would appreciate that.

I want to change subjects here for just a minute and talk about investment tax credits and see if I can get your feel for alternative energy. Since I have been here in Congress and over the last couple of years, I have tried to look for some parity between, say, solar tax credits, geothermal tax credits, wind tax credits—and I am sure you are very familiar with these.

In the PATH Act of 2015, some of these tax credits were left out. The production tax credits, specifically I am talking about commercial geothermal—and I am an all-of-the-above energy guy—and these alternative energies like solar, geothermal, and wind have huge potential in the State of Nevada as far as job creation, and are an industry that could do quite well.

I want to know if you are aware of the issue of parity between these industries and if you have any concerns or problems with trying to find some equal treatment between the different industries?

Secretary MNUCHIN. I am only broadly aware of the issue, but I would be more than happy to follow up with you and your staff on it.

Senator HELLER. Okay. I would be happy to get some questions to you.

I want to talk also about State and local tax deductions. Obviously, the State of Nevada is one that has no personal income tax, and we are able to write off sales tax. With the blueprint in discussions that we have had, everything is on the table, including the removal of those deductions. It would cost the average person in the State of Nevada about $1,000 more in taxes if those deductions were removed.

I guess I need a commitment from you that as we go through this process, we can make sure that it is equitable and that individuals in the State of Nevada will, in fact, benefit from the proposal you have with or without these deductions.

Secretary MNUCHIN. I would be more than happy to work with you. And you do not have State taxes, so I can assure you, the people who have State taxes really call me on this one.

Senator HELLER. I can imagine.

Secretary MNUCHIN. But I hope you can appreciate that we are trying to get the Federal Government out of the business of subsidizing States.

Senator HELLER. I want to talk to you about one more issue, and that is mortgage debt relief. We have talked about mortgages in the State of Nevada in the past. And the declining home prices, rising foreclosure rates, frankly, have forced many families to sell their homes in Nevada for less than what they paid for them and, in some cases, less than the outstanding debt.

I have worked with several members on this committee to try to find some relief for those individuals who are being asked to pay for taxes for income that they have never received. I am hoping that you would help address this.

Secretary MNUCHIN. Absolutely. I realize the serious issue of that, and we will follow up with you.

Senator HELLER. I appreciate that. I will get a list of questions to you——

Secretary MNUCHIN. Thank you.

Senator HELLER [continuing]. Get those follow-ups in there. Thank you, again, for being here today.

Secretary MNUCHIN. Thank you.

Senator WYDEN. Thank you, Senator Heller.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman.

Mr. Secretary, thank you for being here.

Secretary MNUCHIN. Nice to see you.

Senator MENENDEZ. Let me ask you, do you believe it is a good idea to cut Medicaid to provide tax cuts for the wealthy?

Secretary MNUCHIN. Again, we have no intention of cutting Medicaid.

Senator MENENDEZ. I am asking you as an idea. As an idea, do you believe that it is a good idea to cut Medicaid to pay for tax cuts for the wealthy?

Secretary MNUCHIN. That is not the intent of cutting Medicaid.

Senator MENENDEZ. So is your answer "yes," "no"?

Secretary MNUCHIN. No. My comment is that it——

Senator MENENDEZ. Well, whether or not it is your intent, do you believe—we are talking about, you know, the administration also sets policy views, so your deferral is amazing, but the administration sets policy views. Does the administration believe that it is a good idea to cut Medicaid to pay for tax cuts for the wealthy?

Secretary MNUCHIN. Are you referring to the—what are you referring to in the "tax cuts for the wealthy"?

Senator MENENDEZ. Well, certainly, let's take the Mnuchin Rule.

Secretary MNUCHIN. So, are you referring to the taxes as part of Obamacare? Because we heard earlier, many of those taxes hit the middle-income——

Senator MENENDEZ. Well, I am referring to what the House Republican health-care bill does, because it cuts nearly $1 trillion from Medicaid and it rips away health care from the most vulnerable in our society, and it hands the money over to the most privileged in our country.

Secretary MNUCHIN. I do not share your view that it hands the money over to the most privileged. A lot of the——

Senator MENENDEZ. But you share the view that it cuts nearly $1 trillion from Medicaid?

Secretary MNUCHIN. Again, it scales back the growth of Medicaid.

Senator MENENDEZ. It scales back? It cuts nearly $1 trillion. You call that scaling back? I guess on Wall Street $1 trillion is nothing.

Secretary MNUCHIN. No, $1 trillion is——

Senator MENENDEZ. In the lives of real people, it is something.

Secretary MNUCHIN. Senator, I appreciate your comments. The $1 trillion is, obviously, a lot of money. I realize that—I am happy to talk about the tax aspect of that——

Senator MENENDEZ. Well, let me ask you this.

Secretary MNUCHIN [continuing]. But the other areas on health care are out of my domain.

Senator MENENDEZ. Let me ask you this. Will the President adhere to his own budget and only sign a tax reform bill that doesn't increase the debt? "Yes" or "no"?

Secretary MNUCHIN. Again, I think the President will look at—when there is an overall tax reform bill that can pass the House and the Senate, the President has always said he is willing to negotiate——

Senator MENENDEZ. So, he might sign one that increases the debt is what you are saying? That is a possibility?

Secretary MNUCHIN. What I would say is that the President always has said that he is willing to negotiate on these issues and he will make a decision, and I will make a recommendation when we have an overall bill.

Senator MENENDEZ. I know, but the question is——

Secretary MNUCHIN. The President is very——

Senator MENENDEZ. There are no policy standards here. You want us to judge in the absence of any executive policy standards. It is all very nebulous. I understand negotiation, but at the end of the day, there have to be some standards.

Let me ask you this. Will the President commit himself to your own Mnuchin Rule and not sign a tax reform bill that cuts taxes on the top 1 percent?

Secretary MNUCHIN. The President is very concerned about the debt and wants to have plans to pay down the debt, and the President is very focused on there being a middle-income tax cut as part of this.

Senator MENENDEZ. Well, if you sign a bill that actually permits debt to take place, then that concern is not that great.

Let me ask you this. Will the President sign a tax reform bill that does not cut taxes for all families earning under $100,000?

Secretary MNUCHIN. It is not his intent to do that. He wants a middle-income tax cut.

Senator MENENDEZ. It is not his intent. So does that mean "no," he will not?

Secretary MNUCHIN. I cannot speak for the President on what he will do in hypothetical situations.

Senator MENENDEZ. Well, you advise him. Would you advise him not to?

Secretary MNUCHIN. Yes, I would advise him not to, and we will make sure there are tax cuts in this process for the middle class.

Senator MENENDEZ. Will the President sign a bill that gives more tax cuts as a percentage of income to the top 1 percent in the middle class?

Secretary MNUCHIN. Again, I am not going to go through a bunch of hypothetical scenarios of what the President will do and what the President will not do. I am happy to explain what the President's objectives are, and we are moving through a process.

Senator MENENDEZ. Let me ask you these. Maybe these will have greater clarity. Will the President sign a tax reform bill that creates a new surtax for millionaires to shore up Medicare?

Secretary MNUCHIN. I do not believe that is in the current plan.

Senator MENENDEZ. So that would be a "no"?

Secretary MNUCHIN. I said it——

Senator MENENDEZ. Will the President sign a tax reform bill that increases the estate tax?

Secretary MNUCHIN. I do not believe that is in the current plan.

Senator MENENDEZ. So that would be a "no" then. Will the President sign a bill that does not cut taxes on large corporations?

Secretary MNUCHIN. The President wants to make sure that we have a competitive business system, and for many large companies, they pay substantially less than the 35 percent. So, our intent is to lower the rate and broaden the base.

Senator MENENDEZ. So the answer to that is "no."

So you have answered pretty clearly, definitively. You could not answer "yes" or "no" on anything else but pretty definitively that on those things, it paints a pretty clear picture of what his priorities will be.

He will sign a bill that explodes the debt, leaves middle-class families in the cold, breaks the Mnuchin Rule by cutting taxes for the top 1 percent, but he will not sign a bill unless it includes a giveaway to large multinational corporations.

Secretary MNUCHIN. Senator, in all due respect, okay, that is not what I said, and that is not the President's——

Senator MENENDEZ. Oh no, you did not say that specifically, but your line of questions and answers gives me that.

Let me just say one final thing. I do not get—this sounds like Enron-type accounting. The budget, the Trump budget, has virtually no details on tax reform. Yet it assumes their nonexistent plan will create an additional $2 trillion in revenue, and it uses an imaginary revenue to plug an all-too-real hole in the deficit. Besides the problem of counting your chickens before they hatch, the administration also assumes that that same $2 trillion in imaginary dollars will be used to offset tax cuts.

So my question is, how did the administration estimate the macroeconomic effects of tax reform without knowing any of the specifics of tax reform, including whether and how revenue deductions would be offset?

Secretary MNUCHIN. I am sorry you were not here earlier, but I answered similar questions several times already, in that we did not have the details to put in on the impact of taxes. We have complete transparency.

Senator MENENDEZ. You do not have any details today?

Senator WYDEN. We are going to have to wrap this up.

Senator MENENDEZ. Well, I will finalize, Mr. Chairman.

You do not have any details, and so if you do not have any details of what it will look like, I do not know how you do such macroeconomic forecasting.

Thank you, Mr. Chairman.

Senator WYDEN. Okay. Thank you.

Mr. Mnuchin, we have one other area we have to explore before we wrap up.

The Treasury Department makes payments directly to health insurers to help cover deductibles and copayments for roughly 7 million Americans. These are folks with modest incomes. They have private health plans they bought on the insurance exchange, and this is for help with deductibles and copayments. These are called Cost Sharing Reduction payments, CSRs.

The President has been making the payments since he took office, but recently it has been reported that he is threatening to stop. We have gotten enormous amounts of letters, emails, and tweets from citizens, insurers, Governors, and experts that this really dangerous rhetoric about these payments is causing a lot of uncertainty in the markets, and this is raising premiums for hard-working Americans.

I have two letters from State Commissioners and insurance executives. I am just going to put those in the record by unanimous consent.

[The letters appear in the appendix beginning on p. 68.]

Senator WYDEN. Now, we know that you and the President have stated your strong belief in the free market, but the lack of clarity here is just causing turmoil. It is almost like gasoline is being poured on the fires of uncertainty in the health-care marketplace, and the private sector just cannot continue to operate with this level of uncertainty.

The insurers have to submit their proposed rates for 2018, and they cite the fact that these Cost Sharing Reduction payments remain unresolved as a main reason for premium increases. So there has been all of this discussion about this.

But my staff discovered in the President's own budget that there is an assumption that they are going to be paid out in 2018. So after all of this hullabaloo, I was pretty surprised at this. So my question is, Mr. Secretary, is the President going to follow his own budget proposal? This is in the budget document. We were kind of amazed it is in there. Is he going to follow his own budget document, his own proposal, and continue funding these cost sharing payments next year?

Secretary MNUCHIN. Thank you, Senator Wyden. I have not had any direct discussions with the President on this, but I am more than happy to follow up with Director Mulvaney and him on this issue.

Senator WYDEN. Well, I am asking you—this is in your budget, Mr. Secretary. I am not asking you if you went to medical school. I am not asking you about health-care policy. I am trying to find out about whether the President's budget—and it is in your Treasury appendix section—whether you as Treasury Secretary agree that these payments ought to continue as they have been made for the last several years?

Secretary MNUCHIN. Again, I respect your question, and I am going to follow up and get back with you on that.

Senator WYDEN. Well, if I am an insurer who is setting rates right now, should I believe that the reported threats about these payments from the administration are accurate, or should I believe the proposal that is in your Treasury budget? Which should I believe right now?

Secretary MNUCHIN. We are happy to provide clarity for you and to the free market on that.

Senator WYDEN. I will just tell you, Mr. Secretary, having started this, I do not know, maybe 2½ hours ago, we have really gotten virtually no clarity on the big questions, starting from this proposal that so dramatically favors the very wealthy to my colleagues' questions. I mean, this is really a critical issue, and it is critical right now because the 90-day period where this is going to continue to be debated means that everybody is going to be up in the air while the insurance companies are trying to make decisions. And as somebody who believes in the free market, I would hope that you back the proposal in your own budget. It would be one thing if it was coming from somewhere else. But it is in your own budget. And I am just baffled why you will not support your own budget.

So let me just leave you with where I think we are. We now have on offer a one-page proposal, and I gather that there is one section that may have been added. I have not had a chance to look at it in detail, but I gather it is something involving retirement.

At the rate we are going, we are going to have a full proposal, you know, somewhere like 2075 or something like that. We have really got to get moving. I mean, the American people, as I said—the first sentence out of my mouth—the American people demand that we work in a bipartisan way on the issues that are important to them, and particularly matters like health care and taxes. These are key bread-and-butter issues for anybody who is a nurse, anybody who is a cop, working-class people, people who aspire to be middle-class.

So we have to get more specifics. I have told you, both publicly and privately, I wrote two full-fledged tax reform bills, not kind of a paper with a few principles on it. They are actual bills. They provide a real middle-class tax cut, and Republicans went along on it.

So it can be done. And it has to be real as opposed to much of what my colleagues have said.

So I gather that some emails about meetings coming up that are going to be bipartisan were sent this morning. I just want to make it clear that to get this done, we have to take the one-pager that is shorter than a drugstore receipt that my staff was seeing last night and turn it into something that could actually produce a bipartisan bill.

I know from listening to my colleagues on this side of the aisle, they agree the current system is a mess. It is a dysfunctional mess. We need changes to create more good-paying red, white, and blue jobs. I made it clear this morning that I would work very closely with my friend Chairman Hatch because he believes that we also ought to try to work in a bipartisan way, but you are going to have to speed this up in terms of getting us specifics.

So with that, Mr. Secretary, we will adjourn, and we hope to continue this discussion very soon.

Secretary MNUCHIN. Thank you.

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

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Orrin G. Hatch, a U.S. Senator From Utah

WASHINGTON—Senate Finance Committee Chairman Orrin Hatch (R–Utah) today delivered the following opening statement at a hearing to examine the administration's fiscal year (FY) 2018 budget request for the Treasury Department and current policies to overhaul the Nation's tax code:

Today's hearing has a dual focus. We will discuss the President's Budget for Fiscal Year 2018 as well as ongoing efforts to reform our Nation's tax code.

We are pleased to be joined here today by Treasury Secretary Steven Mnuchin, who will provide the administration's perspective on these important issues.

Welcome back to the Finance Committee, Secretary Mnuchin. As this is your first budget hearing before this committee, let me warn you: these hearings tend to be pretty grueling, but that is a necessary part, not only of the budget process, but also of the committee's oversight function.

But not to worry, I think you're up to the challenge.

Let me begin by saying a few words about the President's Budget.

Obviously, we're all still absorbing the finer details of the proposed budget. But, at this point, I can say definitively that I applaud the President for his focus on advancing pro-growth policies to get our economy moving. And I share the administration's concerns about our debt, which ballooned by nearly doubling under the previous administration.

The President's budget envisions increased economic growth that eventually reaches 3 percent.

As I understand it, that vision relies on implementation of a number of policies, including pro-growth tax reform, cutting unnecessary regulation, building infrastructure, reforming health care, boosting energy production, and reducing deficits that would significantly improve the supply side of the economy.

Of course, it is not unheard of that an administration places belief in the efficacy of its policy proposals.

For example, in former President Obama's fiscal year 2010 budget, growth was assumed to get to as high as 4.6%, and was assumed to average 3.8% over an extended 8-year period. And that was premised on the administration's belief in its policy prescriptions.

So, while critics may want to criticize the optimistic nature of the budget's growth projections, it is, I believe, more realistic than a number of budget proposals we've seen, particularly some that came from the previous administration.

I also share the overall goal in the budget to reduce deficits without raising taxes, keeping in mind that our Nation's debt nearly doubled during the previous administration.

We have a number of difficult choices ahead of us as we work to address inefficiencies and reform wasteful programs and agencies, and that difficulty is reflected in the budget. I look forward to continuing to examine the various proposals and to hearing Secretary Mnuchin's insights about the items in the budget.

Now, I'd like to spend a few minutes discussing the other element of today's hearing: tax reform.

For 6 years now, I have been beating the drum on tax reform.

I've sought to make the case for reform here in the committee, on the Senate floor, in public forums and events, and in private conversations. And, I haven't been alone. There has been a bipartisan recognition—one that I think is growing more by the day—that our current tax system doesn't work.

Throughout this endeavor, I've stated numerous times that, if it's going to be successful, we will need to see engagement from the President. And, before anyone writes that off as a political statement, let me make it clear that I wasn't simply advocating for the election of a Republican President. On the contrary, I repeatedly implored President Obama to engage with Congress on tax reform, but to no avail.

The current administration put out a tax reform framework earlier this month, one that I think can serve as an outline as this effort moves forward, keeping in mind that, as with any major undertaking, we'll need to be realistic and commit to practicing the art of the doable.

I expect that you'll get a number of questions about the tax plan here today, Secretary Mnuchin. In addition, I expect we'll hear a lot about the process by which tax reform will move through Congress.

On that point, we've already heard a few demands from my friends on the other side of the aisle, stated as if they were preconditions for any serious engagement on tax reform. My hope is that these aren't really preconditions, but still, I do want to address one of them briefly here today.

One of the demands we've heard is that Republicans abandon the use of budget reconciliation for tax reform. This, in my view, is an odd demand.

Historically speaking, most major tax bills that have moved through reconciliation have had bipartisan support. In fact, in the past, when Republicans have controlled the House and Senate along with the White House, all of our tax reconciliation bills have enjoyed some Senate Democratic support.

If we can reach agreements on policy, there is absolutely no reason why Democrats couldn't agree to support a tax reform package moved through reconciliation.

I can't imagine a scenario in which my Democratic colleagues would be more amendable to compromising on tax reform policy if reconciliation is taken off the table. And, in fact, the only thing we'd accomplish by foreclosing the use of reconciliation would be to ensure that the minority would be able to more easily block any bill from passing, which is a strange demand to make before beginning a good-faith negotiation.

In any event, whether this is truly a precondition or simply a rhetorical point on the part of my colleagues, let me be clear: my strong preference is that our tax reform efforts be bipartisan. I have reached out to my colleagues on both sides of the aisle and sincerely hope that both parties can be at the table.

I think I've more than adequately demonstrated my willingness to work with my Democratic colleagues on this committee and elsewhere. My intention is to continue working with my Democratic colleagues on tax reform, so long as they are willing to engage.

I don't want to speak for Secretary Mnuchin today, but I think it's safe to say that he share's this desire and is similarly committed to working with our Democratic colleagues on this effort.

With that, let me once again thank Secretary Mnuchin for being here today. I look forward to a rigorous and thoughtful discussion of these and other issues.

The Wall Street Journal, August 14, 2008

THE OBAMA TAX PLAN

By Jason Furman and Austan Goolsbee

Even as Barack Obama proposes fiscally responsible tax reform to strengthen our economy and restore the balance that has been lost in recent years, we hear the familiar protests and distortions from the guardians of the broken status quo.

Many of these very same critics made many of these same overheated predictions in previous elections. They said President Clinton's 1993 deficit-reduction plan would wreck the economy. Eight years and 23 million new jobs later, the economy proved them wrong. Now they are making the same claims about Senator Obama's tax plan, which has even lower taxes than prevailed in the 1990—including lower taxes on middle-class families, lower taxes for capital gains, and lower taxes for dividends.

Overall, Senator Obama's middle-class tax cuts are larger than his partial rollbacks for families earning over $250,000, making the proposal as a whole a net tax cut and reducing revenues to less than 18.2% of GDP—the level of taxes that prevailed under President Reagan.

Both candidates for president have proposed tax plans. But they are starkly different in their approaches and their economic impact. Senator Obama is focused on cutting taxes for middle-class families and small businesses, and investing in key areas like health, innovation and education. He would do this while cutting unnecessary spending, paying for his proposals and bringing down the budget deficit.

In contrast, John McCain offers what would essentially be a third Bush term, with his economic speeches outlining $3–4 trillion of tax cuts over 10 years beyond what President Bush has already proposed and geared even more to high-income earners. The McCain plan would lead to deficits the likes of which we have never seen in this country. It would take money from the middle class and from future generations so that the wealthy can live better today.

Senator Obama believes a focus on the middle-class is appropriate in the wake of the first economic expansion on record where the typical family's income fell by almost $1,000. The Obama plan would cut taxes for 95% of workers and their families with a tax cut of $500 for workers or $1,000 for working couples. In addition, Senator Obama is proposing tax cuts for low- and middle-income seniors, homeowners, the uninsured, and families sending a child to college or looking to save and accumulate wealth.

The Obama plan would dramatically simplify taxes by consolidating existing tax credits, eliminating the need for millions of senior citizens to file tax forms, and enabling as many as 40 million middle-class filers to do their own taxes in less than 5 minutes and not have to hire an accountant.

Senator Obama also recognizes that small businesses are the engine of job growth in the economy. That is why he is proposing additional tax cuts, including a tax credit for small businesses that provide health care, and the elimination of capital gains taxes for small businesses and start ups. The vast majority of small businesses would face lower taxes under the Obama plan than under the McCain plan. In addition, Senator Obama supports reforming corporate taxes in a manner that would help create jobs in America and simplify the tax code by eliminating distortions and special preferences.

Senator Obama believes that responsible candidates must put forward specific ideas of how they would pay for their proposals. That is why he would repeal a portion of the tax cuts passed in the last 8 years for families making over $250,000. But to be clear: He would leave their tax rates at or below where they were in the 1990s.

– The top two income-tax brackets would return to their 1990s levels of 36% and 39.6% (including the exemption and deduction phase-outs). All other brackets would remain as they are today.

– The top capital-gains rate for families making more than $250,000 would return to 20%—the lowest rate that existed in the 1990s and the rate President Bush proposed in his 2001 tax cut. A 20% rate is almost a third lower than the rate President Reagan set in 1986.

– The tax rate on dividends would also be 20% for families making more than $250,000, rather than returning to the ordinary income rate. This rate would be 39% lower than the rate President Bush proposed in his 2001 tax cut and would be lower than all but 5 of the last 92 years we have been taxing dividends.

– The estate tax would be effectively repealed for 99.7% of estates, and retained at a 45% rate for estates valued at over $7 million per couple. This would cut the number of estates covered by the tax by 84% relative to 2000.

Overall, in an Obama administration, the top 1% of households—people with an average income of $1.6 million per year—would see their average federal income and payroll tax rate increase from 21% today to 24%, less than the 25% these households would have paid under the tax laws of the late 1990s.

Senator Obama believes that one of the principal problems facing the economy today is the lack of discretionary income for middle-class wage earners. That's why his plan would not raise any taxes on couples making less than $250,000 a year, nor on any single person with income under $200,000—not income taxes, capital gains taxes, dividend or payroll taxes.

In contrast, Senator McCain's tax plan largely leaves the middle class behind. His one and only middle-class tax cut—a slow phase-in of a bigger dependent exemption—would provide no benefit whatsoever to 101 million families who do not have children or other dependents, or who have a low income.

But Senator McCain's plan does include one new proposal that would result in higher taxes on the middle class. As even Senator McCain's advisers have acknowledged, his health-care plan would impose a $3.6 trillion tax increase over 10 years on workers. Senator McCain's plan will count the health care you get from your employer as if it were taxable cash income. Even after accounting for Senator McCain's proposed health-care tax credits, this plan would eventually leave tens of millions of middle-class families paying higher taxes. In addition, as the Congressional Budget Office has shown, this kind of plan would push people into higher tax brackets and increase the taxes people pay as their compensation rises, raising marginal tax rates by even more than if we let the entire Bush tax-cut plan expire tomorrow.

The McCain plan represents Bush economics on steroids. It has $3–4 trillion more in tax cuts than President Bush is proposing, largely directed at corporations and the most affluent. Senator McCain would implement these cuts without proposing any meaningful steps to simplify taxes or eliminate distortions and loopholes. In addition, Senator McCain has floated over $1 trillion in new spending increases but barely any specific spending cuts.

As previously mentioned, the Obama plan is a net tax cut—his middle-class tax cuts are larger than the rollbacks he has proposed for families making over $250,000. Senator Obama would pay for this tax cut by cutting spending—including responsibly ending the war in Iraq, reducing excessive payments to private plans in Medicare, limiting payments for high-income farmers, reducing subsidies for banks that make student loans, reforming earmarks, ending no-bid contracts, and eliminating other wasteful and unnecessary programs.

While Senator Obama would shrink the deficit from its current record levels, he recognizes that it is even more important to confront our long-term fiscal challenges, including the growth of health costs in the public and private sector. He also believes it is critical to work with members of Congress from both parties to strengthen Social Security while protecting middle-class families from tax increases or benefit cuts. He has done what few presidential candidates have been willing to do by making a politically risky proposal to strengthen solvency by asking those making over $250,000 to contribute a bit more to Social Security to keep it sound.

Senator Obama does not support uncapping the full payroll tax of 12.4% rate. Instead, he is considering plans that would ask those making over $250,000 to pay in the range of 2% to 4% more in total (combined employer and employee). This change to Social Security would start a decade or more from now and is similar to the rate increases floated by Senator McCain's close adviser Lindsey Graham, and that Senator McCain has previously said he "could" support.

In contrast, Senator McCain has put forward the most fiscally reckless presidential platform in modern memory. The likely results of his Bush-plus policies are clear. As Berkeley economist Brad Delong has estimated, the McCain plan, as compared to the Obama plan, would lower annual incomes by $300 billion or more in real terms by 2017, costing the typical worker $1,800 or more due to the effect of large deficits on national savings and thus capital formation. Senator McCain's neglect of critical public investments would further impede economic growth for decades to come.

Do not take the critics' word for it. Go look at the plans for yourself at *www.barackobama.com/taxes*. Get the facts and you will see the real priorities at stake in this election. America cannot afford another 8 years like these.

PREPARED STATEMENT OF HON. STEVEN T. MNUCHIN, SECRETARY, DEPARTMENT OF THE TREASURY

Chairman Hatch, Ranking Member Wyden, and members of the committee, it is an honor to be here today. I am looking forward to working with members of Congress and this committee on passing important legislation for the American people.

My number-one priority as Treasury Secretary is creating sustainable economic growth for all Americans. The best way to achieve this is through a combination of tax reform, regulatory relief, and protecting taxpayers; this also includes making some difficult decisions with respect to our budget. We are currently bearing the costs of excessive government commitments of previous years, and this has forced us into hard choices.

But the remarkable thing about economic growth is that it builds on itself. If we develop the right policies today, our children and grandchildren will reap the benefits of an ever-growing economy. Indeed, in the next 10 years, if we return to the modern historic average of above 3% annual GDP growth, our economy would grow by trillions of dollars. This will be meaningful to every man, woman, and child in this country and future generations.

Tax reform will play a major role in our campaign for growth. It has been more than 30 years since we have had comprehensive tax reform in this country. This administration is committed to changing that. We have about 100 people working at Treasury on this issue.

We are working diligently to bring tax relief to lower and middle-income Americans as well as make American businesses competitive again. All of this comes as we simplify the tax code and make it easier for hardworking Americans to file.

Finally, I would like to speak about the importance of free and fair international trade. Few doubt that free trade is a crucial component of economic growth. But trade deals that disadvantage American workers and businesses can hardly be considered either free or fair.

In meetings with my international counterparts I have stressed this dual importance. Just 2 weeks ago, I had productive meetings with the finance ministers of the G7, and earlier, I met with members of the IMF and World Bank. They understand our concerns, and we have approached our international dialogue with a renewed spirit of mutual understanding.

In the President's address to the joint session of Congress, he spoke about the marvels that this country is capable of when its citizens are set free to pursue their visions. Fundamental to that freedom is removing imprudent regulation and uncompetitive taxes from blocking their way.

This has been a significant few months at Treasury. We have been studying, developing, and implementing policies that will put this country on the path toward sustained economic growth.

In the coming months, we will work with this committee and the Congress in what we will look back on as an important time for this Nation's economy and in our history.

Thank you and I look forward to answering your questions.

QUESTIONS SUBMITTED FOR THE RECORD TO HON. STEVEN T. MNUCHIN

QUESTIONS SUBMITTED BY HON. ORRIN G. HATCH

Question. Secretary Mnuchin, one of the things that I applaud in the President's budget is recognition that we are currently on an unsustainable fiscal path. Unfortunately, the previous administration's policies, which were too often not focused on growth but, rather, on increasing regulation and redistribution, nearly doubled the country's debt.

Treasury is currently using so-called "extraordinary measures" to keep the debt below the statutory debt limit, but the ability to continue to use such measures is limited. When the availability of such measures runs out, the debt limit will be breached, absent action by Congress to either increase or suspend the debt limit.

Secretary Mnuchin, when do you project Treasury will run out of extraordinary measures to buy headroom below the debt ceiling; that is, when do you project that, absent action by Congress, the government would be forced to default on the Nation's debt?

Answer. As you're aware, on September 8, 2017, the President signed into law Pub. L. 115–16, which suspended the statutory debt limit through December 8, 2017.

Question. Secretary Mnuchin, Senator Wyden, my friend and the ranking member of this committee, dubbed your objective of not providing an absolute tax cut for the so-called rich the "Mnuchin Rule." And I understand that you take that as a sort of honor, being in the midst of other Democrat rules such as the Volcker Rule, which seems to be a 900 or so page effort by regulators to define a simple concept, and the Buffet rule, which advocates for higher taxes on some Americans that the rule's namesake would largely or entirely escape himself. I'll leave it up to you whether to feel honored or not.

In any case, my understanding is that your objective—and the President's objective—is to provide competitive tax rates for businesses and cut taxes for the middle class, while not giving tax breaks to the so-called rich. Of course, what tax reform ends up looking like will depend on your objectives, as well as objectives, efforts, and preferences of members of Congress, hopefully from both sides of the aisle.

Secretary Mnuchin, in analyzing tax reform options, have you been thinking about how to prevent upper earners from disproportionately benefitting from lower taxes on business and investment income and how to prevent people from mischaracterizing labor income as capital income in order to pay lower taxes? If so, what conclusions or ideas can you share with us today?

Answer. Yes, we have been considering these issues. The President and I are committed to tax reform that includes middle-income tax relief. We are working with Congress and other stakeholders to develop appropriate policies to achieve that goal.

We also have been thinking about the potential problems introduced by taxing business income at a rate lower than labor income. We are aware that there has to be some safeguards to prevent the inappropriate characterization of labor income as business income and have tentatively explored a variety of approaches. There are any number of rules that can help, including rules that specify reasonable compensation and that limit excessive accumulation of earnings within a business. We look forward to working with Congress and other stakeholders in designing rules that will be effective.

Question. Secretary Mnuchin, I have another question with respect to the so-called "Mnuchin Rule." Some have argued that if taxes imposed by the Affordable Care Act were to be repealed, that all of the resulting tax reductions would accrue to the so-called "rich," say those with incomes above $200,000. Some have gone so far as to say that "not one dime" of tax reductions would accrue to the "middle class."

Secretary Mnuchin, can you tell me whether any of the taxes that were imposed by the Affordable Care Act distribute to middle-class income earners, in which case the claim that "not one dime" of tax reduction from repeal of the taxes would accrue to anyone but the so-called rich would be false and would, in fact, reflect a lack of recognition of adverse effects on middle-class Americans of taxes levied by the Affordable Care Act?

Answer. Yes, several Affordable Care Act taxes are paid by middle-income earners. For instance, for tax year 2016, the ACA requires all single filers with gross income above $10,350 ($20,700 for joint filers) who do not have health-care coverage, and who do not qualify for an exemption, to remit to the IRS a tax penalty, known as a shared responsibility payment (also known as the individual mandate). For tax year 2015, approximately 6.5 million taxpayers, the vast majority with incomes below $200,000, reported these payments. In addition, the so called "Cadillac Tax" on high-premium health insurance plans is likely to be paid on plans received by some middle-income families, as are the higher taxes on over-the-counter medications and the contribution limits on Flexible Spending Accounts, to name a couple others.

QUESTIONS SUBMITTED BY HON. RON WYDEN

RETIREMENT SAVINGS

Question. Does the administration intend as part of tax reform to change the treatment for some or all contributions to tax-preferred retirement savings accounts and plans from pre-tax to after-tax, with a corresponding change of not taxing distributions from those accounts or plans?

Answer. The tax reform framework released in September retained tax benefits that encourage work, higher education, and retirement security. The framework also encouraged Congress to simplify these benefits to improve their efficiency and effectiveness. The administration will consider proposals from the Congress that meet these goals.

MULTI-EMPLOYER PENSION PLANS

Question. In a letter to me dated May 23, 2017, regarding multiemployer pension plans, Treasury observed that "[t]he problems facing multiemployer plans and the PBGC are complex and varied, and they cannot be solved through administrative action alone under current law." The letter then concludes that Treasury is committed to working with Congress to develop solutions. Do you and the Trump administration support a legislative alternative to the Multiemployer Pension Reform Act of 2014 that involves Federal Government assistance or funding for critical and declining status plans beyond that law's benefit suspension and PBGC partition rules?

Answer. Treasury is committed to working with Congress and other stakeholders to develop fiscally responsible solutions to the issues facing multiemployer pension plans. Treasury believes that a fiscally responsible solution would avoid the need for additional Federal funding. It would be premature for Treasury and the administration to endorse a particular legislative alternative at this time.

ESTATE TAX

Question. Secretary Mnuchin, Table S–4 of the budget indicates that under the administration's budget, estate and gift tax receipts are expected to increase from $21 billion in 2016 to $43 billion in 2017. In addition, section 11 of the budget's Analytical Perspectives states: "The budget assumes deficit neutral tax reform, which the administration will work closely with the Congress to enact. . . . Tax relief for American families, especially middle-income families, should . . . abolish the death tax, which penalizes farmers and small business owners who want to pass their family enterprises on to their children."

The estate tax applies only to families with estates in excess of $11 million. Could you please explain why repeal of the estate tax is listed under the section describing tax relief for middle-income families? Please describe what income threshold the President uses to define middle-income families.

Answer. The repeal of the estate tax is included in the section describing several guiding principles for "[t]ax relief for American families, especially middle-income families." As stated in the budget, repealing the estate tax is intended to help farmers and small businesses, many of whom are middle-income earners.

Question. The budget shows that under the President's policies estate tax receipts will increase from $21 billion in 2016 to $43 billion in 2027. However, the budget also states that the President plans to repeal the estate tax. Could you please explain how repealing the estate tax increases annual Federal estate and gift tax receipts by more than $20 billion over the decade?

Answer. The budget assumes estate tax repeal will be part of deficit neutral tax reform. Because the tax reform proposal is still under development, the budget does not show the effects of the proposal on individual sources of revenue. Thus, the estate tax receipts in the budget are a placeholder at current law levels.

ECONOMIC GROWTH ASSUMPTIONS

Question. Secretary Mnuchin, Table S–2 of the President's budget assumes more than $2 trillion in new revenue attributable to "economic feedback." Please explain how much of the $2 trillion in new revenues attributable to economic feedback is assumed to be attributable to tax reform.

Answer. The feedback effect is due to a combination of tax reform, regulatory reform, and trade reform. We do not have specific estimates for each component of the feedback effect, but the feedback from 3-percent GDP growth amounts to trillions of dollars flowing into the economy.

TAX REFORM PAYING FOR ITSELF

Question. Secretary Mnuchin, on April 20, 2017 you stated "tax reform will pay for itself with growth." On May 24, 2017 you stated the budget did not contain any tax reform proposals because you are "not far enough along to estimate what that impact will be."

In your opening statement during the May 25th hearing before this committee, you stated that tax reform will play "a major role" in achieving the 3-percent economic growth assumed in the Trump budget, the same budget that just the day before you said did not include tax reform proposals.

That same morning, OMB Director Mick Mulvaney told the Budget Committee, which I serve on, that tax reform will be "deficit-neutral."

Please explain the assumed revenue and deficit effects of the administration's tax reform plan.

Answer. *See* response below.

Question. Is any part of the administration's tax reform plan expected to be paid for with economic growth? If so, what portion of revenue loss is expected to be made up for with economic growth?

Answer. *See* response below.

Question. You have said repeatedly that tax reform will pay for itself through increased economic growth. How much will the President's tax cuts cost before repealing tax expenditures and closing tax loopholes? How much in higher revenues from growth will be generated by these tax cuts? If these amounts are not currently knowable by you and Treasury staff, then how can you know that tax reform will pay for itself through increased revenues from higher economic growth?

Answer. *See* response below.

Question. Please cite estimates—prepared by government or independent economists—of other tax cut proposals that fully paid for themselves through revenues generated by higher economic growth.

Answer. *See* response below.

Question. Please provide real-world examples of comprehensive tax reform proposals that have fully paid for themselves—either at the State level, or anywhere else in the world. By "fully paid for," I mean where the tax cut portion, before repealing tax expenditures and closing tax loopholes, is paid for by the generation of higher revenues from increased economic growth.

Answer. We are working hard to put together a tax reform proposal. While adequate revenues are important, they are only one of several important factors. One of our highest priorities is reinvigorating U.S. growth, which will help offset, at least in part, the revenue impact of tax reform. Cuts in income tax rates, including those rates applied to labor income and to capital income, are believed by many economists to offer a potential for significant revenue feedback. For example, Greg Mankiw has argued that growth can offset about half of the cost of capital income tax cuts. The Tax Foundation found that the House Republicans' tax reform blueprint and the Trump campaign plans would have very large revenue feedback effects from induced economic growth. According to their calculations, revenues from additional growth would make the House plan nearly revenue-neutral and would offset about 40 percent of the revenue cost of the Trump campaign plan. The 2018 budget assumes that the tax reform plan is deficit-neutral before accounting for growth effects, and that revenues from additional growth are devoted toward deficit reduction. We look forward to continuing to work with our colleagues in Congress and with other stakeholders to develop a tax reform proposal that will benefit all Americans.

REVENUE-NEUTRAL TAX REFORM VS. DEFICIT-NEUTRAL TAX REFORM

Question. Table S–4 of the budget indicates that the President proposes *revenue-neutral* tax reform. However, section 11 of the budget's Analytical Perspectives states "[t]he budget assumes deficit-neutral tax reform." While revenue-neutral tax reform can be deficit-neutral, deficit-neutral tax reform is not necessarily revenue-neutral. This is because major tax policies benefitting working families such as the

Earned Income Tax Credit and the Child Tax Credit are refundable credits, which provide refunds to taxpayers that are treated as outlays instead of revenues for budget purposes. Therefore, a tax reform proposal could be deficit-neutral and significantly scale back refundable credits while providing a net cut in revenues. Could you please clarify whether the President will veto any tax reform plan that is not (a) revenue-neutral or (b) deficit-neutral?

Answer. The President recognizes the need for the tax system to generate adequate revenue to pay for important governmental functions. Any tax reform signed into law will have an adequate revenue stream, and we look forward to working with our colleagues in Congress and other stakeholders to appropriately balance revenue against the other desirable features of a reformed pro-growth tax system that is fair to American workers and businesses.

TAX EXPENDITURES UNDER CONSIDERATION FOR REPEAL BY THE ADMINISTRATION

Question. In your testimony you made statements about the administration's intention to repeal or preserve certain specific provisions in tax reform. To help clarify the administration's intentions in tax reform, I have included below a list of major tax expenditures in the current Internal Revenue Code as listed in section 13 of the budget's Analytical Perspectives. For each tax expenditure in the table below, please indicate whether the administration intends to preserve, repeal, or modify the provision. Also, please describe any new revenue sources outside of the tax expenditure budget the administration would consider.

Answer. *See* response below.

National defense:

1. Exclusion of benefits and allowances to armed forces personnel.

International affairs:

2. Exclusion of income earned abroad by U.S. citizens.
3. Exclusion of certain allowances for Federal employees abroad.
4. Inventory property sales source rules exception.
5. Deferral of income from controlled foreign corporations (normal tax method).
6. Deferred taxes for financial firms on certain income earned overseas.

General science, space, and technology:

7. Expensing of research and experimentation expenditures (normal tax method).
8. Credit for increasing research activities.

Energy:

9. Expensing of exploration and development costs, fuels.
10. Excess of percentage over cost depletion, fuels.
11. Exception from passive loss limitation for working interests in oil and gas properties.
12. Capital gains treatment of royalties on coal.
13. Exclusion of interest on energy facility bonds.
14. Energy production credit.
15. Marginal wells credit.
16. Energy investment credit.
17. Alcohol fuel credits.
18. Bio-Diesel and small agri-biodiesel producer tax credits.
19. Tax credits for clean-fuel burning vehicles and refueling property.
20. Exclusion of utility conservation subsidies.
21. Credit for holding clean renewable energy bonds.
22. Deferral of gain from dispositions of transmission property to implement FERC restructuring policy.
23. Credit for investment in clean coal facilities.
24. Temporary 50% expensing for equipment used in the refining of liquid fuels.
25. Natural gas distribution pipelines treated as 15-year property.
26. Amortize all geological and geophysical expenditures over 2 years.
27. Allowance of deduction for certain energy efficient commercial building property.
28. Credit for construction of new energy efficient homes.
29. Credit for energy efficiency improvements to existing homes.
30. Credit for residential energy efficient property.
31. Qualified energy conservation bonds.
32. Advanced Energy Property Credit.

33. Advanced nuclear power production credit.
34. Reduced tax rate for nuclear decommissioning funds.

Natural resources and environment:

35. Expensing of exploration and development costs, nonfuel minerals.
36. Excess of percentage over cost depletion, nonfuel minerals.
37. Exclusion of interest on bonds for water, sewage, and hazardous waste facilities.
38. Capital gains treatment of certain timber income.
39. Expensing of multiperiod timber growing costs.
40. Tax incentives for preservation of historic structures.
41. Industrial CO_2 capture and sequestration tax credit.
42. Deduction for endangered species recovery expenditures.

Agriculture:

43. Expensing of certain capital outlays.
44. Expensing of certain multiperiod production costs.
45. Treatment of loans forgiven for solvent farmers.
46. Capital gains treatment of certain income.
47. Income averaging for farmers.
48. Deferral of gain on sale of farm refiners.
49. Expensing of reforestation expenditures.

Commerce and housing:

Financial institutions and insurance:

50. Exemption of credit union income.
51. Exclusion and deferral of policyholder income earned on life insurance and annuity contracts.
52. Exclusion or special alternative tax for small property and casualty insurance companies.
53. Tax exemption of insurance income earned by tax-exempt organizations.
54. Small life insurance company deduction.
55. Exclusion of interest spread of financial institutions

Housing:

56. Exclusion of interest on owner-occupied mortgage subsidy bonds.
57. Exclusion of interest on rental housing bonds.
58. Deductibility of mortgage interest on owner-occupied homes.
59. Deductibility of State and local property tax on owner-occupied homes.
60. Deferral of income from installment sales.
61. Capital gains exclusion on home sales.
62. Exclusion of net imputed rental income.
63. Exception from passive loss rules for $25,000 of rental loss.
64. Credit for low-income housing investments.
65. Accelerated depreciation on rental housing (normal tax method).
66. Discharge of mortgage indebtedness.

Commerce:

67. Discharge of business indebtedness.
68. Exceptions from imputed interest rules.
69. Treatment of qualified dividends.
70. Capital gains (except agriculture, timber, iron ore, and coal).
71. Capital gains exclusion of small corporation stock.
72. Step-up basis of capital gains at death.
73. Carryover basis of capital gains on gifts.
74. Ordinary income treatment of loss from small business corporation stock sale.
75. Deferral of gains from like-kind exchanges.
76. Depreciation of buildings other than rental housing (normal tax method).
77. Accelerated depreciation of machinery and equipment (normal tax method).
78. Expensing of certain small investments (normal tax method).
79. Graduated corporation income tax rate (normal tax method).
80. Exclusion of interest on small issue bonds.
81. Deduction for U.S. production activities.
82. Special rules for certain film and TV production.

Transportation:

83. Tonnage tax.
84. Deferral of tax on shipping companies.

85. Exclusion of reimbursed employee parking expenses.
86. Exclusion for employer-provided transit passes.
87. Tax credit for certain expenditures for maintaining railroad tracks.
88. Exclusion of interest on bonds for Highway Projects and rail-truck transfer facilities.

Community and regional development:

89. Investment credit for rehabilitation of structures (other than historic).
90. Exclusion of interest for airport, dock, and similar bonds.
91. Exemption of certain mutuals' and cooperatives' income.
92. Empowerment zones.
93. New Markets Tax Credit.
94. Credit to holders of Gulf Tax Credit Bonds.
95. Recovery Zone Bonds.
96. Tribal Economic Development Bonds.

Education, training, employment, and social services:

Education:

97. Exclusion of scholarship and fellowship income (normal tax method).
98. Tax credits and deductions for postsecondary education expenses.
99. Education Individual Retirement Accounts.
100. Deductibility of student-loan interest.
101. Qualified tuition programs.
102. Exclusion of interest on student-loan bonds.
103. Exclusion of interest on bonds for private nonprofit educational facilities.
104. Credit for holders of zone academy bonds.
105. Exclusion of interest on savings bonds redeemed to finance educational expenses.
106. Parental personal exemption for students age 19 or over.
107. Deductibility of charitable contributions (education).
108. Exclusion of employer-provided educational assistance.
109. Special deduction for teacher expenses.
110. Discharge of student loan indebtedness.
111. Qualified school construction bonds.

Training, employment, and social services:

112. Work Opportunity Tax Credit.
113. Employer provided child care exclusion.
114. Employer-provided child care credit.
115. Assistance for adopted foster children.
116. Adoption credit and exclusion.
117. Exclusion of employee meals and lodging (other than military).
118. Credit for child and dependent care expenses.
119. Credit for disabled access expenditures.
120. Deductibility of charitable contributions, other than education and health.
121. Exclusion of certain foster care payments.
122. Exclusion of parsonage allowances.
123. Indian employment credit.
124. Credit for employer differential wage payments.

Health:

125. Exclusion of employer contributions for medical insurance premiums and medical care.
126. Self-employed medical insurance premiums.
127. Medical Savings Accounts/Health Savings Accounts.
128. Deductibility of medical expenses.
129. Exclusion of interest on hospital construction bonds.
130. Refundable Premium Assistance Tax Credit.
131. Credit for employee health insurance expenses of small business.
132. Deductibility of charitable contributions (health).
133. Tax credit for orphan drug research.
134. Special Blue Cross/Blue Shield tax benefits.
135. Tax credit for health insurance purchased by certain displaced and retired individuals.
136. Distributions from retirement plans for premiums for health and long-term care insurance.

Income security:

137. Child credit.

138. Exclusion of railroad retirement (Social Security equivalent) benefits.
139. Exclusion of workers' compensation benefits.
140. Exclusion of public assistance benefits (normal tax method).
141. Exclusion of special benefits for disabled coal miners.
142. Exclusion of military disability pensions.

Net exclusion of pension contributions and earnings:

143. Defined benefit employer plans.
144. Defined contribution employer plans.
145. Individual Retirement Accounts.
146. Low- and moderate-income savers credit.
147. Self-Employed plans.

Exclusion of other employee benefits:

148. Premiums on group term life insurance.
149. Premiums on accident and disability insurance.
150. Income of trusts to finance supplementary unemployment benefits.
151. Income of trusts to finance voluntary employee benefits associations.
152. Special ESOP rules.
153. Additional deduction for the blind.
154. Additional deduction for the elderly.
155. Tax credit for the elderly and disabled.
156. Deductibility of casualty losses.
157. Earned Income Tax Credit.

Social Security:

Exclusion of social security benefits:

158. Social Security benefits for retired and disabled workers and spouses, dependents, and survivors.
159. Credit for certain employer contributions to Social Security.

Veterans benefits and services:

160. Exclusion of veterans death benefits and disability compensation.
161. Exclusion of veterans pensions.
162. Exclusion of GI bill benefits.
163. Exclusion of interest on veterans housing bonds.

General purpose fiscal assistance:

164. Exclusion of interest on public purpose State and local bonds.
165. Build America Bonds.
166. Deductibility of nonbusiness State and local taxes other than on owner-occupied homes.

Interest:

167. Deferral of interest on U.S. savings bonds.

Addendum: Aid to State and local governments:

Deductibility of:

168. Property taxes on owner-occupied homes.
169. Nonbusiness State and local taxes other than on owner-occupied homes.
170. Exclusion of interest on State and local bonds for:
    a. Public purposes.
    b. Energy facilities.
    c. Water, sewage, and hazardous waste disposal facilities.
    d. Small-issues.
    e. Owner-occupied mortgage subsidies.
    f. Rental housing.
    g. Airports, docks, and similar facilities.
    h. Student loans.
    i. Private nonprofit educational facilities.
    j. Hospital construction.
    k. Veterans' housing.

Answer. Tax reform is still a work in progress and it would not be constructive to pre-judge the process by setting forth, at this point, a detailed list of tax provisions that the administration may propose be preserved, repealed, or modified. From Treasury's perspective, a variety of reform proposals are suitable for discussion, provided that they are consistent with the principles for reform outlined by the administration.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU (TTB) FUNDING

Question. Secretary Mnuchin, between 2012 and 2016 the number of U.S. breweries has more than doubled, however, TTB funding has not kept pace. TTB is responsible for administration of Federal excise tax laws, as well as certain Federal alcohol and labeling regulations. Specifically, brewers are required to obtain TTB approval for beverage labels and formulas in certain cases. The brewing industry recognizes these regulations are crucial to ensure the integrity of the industry and fairness in the marketplace.

Due to resource limitations and the significant increases in the number of U.S. brewers, TTB has in recent years faced a significant backlog of formula and label approvals—sometime as long as 2 months. In 2015 Congress acted in a bipartisan, bicameral manner to address this backlog by appropriating $5 million to streamline and accelerate formula and label approvals. In the FY 2017 appropriations bill passed earlier this year, Congress again, in a bipartisan, bicameral manner extended and enhanced appropriations for TTB's regulatory functions.

The TTB FY 2018 budget justification, which is part of the President's budget, proposed to terminate these funding increases. In addition, the budget justification described this bipartisan, bicameral priority as an "earmark."

Please describe the policy justification for proposing to terminate the funding increases for formula and label approval. In addition, please describe what steps were taken to consult Congress, industry, or other stakeholders before making the decision to propose terminating this program.

Answer. The President's budget reflects the need to make many difficult decisions across government in order to focus resources on activities that promote national security and public safety and move toward a balanced budget. Progress that has been made in the reduction of TTB label approval wait times and enhancements in the electronic formula approval process led to the budget recommendation with regard to funding that has been used to streamline and accelerate formula and label approvals. TTB is in continual contact with the industry with regard to performance levels.

Question. Beer brewers exist in every State, and the beverage alcohol industry represents a significant portion of the U.S. economy. Please explain why the Treasury Department views appropriations to improve broad agency operations as an "earmark."

Answer. The congressional appropriation of $5 million to streamline and accelerate formula and label approvals is an "earmark" in the common sense of the term—a set-aside for a specific purpose.

Question. Despite the budget's significant cuts to TTB broadly and its proposals to undermine efforts to accelerate formula and label approvals, the TTB budget justification suggests that TTB "customer satisfaction" is expected to increase. Please describe the methodology used to obtain this contradictory result.

Answer. The specific reference in the Congressional Justification for Appropriations and Annual Performance Report and Plan to increased customer satisfaction relates directly to the impending release of a new version of Permits Online. TTB expects the release of a new version of Permits Online to increase satisfaction rates by improving system-based guidance as well as overall customer experience with the system. TTB will continue its efforts to increase overall customer satisfaction by streamlining internal processes, implementing enhancements to online filing systems, modernizing filing requirements, providing clearer guidance to industry members, and by clearly communicating realistic service standards so that industry members may plan their operations accordingly.

INFRASTRUCTURE

Question. The Trump administration has proposed providing $200 billion to support infrastructure investments, while noting that "more Federal spending" is "not the solution," and while gutting more than $200 billion in existing Federal grant programs.

What is the intended use of the newly supplied $200 billion?

Answer. The President's Infrastructure Initiative takes a fundamentally different approach to how the government funds infrastructure. As stated in the President's budget and accompanying Infrastructure Fact Sheet, the target of $1 trillion in infrastructure investment will be funded through a combination of new Federal funding, incentivized non-Federal funding, and newly prioritized and expedited projects. The $200 billion in Federal investment will be structured to incentivize additional non-Federal funding, and reduce the cost associated with accepting Federal dollars to leverage at least $1 trillion in total infrastructure spending. The infrastructure initiative will also focus on streamlining regulations and permitting; tapping into private sector capital and management methods; and aligning infrastructure with the entity best suited for operation and maintenance.

Question. Is it the intention of this administration to reduce Federal support for infrastructure through the Highway Trust Fund?

Answer. There is a structural deficit that continues to exist within the Highway Trust Fund (HTF) because more is spent annually for transportation programs than the trust fund receives from gas tax revenue and other user fees. The administration does not believe it is appropriate for budgetary presentation purposes to show HTF spending in excess of what the HTF can legally support. Therefore, beginning in 2021, the budget reflects a reduction in HTF outlays to levels that can be supported with existing HTF tax receipts.

The administration looks forward to working in collaboration with Congress to address this structural deficit to sustain the HTF beyond the FAST Act.

Question. Various members of the administration have alluded to using a 10-percent tax to the currently deferred offshore profits to pay for infrastructure investment.

Does the administration intend to use these revenues to pay for infrastructure investment?

Answer. The administration's tax reform principles call for a one-time tax on profits held offshore. The budget makes no assumptions regarding the use of the specific proceeds from repatriation.

CHINA 100-DAY PLAN

Question. In April, Chairman Hatch and I, along with Chairman Brady and Ranking Member Neal, sent a letter to President Trump outlining our key priorities for addressing trade barriers with respect to China. Secretary Mnuchin, as co-chair of the U.S.-China Comprehensive Economic Dialogue, are you committed to making resolution of the issues outlined in that letter your top priority, including by addressing market distorting behavior such as overcapacity that harms American manufacturers, and discriminatory and distortive technology policies, such as China's proposed restrictions on U.S. cloud computing providers? If "yes," what steps have you taken to date to resolve these issues with China?

Answer. I am committed to addressing the issues outlined in your letter. The focus of this administration is on delivering concrete results for our workers and firms. During the April Presidential Summit, we pressed China on a range of priority trade issues, including China's discriminatory technology and cybersecurity policies and its trade-distorting industrial excess capacity. We agreed at that same meeting to undertake with China a 100-day action plan to seek tangible progress on a set of trade and investment issues, and a month later we announced initial commitments by China to expand market access for U.S. agricultural trade and financial services. We continue to press China to address trade distortions, including overcapacity in the steel and aluminum industries, and to ensure non-discriminatory treatment of U.S. technology products and services. We will continue to work through the CED process toward a more fair and balanced economic relationship with China by expanding opportunities for U.S. workers and businesses.

CURRENCY

Question. This administration has issued its first report on foreign exchange policies of major U.S. trade partners—under enhanced criteria and enforcement measures put in place by this committee. In that report, Treasury for the most part followed the analysis of the last administration, which had concluded since April of last year that China is not currently manipulating its currency. In an interview with the *Economist* that you were present at, the President seemed to say that he is not naming China a currency manipulator because of national security concerns—in particular cooperation over North Korea. Could you tell me what the position is of the administration? If China is no longer manipulating its currency, wasn't it also doing so last year when the Obama administration declined to designate them as a manipulator? If you're claiming manipulation ended during the Trump administration, what specific action(s) has China taken this year with respect to its currency practices that support your claim?

Answer. This administration's position places a very high priority on ensuring that American workers and companies face a level playing field when competing internationally. Treasury is committed to aggressively and vigilantly monitoring and combatting currency practices that unfairly disadvantage our exports and unfairly advantage the exports of our trading partners through artificially distorted exchange rates.

China has a long track record of engaging in persistent, large-scale, one-way foreign exchange intervention, doing so for roughly a decade to resist renminbi (RMB) appreciation even as its trade and current account surpluses soared. However, China's recent intervention in foreign exchange markets has sought to prevent a rapid RMB *depreciation* that would have negative consequences for the United States, China, and the global economy.

INTERNATIONAL LABOR AFFAIRS BUREAU

Question. As the President's own budget describes it, the Department of Labor's International Labor Affairs Bureau "promotes a fair global playing field for workers in the United States and around the world by enforcing trade and labor commitments, strengthening labor standards, and combating child labor, forced labor and human trafficking." Given the President's repeated promises to give workers a fair shake in the global economy, why is ILAB's budget being slashed by more than 75%?

Answer. As the Department responsible for promoting economic growth, we are committed to ensuring that workers have a safe and level playing field. Given that the Bureau of International Labor Affairs is not in the jurisdiction of the Department of the Treasury, I am not in a position to comment on its budget. However, we work very collaboratively with the Department of Labor on a number of issues and support their efforts to ensure that trade agreements and preference programs are fair to U.S. workers and companies, and that the exploitation of children and adults is addressed.

RUSSIA OIL TRANSACTION AND U.S. SANCTIONS

Question. Secretary Mnuchin, last week you suggested that the Committee on Foreign Investment in the United States would be prepared to investigate the national security implications of a potential acquisition of Citgo by Russian oil producer Rosneft. That transaction also raises serious concerns regarding the application of U.S. sanctions administered by Treasury's Office of Foreign Assets Control, since as you know both Rosneft and its chairman—a close ally of President Putin—are currently prohibited from participating in certain transactions in the United States and with U.S. entities due to Russian aggression in Crimea. Would Rosneft be barred, under current Treasury sanctions directives, from exercising the lien it holds against Citgo?

Answer. Rosneft is subject to sectoral sanctions that prohibit U.S. persons from (1) transacting or dealing in new Rosneft-issued debt of greater than 90 days maturity, or (2) providing goods, services (other than financial services), or technology in support of exploration or production for deepwater, Arctic offshore, or shale projects that have the potential to produce oil in Russian waters and in which Rosneft is involved. These sectoral sanctions do not preclude Rosneft from obtaining an interest in a U.S. entity.

However, as the details of this potential acquisition are still developing, we cannot yet make a determination as to whether it may ultimately involve other sanctions issues. For example, Igor Sechin, Rosneft's executive chairman, is a Specially Designated National pursuant to Executive Order 13661, and accordingly, his involvement in a potential transaction could have sanctions implications. Treasury will continue to closely monitor the situation.

ACA COST-SHARING PAYMENTS

Question. There's been a lot of discussion about "cost-sharing reduction subsidies," or "CSRs." These are payments made directly to insurers that help cover things like deductibles and co-pays for those between 100–250% of the poverty who bought their insurance on the Exchange. Roughly 7 million Americans have these private plans.

The President has been making these payments since he took office, but recently it's been reported that he is threatening to stop. We have heard from insurers, insurance commissioners, Governors, and other experts, that dangerous rhetoric about CSRs is causing uncertainty in health insurance markets, raising premium rates for hardworking Americans.

The administration's lack of clarity on this is causing turmoil. There is no way that the private sector can continue to operate with this level of uncertainty. Insurers are starting to submit their proposed rates for 2018, and they cite the fact that CSRs remain unresolved as a main reason for premium increases.

With all of the discussion on whether or not CSRs would continue to be paid, my staff discovered that the President's own budget assumes they will continue in 2018. As you know, the Treasury Department administers the CSR payments, and my staff found this information in the Treasury appendix. When I asked you about these payments at the Senate Finance hearing, you couldn't answer the question and said you would get back to me so I am resubmitting the question in writing.

Will the President follow his own budget proposal and continue funding CSR payments next year?

Answer. *See* response below.

Question. If the administration will not commit to funding CSR payments next year, why was it included in the budget?

Answer. The administration recently determined that there is not a valid appropriation for providing CSR payments, and has stopped making them. At the time when the budget was released, White House and agency lawyers were still reviewing the matter.

The administration has emphasized the importance of reforming our health-care system to one that works better for patients and their providers. Our budget proposal calls for Congress to repeal and replace the Affordable Care Act, which could eliminate the need for the CSR subsidy.

QUESTIONS SUBMITTED BY HON. SHERROD BROWN

Question. During a hearing in the Senate Banking Committee, you told Senator Toomey that you want to work with Congress to appropriate the CFPB.

I oppose that change because I am concerned that it could be used to starve the agency of resources, resulting in fewer consumer protections.

When the President's budget came out, it proved me right. The only way to generate the $6.8 billion in savings that you project is by zeroing out the CFPB's entire budget.

Secretary Mnuchin, how can the CFPB protect consumers from predatory lenders and abusive servicers, at banks like OneWest for example, without any money?

Answer. I strongly support robust consumer financial protection. I also believe that the CFPB should be funded through the annual congressional appropriations process like most Federal regulatory agencies. Congress's power of the purse serves as an important check to ensure that regulators exercise their power responsibly and spend taxpayer dollars wisely.

Question. Are you considering including in the administrations tax reform proposal changes to the overall deductibility of interest as a business expense?

Answer. Tax reform is still a work in progress, and we are considering a wide range of changes to the tax system.

Question. Are you considering including in the administrations tax reform proposal changes to the historic tax credit?

Answer. Tax reform is still a work in progress, and we are considering a wide range of changes to the tax system.

Question. When will the administration present Congress with a proposal to repeal the Multiemployer Pension Rehabilitation Act and replace that legislation with a permanent solution to protect the pensions of participants in the Central States Teamsters Pension, the United Mine Workers Association Pension, and every other distressed multiemployer pension plan?

Answer. Treasury is committed to working with Congress and other stakeholders to develop fiscally responsible solutions to address the issues that continue to face multiemployer pension plans. For Treasury, fiscally responsible solutions would avoid the need for additional Federal funding. In the interim, we continue to work hard on fulfilling our role of administering the law as it currently stands.

QUESTIONS SUBMITTED BY HON. BENJAMIN L. CARDIN

Question. When you met with the Senate Finance Committee members in May, I was encouraged by your statements that the administration would prefer to put together a bipartisan tax reform bill. I believe that the only way we can get to strong bipartisan reform is by having a public and transparent tax reform process.

I understand that before last week's hearing, you reached out to Senate Finance Committee staff in order to schedule a meeting to discuss your tax reform package. And, last weekend, President Trump indicated via Twitter that his tax reform package was "moving along in the process very well, actually ahead of schedule."

Could you clarify what schedule and steps in the "process" Mr. Trump is referring to?

Answer. *See* response below.

Question. In addition to the meeting you mentioned during the hearing, do you have any specific plans in place coordinate with the Senate Finance Committee regularly on a bipartisan basis as you flesh out the details of your tax reform overview? If so, what are those plans?

Answer. *See* response below.

Question. Do you agree that public hearings would be helpful not only to building bipartisan consensus, but also to providing a transparent process for our constituents? Again, without this transparency and public buy-in, I do not think bipartisan tax reform is achievable.

Answer. We have had numerous meetings with members of Congress on both sides of the aisle and their staffs, along with many other stakeholders. We welcome input from all interested parties and look forward to continuing to work with the Congress to achieve our shared goal of comprehensive tax reform that grows our economy and provides middle-income tax relief.

Question. Before I joined the U.S. Congress, I was a State legislator in Maryland. Because of that experience, I know how important the partnership between the Federal Government and State and local governments can be.

The budget already targets programs that are important to State and local governments outside of Treasury's jurisdiction. Within your jurisdiction, I'm particularly concerned about the fate of the State and local tax deduction.

I know that you're still working on the details of your tax reform plan. But I also understand from our bipartisan meeting last week—and your other statements in the past and during the hearing—that the State and local tax deduction will be eliminated.

Could you confirm whether you are still considering eliminating the State and local tax deduction? If so, how do you respond to the concern that you are raising revenues through what amounts to double taxation? Essentially, your plan would be taxing income, property, and purchases twice. This may not matter as much to the lowest and highest income brackets but it does matter to households who are considered in the middle class, especially in high cost of living areas.

Answer. *See* response below.

Question. How do you respond to the concern that you are limiting the ability of State and local governments to govern as they see fit? The deduction has been in place since the beginning of our income tax system. Many State and local government organizations are against eliminating the deduction. I understand that President Trump wants to see State and local governments retain flexibility in helping their citizens. If that's the case, I'm curious as to your reasoning behind targeting this deduction in particular.

Answer. *See* response below.

Question. Finally, if you are still considering eliminating the State and local tax deduction, are you targeting all State and local tax deductions, or just the State and local income tax deduction? For example, as you know, taxpayers can deduct State and local general sales tax instead of State and local income tax. During the hearing, Senator Heller raised the State and local deduction and sales taxes, and your answer to that issue was a bit unclear. In particular, you said, "We'd be more than happy to work with you, and you don't have State taxes, so I can assure you the people who have State taxes really call me on this one." A clarification on this issue from you would be helpful.

Answer. The deduction for State and local taxes allows taxpayers who itemize to choose to deduct either State income taxes or sales taxes, which provides an opportunity for the tax deduction in states that do not impose income taxes. Modifying the tax treatment of State and local tax deductions is something that should be considered in the broader context of tax reform. Tax reform is still an ongoing process, and I am confident that Congress will ultimately pass into law pro-growth tax reform that provides middle-income tax relief.

Question. During your hearing, you took a number of revenue-raising "base broadeners" off the table that are needed to make the administration's tax cuts revenue-neutral. Many of these "base broadeners" represent large tax expenditures, such as accelerated depreciation. On the one hand, it was very useful to hear these specifics. As you know, one of the biggest concerns we hear from taxpayers has been the lack of certainty surrounding the tax reform process, including the "loopholes" referenced in President Trump's tax plan. On the other hand, by eliminating the consideration of these "base broadeners," the administration has made it very difficult to pay for the large tax cuts that Mr. Trump is proposing, without turning to deficit-financed cuts, or using an alternative revenue source.

Do you have any concerns about the impact that deficit-financed tax cuts could have on the middle class? For instance, tax cuts financed with government debt could raise interest rates, which could have a significant impact on the cost of things like mortgages and car loans for many middle-income households.

Answer. We are concerned about welfare of hardworking American families, and that is why middle-income tax relief is a priority for tax reform. We expect, of course, that in addition to direct tax relief, the middle class would benefit from the jobs and higher wages that would accompany pro-growth tax reform.

Question. Are you considering any alternative revenue sources as you flesh out the details of the administration's tax reform proposal? For instance, in your recent hearing before our House Ways and Means colleagues, you suggested a value-added tax could be used to pay for tax reform as an alternative to the House's border adjustability tax. You and I have also discussed my Progressive Consumption Tax Act, which imposes a 10-percent consumption tax, lowers the individual income tax, and lowers the corporate tax, in a way that is at least as progressive as our current system.

Answer. We expect to raise revenue from base broadening, including repealing special interest tax breaks. Such changes also will make the tax code more equitable and more efficient.

Question. During your hearing, you answered a series of questions about the "economic feedback" effects incorporated into your budget.

In particular, to questions regarding the double-counting of economic growth obtained through tax reform, you stated the "intent was not to do double-counting" and that instead you "overlaid the administration's plans for growth" but that "we do not have tax changes, so we did not model in tax changes."

To clarify, did you mean that the administration was comfortable modeling the growth benefits of tax reform—but did not feel comfortable modeling the costs of tax reform?

Answer. *See* response below.

Question. If so, could you please share the assumptions you made to model the growth benefits, and the reasons why those assumptions could not be used to model the costs of tax reform?

Answer. *See* response below.

Question. If not, could you explain what you meant by the statements above?

Answer. Our tax reform principles outlined in the budget are simply that—principles or targets that would inform a desirable tax system. We did not put forth, nor did we model in the budget, a complete set of specific proposals consistent with those principles. The budget does reflect, however, our view that appropriate tax reform can contribute significantly to economic growth.

Question. You also responded to the question "Is the growth coming through tax changes?" in the following way: "One of them, but there's also plenty of other economic policies, trade policies, or whether it's our regulatory policies. There's plenty of other things that will impact the growth."

Could you please share a list of the other economic policies that contributed to the growth effects in your budget? Could you also indicate how much economic growth was estimated to be gained from those other, non-tax policies?

Answer. We anticipate that economic growth will result from a combination of tax reform, regulatory reform, and trade reform. We believe it is reasonable to expect that tax reform alone can significantly add to economic growth, which can in turn increase tax revenues. We did not put forth, nor did we model in the budget, specific trade and regulatory reform proposals because the administration is still evaluating those reform proposals.

Question. During the hearing, and in other public forums like the meeting of the G7, you stated that "over 70 percent of the cost of corporate taxes are actually borne by the worker," and so reducing the corporate tax rate will mean increased wages and opportunities for U.S. workers.

I support making our tax code more competitive and doing so in a way that helps American workers. However, it's my understanding that the incidence of the corporate tax burden is quite controversial. For instance, the Joint Committee on Taxation staff follows what I believe is the middle range of the current economic literature by assuming that 25 percent of corporate income taxes are borne by domestic labor and 75 percent are borne by owners of domestic capital—almost the opposite of what you are assuming.

Could you please clarify the sources for your assumptions (in the hearing, you mentioned "multiple economic studies")?

Answer. *See* response below.

Question. In addition, is it your position that your "70% on workers" assumption represents a consensus economic position, or falls in the middle of the range proposed by economists?

Answer. *See* response below.

Question. If not, could you please explain why you have chosen a position without consensus in arguing that a corporate rate reduction will benefit workers more than shareholders?

Answer. I was expressing an informed opinion based on available information. While estimates of the incidence of the corporate income tax by reputable economists and organizations span a range, most economists agree that a substantial share of the burden of the tax is shifted onto labor. Recent literature reviews include two CBO working papers (*e.g.,* Jennifer Gravelle's working papers 2010–3 and 2011–01) and a recent paper by Professor Glenn Hubbard (Azemar and Hubbard in the *Canadian Journal of Economics,* December 2015). This literature shows that 70 percent shifted to workers is within the realm of reasonableness. Hubbard, for example, has new results that suggest about 60 percent is shifted to labor. Another frequently cited CBO paper by William Randolph has 70 percent shifted to labor. Some studies have over 100 percent of the burden shifted to labor.

QUESTIONS SUBMITTED BY HON. JOHN CORNYN

Question. Mr. Secretary, I want to circle back on a topic that we initially discussed in my office prior to your confirmation, and that we discussed again about a month ago. The Committee on Foreign Investment in the United States, or CFIUS, plays a very important role in reviewing foreign investment transactions and vetting them for national security risks. As we speak, China continues its aggressive campaign to vacuum up advanced U.S. technology however and wherever it can, whether stealing it through cyber means, taking advantage of research environments within U.S. academic institutions to get it, and investing in companies that have it.

I consider this to be a serious and growing national security problem, which is why I am working on legislation to close obvious gaps in the CFIUS process. China seeks not just the technology, but also U.S. "know-how," the so-called human capital that resides with these U.S. companies, and that is not something our export control system really guards against. It is clear that China has identified the gaps in our processes, as the Director of the National Security Agency, Admiral Mike Rogers, recently said in testimony before another Senate committee. In particular, China continues to coerce U.S. companies into forming joint ventures, based in China, with Chinese entities for the purpose of getting U.S. technology. These joint ventures, in most cases, are not subject to CFIUS jurisdiction, which is a glaring problem.

Another one of these gaps is what others have dubbed, "foundational technologies," or early-stage technologies that are so cutting-edge, so new that they are beyond the current reach of our export control system, at least until it figures out how to categorize them. These are the technologies that China wants and has had some success in getting its hands on.

Do you agree that, in the past few years, China has been exploiting the open investment system that we have in the United States, particularly with an eye towards harvesting our technology?

Answer. China's industrial policies for technology explicitly State the aim of acquiring know-how to promote indigenous Chinese "champions." To the extent that it seeks to carry out these policies through acquisition of U.S. technology, and to the extent that any country seeks to acquire U.S. technology in pursuit of strategic objectives, it is appropriate and necessary for us to consider the impact of such activities on U.S. national security, including—importantly—through CFIUS. CFIUS is one of several tools, like export controls, that the United States has to address concerns related to transactions involving potential technology transfer risks. We are prepared to work with Congress to ensure that the U.S. Government has the necessary and appropriate tools to address any emerging national security risks.

Question. Do you feel like the current CFIUS process adequately protects against this threat, or are targeted and measured legislative reforms needed?

Answer. *See* previous response.

Question. Mr. Secretary, President Obama's first budget in 2009 assumed an average growth rate of 4 percent over the first 4 years. President Trump's budget assumes less than 2.8 percent over the next 4 years. In addition, President's Obama's first budget assumed an average growth of 3.2 percent over 10 years; President Trump's budget assumes 2.9 percent. In seven of the eight budgets submitted by the previous administration, 3 percent or more of economic growth was assumed at some point in time. Finally, half of the budgets proposed by President Obama also assumed annual growth of more than 4 percent sometime in the 10-year budget window.

With this mind, how would you describe the economic assumptions in the President's budget?

Answer. They are reasonable post-policy assumptions.

Question. What factors or policies do they reflect?

Answer. We anticipate that economic growth will result from a combination of tax reform, regulatory reform, and trade reform. We believe it is reasonable to expect that tax reform alone can significantly add to economic growth, which can in turn increase tax revenues. We did not put forth, nor did we model in the budget, specific trade and regulatory reform proposals because the administration is still evaluating those reform proposals.

Question. As you may know, Texas has led the Nation in exports since 2002. In 2016 alone, Texas farmers, ranchers, and manufacturers exported more than $232 billion worth of goods to buyers around the globe. In fact, $92 billion worth of goods went to Mexico, which represented more than 37 percent of the State's total goods exports.

NAFTA went into effect in 1994—more than 23-years ago—and has provided significant opportunities for American businesses and consumers. Today, 8 million U.S. jobs depend on trade with Canada, and more than 5 million U.S. jobs depend on trade with Mexico. That means hundreds of thousands of jobs in each State depend on trade with our NAFTA partners. In Texas, more than 380,000 jobs depend on trade with Mexico.

I recently discussed the importance of NAFTA with Secretary of Commerce Wilbur Ross and U.S. Trade Representative Bob Lighthizer. They mentioned to me that their number-one priority in modernizing NAFTA is to "do no harm." I could not agree more. With the number of benefits trade and NAFTA represent to my State, you can see how doing no harm is pretty important to those who grow, raise, and assemble the products we consume in Texas and sell internationally.

With that said, what role will you play in the NAFTA negotiations?

Answer. Treasury co-leads with USTR negotiations in financial services and works closely with U.S. financial regulators, Congress, the financial services industry, and other stakeholders to develop and review trade proposals that advance U.S. economic priorities, preserve the ability of U.S. regulators to safeguard the integrity of the financial system, and protect taxpayers.

Treasury also leads on issues related to currency, tax policy, and some areas of Customs policy. Treasury is engaged in the interagency process to determine U.S. trade policy and sends negotiators to rounds of trade talks, as needed.

Question. Can you elaborate on the priorities this administration will seek to achieve in NAFTA negotiations?

Answer. The administration will inform Congress of our detailed negotiating objectives according to the timeframes set out in Trade Promotion Authority (TPA). USTR, in consultation with Treasury and other agencies, is considering the objectives in the context of TPA and will also take into account points raised in consultations with Congress, and the public, including the public hearing on June 27th.

QUESTIONS SUBMITTED BY HON. DEAN HELLER

Question. I have strongly opposed the 385 rules, which Treasury finalized in October 2016. As you know, these rules would impact ordinary day-to-day transactions involving related-party debt. I'm aware of many businesses—from small businesses to large multinationals—in my home State that would have been detrimentally impacted had I not pushed on Treasury to modify its rules. Although we have seen some welcome changes made to these rules once finalized, I believe these rules were an overreach by the previous administration and that an overhaul of the tax code is the only thing that can and will address Treasury's concerns on inversions. Pursuant to the executive order issued this April, Treasury is currently reviewing "significant" tax regulations that "impose an undue financial burden on [American] taxpayers, add undue complexity . . . , or exceed statutory authority."

What is the status of this review? Is Treasury planning to withdraw the 385 rules in the near future?

Answer. On April 21, 2017, President Trump signed Executive Order 13789, which orders the Secretary to immediately review all significant tax regulations issued by the Department of the Treasury on or after January 1, 2016, and, in consultation with the Administrator of the Office of Information and Regulatory Affairs, Office of Management and Budget, identify in an interim report to the President all such regulations that: (1) impose an undue financial burden on United States taxpayers; (2) add undue complexity to the Federal tax laws; or (3) exceed the statutory authority of the Internal Revenue Service. The Treasury Department completed that review on October 2, 2017. With respect to the section 385 regulations, the Treasury and IRS have delayed application of the burdensome documentation rules until 2019. I also anticipate that tax reform legislation will address the distortions and earnings stripping and other tax incentives that lead to inversions so that the section 385 distribution regulations can be revoked.

Question. Since coming to Congress, I have been an outspoken advocate for parity between tax credits for solar, geothermal, and other innovative technologies. However, due to a drafting error, the section 48 investment tax credits (ITCs) for certain innovative technologies—including commercial geothermal—were inadvertently omitted from the 2015 PATH Act. The resulting disparity in tax treatment has created an uneven playing field that disincentivizes investment in these orphan technologies. Since the PATH Act's passage, I have been working with my colleagues to rectify the situation and secure a fix for commercial geothermal and other orphan technologies. This fix is critically important for the alternative energy sectors in Nevada, which have the potential of creating a huge number of jobs in the State.

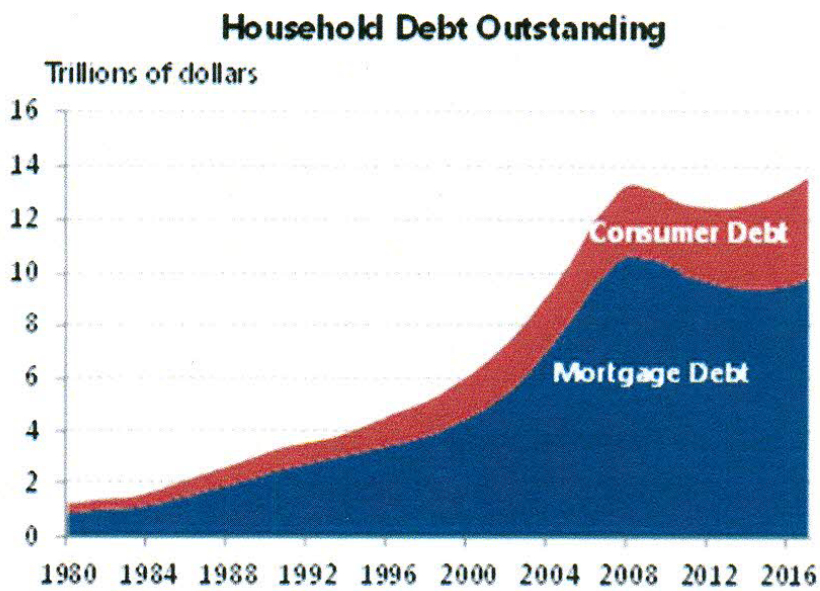
Do you have any concerns or problems with providing parity across the alternative energy sectors so that all section 48 technologies are treated equally?

Answer. It is a priority of this administration to promote U.S. energy sources, and we recognize the important role that all of the different technologies play in the promotion of U.S. energy sources, both in terms of energy production and job creation. We hope to continue to work with Congress to support innovative energy solutions.

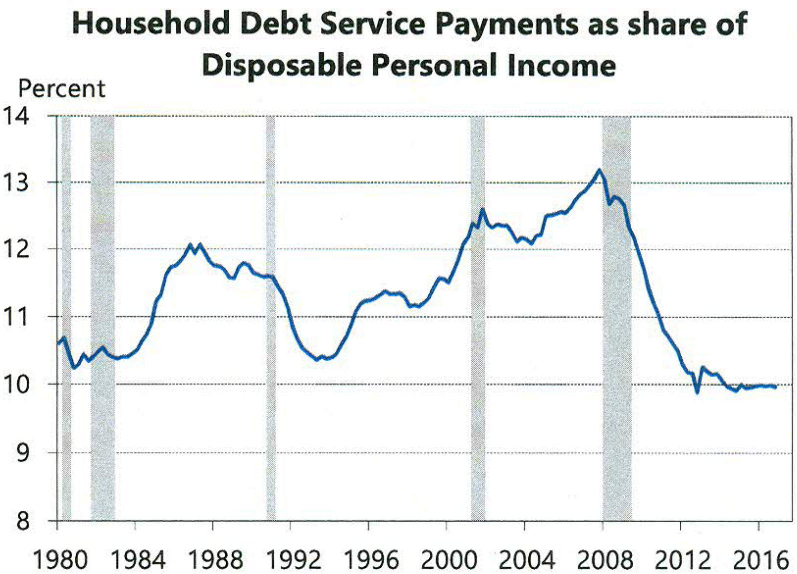
Question. According to a recent report in the *Reno Gazette-Journal,* U.S. consumer debt—including student debt, credit card debt, and auto debt—is approaching $13 trillion.

Do you think the current indebtedness of American consumers will hinder the growth of our Nation's economy? If not, how much more can consumer debt grow before it begins to negatively impact economic growth?

Answer. Consumer borrowing does not appear to be a near-term threat to economic growth, despite its currently high level. In Q1, consumer credit outstanding reached $3.8 trillion, equivalent to 26.5 percent of disposable personal income and the highest proportion in 46 years. Combined with mortgage debt, household debt stood at $13.6 trillion in Q1, equivalent to 94.7 percent of disposable personal income. Although aggregate household debt levels have risen, the debt service ratio, or share of debt service payments in disposable personal income, has remained near historic lows for the past 2 years. In the latest data available, the household debt service ratio was 10.0 percent in 2016 Q4, well below the series peak of 13.2 percent reached in 2007.



Healthy household balance sheets also support the argument that consumer borrowing presents only a modest risk to the near-term outlook. In Q1, net worth rose to 662 percent of disposable income—the highest level since 1955—supported by gains in real estate assets, corporate equities, mutual funds, and retirement accounts. Consumer credit and mortgage debt account for 14.3 percent of household net worth in Q1, and owner's equity in real estate has risen to 58.3 percent as interest rates have remained low and households have paid down mortgage debt. In recent quarters, consumer borrowing has supported the economy amidst slow real wage growth (the latter a result of persistently slow productivity growth in the past few years).



Although consumer borrowing may not be a risk to current economic growth, there are possible downside risks: (1) abrupt increases in interest rates, (2) wealth shocks, and (3) unemployment and income loss. Each of these shocks has the potential to increase debt-service payments, constrain consumption, and increase the probability of default. Of the three broad shocks, quickly rising interest rates poses a low immediate risk since about 73 percent of household debt is from mortgages, often locked in by fixed rates. Overall delinquency rates (including credit cards, auto loans, mortgages, and student loans) have been little changed in recent quarters but auto delinquency rates have shown a modest uptick. In addition, the Federal Reserve has signaled that it anticipates raising interest rates very gradually.

Question. The Trump administration has indicated that it is in favor of repealing all personal deductions except those for mortgage interest and charitable contributions. However, repealing the State and local tax (SALT) deduction would cause the Federal taxes of Nevadans who itemize to go up by more than $1,000 on average, according to a recent Tax Policy Center analysis.

Will you commit to working with me to ensure that the majority of Nevadans are better off under any tax reform that occurs?

Answer. We are committed to reforming the tax system to produce better outcomes for Americans in all States, Nevada included. One important consideration is the effect tax reform will have on economic growth, which can help to improve the situation of some who may lose specially targeted tax breaks.

Question. Declining home prices and rising foreclosure rates have forced many Nevada families to sell their homes for less than they paid for them, and in some cases for less than the outstanding debt. Homeowners in these hardship situations still unfairly face additional income taxes if part of their mortgage loan is forgiven. I have worked and continue to work with several members of this committee to try to find some relief for those individuals being asked to pay taxes on income they have never received.

Given tax reform is moving forward, how would you address this issue?

Answer. As you know, we are working closely with Congress to develop a tax reform package. I am, of course, willing to consider tax relief that would exclude from tax the value of forgiven home mortgage debt.

QUESTION SUBMITTED BY HON. CLAIRE McCASKILL

Question. Since January 2017, I have sent five letters to the Treasury Department regarding its ability to address potential conflicts of interest stemming from President Trump's failure to divest his financial holdings. As I described in these letters, the Treasury may confront conflicts arising during its money laundering investigations, Financial Stability Oversight Council (FSOC) deliberations, and Committee on Foreign Investment in the United States (CFIUS) reviews. In addition, President Trump has tasked the Treasury with receiving profits the Trump Organization will generate from foreign government patronage of Trump-owned hotels and similar businesses. As a result, the Treasury now stands on the front lines of the effort to mitigate President Trump's serious and wide-ranging conflicts of interest.

In response to these concerns, the Treasury sent a letter dated March 31, 2017, in which it merely stated, quote, "Treasury diligently monitors its own compliance with the applicable conflicts of interest laws," and "Treasury's ethics officials work with agency personnel to address and mitigate potential conflicts if and when they arise." Treasury provided a similar response in another letter on May 19, 2017. These inadequate responses suggest the Treasury is unable or unwilling to develop the policies and procedures necessary to shield it from apparent or actual conflicts of interest.

Can Secretary Mnuchin pledge to me and the committee that the Treasury will provide substantive answers to all requests and will work with Congress to address the conflicts of interest challenges posed by the President's holdings?

Answer. Treasury is committed to responding appropriately to requests for information for members of Congress. As stated in the March 31, 2017 and May 19, 2017 letters, Treasury is committed to addressing and mitigating all potential conflicts of interest within its jurisdiction under applicable law if and when they arise.

QUESTIONS SUBMITTED BY HON. TIM SCOTT

Question. The Foreign Accounts Tax Compliance Act (FATCA) was intended to prohibit the use of international financial accounts and transactions to evade Federal income taxes. However, under the previous administration, the IRS and Treasury Department decided that such transactions should be treated as "withholdable payments" and therefore included under the FATCA enforcement regime. International property and casualty insurance transactions have no cash value and can't be used to evade taxes. The inclusion of these transactions under FATCA does not help fight tax evasion, but brings about a significant cost in regulatory compliance.

Please answer the following questions as specifically as possible.

What is your understanding of the previous administration's justification for treating property and casualty premiums as withholdable payments under FATCA?

Answer. *See* response below.

Question. Does the administration believe that the extraterritoriality of capturing insurance agreements on U.S. risk between foreign persons under FATCA is justified?

Answer. *See* response below.

Question. Can your Department issue additional guidance around the definition of when a premium is U.S.-sourced in an effort to reduce the burdens associated with FATCA compliance for insurers and reinsurers?

Answer. *See* response below.

Question. Is the Treasury Department willing to determine if there is a legitimate purpose to imposing FATCA requirements on property and casualty premiums that outweighs the significant burdens on the insurance industry and policyholders?

Answer. This is a complicated issue because, on the one hand, non-cash-value insurance contracts present a low risk of tax evasion, but on the other, we are aware that some foreign insurance companies that issue only non-cash-value insurance contracts are being used by their U.S. owners to avoid reporting certain income to the IRS. The FATCA regulations take these different risk profiles into account and exclude non-cash-value insurance contracts from the definition of a "financial account" and therefore the beneficial owner of the contract is not required to be documented and reported under FATCA. However, a privately held foreign insurance company with substantial passive assets may be treated as passive non-financial foreign entity (passive NFFE) to ensure that information on the U.S. owners of these companies is reported to the IRS. The withholding on premiums paid to insurance contracts may be subject to withholding when the payment is made to a passive NFFE to incentivize the entity to certify to withholding agents whether such entity has any substantial U.S. owners, and if so, to provide certain information to the withholding agent to avoid being withheld upon.

Treasury and the IRS have had many discussions with stakeholders specifically regarding how the FATCA rules should apply to non-cash-value insurance contracts and the companies that issue them, including the development of a regime for directly reporting NFFEs that further streamlines the information reporting of substantial U.S. owners with regards to passive NFFEs. The Treasury Department and the IRS will continue to engage interested stakeholders to implement FATCA in a manner that appropriately balances the compliance objectives of the statute with the burdens imposed.

QUESTIONS SUBMITTED BY HON. DEBBIE STABENOW

Question. I believe that we do not have an economy or a middle class unless we are making things and growing things here in the United States. To stay ahead of the global competition, we must be at the forefront of investment in research and development. Any changes to our tax code should not put at risk the advantage the United States has in R&D and we must find ways to foster that advantage. According to both the Treasury Department and private studies, the R&D tax credit has created economic and job growth in the United States, and kept us competitive with the rest of the world. These are high-paying, good jobs that we should be fighting to keep, and we should not miss opportunities to help encourage businesses to move their R&D inside our borders.

Do you support maintaining and strengthening the R&D tax credit to encourage companies to move their innovation facilities to the United States?

Answer. The administration supports maintaining and strengthening the R&D tax credit.

Question. How will you ensure that U.S. R&D stays ahead of the rest of the world and that companies increase their high-paying research jobs here in the United States?

Answer. The administration supports policies that make the United States a more attractive place for businesses to invest, including in R&D. Specifically, tax reform that reduces the tax rate on businesses would encourage job creation and economic growth. In addition, the administration is committed to eliminating unnecessary and wasteful regulations that function much like taxes by inhibiting economic growth and employment.

Question. In recent iterations of tax reform proposals, consideration was given to closely held businesses. Closely held businesses make significant investments in our economy and are impacted differently than corporations by the tax code. What consideration do you plan to give closely held businesses when reforming the tax code?

Answer. The administration agrees that closely held businesses, including operating partnerships and S corporations, make significant economic and social contributions to the U.S. economy. We are considering tax reform proposals that would provide all businesses, including such closely held businesses, a tax cut.

Question. As you well know, our tax code should be predictable and fair so businesses are able to make long-term plans. One such example has been the business interest expenses deduction, which has been around for nearly 100 years. Businesses of all sizes and industries rely on credit financing and interest deduction to expand their operations, and this is particularly true of small businesses, which are more likely to rely on loans to be able to invest and grow. We need to make sure that we are not raising costs for businesses that are investing in equipment and jobs.

Do you believe interest deductibility is currently a critical tool to help businesses maintain their operations and expand?

Answer. Tax burdens are reduced by lower statutory rates and more generous exemptions, deductions, and credits. Loss of particular tax preferences can be offset by increasing others. Interest expense is typically fully deductible under current

U.S. corporate income tax law, meaning that investment financed by debt, unlike that financed by equity, bears no burden from U.S. corporate income tax on the margin. Many tax reform plans reduce this tax preference for debt by limiting the deductibility of interest and/or reducing the tax burden on investment financed with equity. Eliminating this tax distortion is considered to improve efficiency by, for example, reducing the chances of bankruptcy.

Question. Would elimination or limitation of interest deductibility influence businesses' decisions to invest?

Answer. In isolation, yes, but most tax reform plans fully offset the effect on investment decisions by expanding deductions for equity-financed investment and/or lowering statutory tax rates.

Question. How would the mix of rising interest rates along with the elimination of interest deductibility affect the ability of business owners to borrow and invest in growing their businesses?

Answer. Nominal interest rates reflect inflation and real interest rates. If interest rates rise due to a rise in inflation, revenues typically rise to offset the rise in debt service and other costs. Increases in real interest rates burden borrowers (and reward savers) whether or not interest expense is fully deductible, but the increase in burden is larger with less interest deductibility, in isolation (assuming no offsetting changes in the tax code).

Question. What role does credit financing and interest deductibility through the current tax code play for these small businesses?

Answer. Interest deductibility reduces the tax burden of small businesses, like all other deductions, exemptions, credits, and reduced statutory tax rates.

Question. Whether I can support a tax reform proposal is going to be based on how it will help families in Michigan. That means creating good-paying jobs by promoting manufacturing and agriculture; making sure that we have a well-trained workforce; relieving high cost burdens on middle class such as child care and higher education place; and being fiscally responsible. We need to bring jobs back to the United States, promote innovation, and help small businesses grow and thrive. The administration's proposal did not provide any clarity about how it will help families in Michigan. Estimates from the nonpartisan Tax Policy Center suggest that almost half of the benefits from your tax proposal go to the top 1 percent, and the proposal provides no information about how it will help manufacturing or encourage the creation of good domestic jobs.

How is your proposal going to help an average family in Michigan?

Answer. Middle-income tax relief for all American families, including those in Michigan, is a priority for tax reform. We expect that in addition to direct tax relief for middle-income families, American workers would benefit from the jobs and higher wages that would accompany pro-growth tax reform.

Question. How would this proposal promote manufacturing and create good-paying jobs in Michigan?

Answer. Tax reform that reduces the tax rate on businesses would encourage job creation and economic growth, including in the manufacturing sector, a key source of good-paying jobs in Michigan.

Question. President Trump promised that he would not cut Social Security. However, the budget does exactly that, cutting tens of billions of dollars from Social Security Disability Insurance. These cuts would hurt some of the most vulnerable Americans.

OMB Director Mulvaney said that these cuts do not violate President Trump's campaign promise not to cut Social Security because Social Security Disability Insurance is not what people think of when they think of Social Security. Do you agree with him?

Answer. The Social Security payroll tax funds both the Old Age and Survivors program and the Disability Insurance program. Most workers expect to receive benefits from the Old Age and Survivors program when they retire, and likely welcome reforms to Disability Insurance that promote, where feasible, labor force participation of people with disabilities and help individuals with temporary disabilities return to work.

Question. OMB Director Mulvaney said that Social Security Disability Insurance is "welfare . . . for the long-term disabled." Do you agree with that statement?

Answer. Disability Insurance improves the welfare of the long-term disabled.

Question. OMB Director Mulvaney said that he "hopes" that people lose benefits or get less in benefits under the administration's proposed Social Security cuts. Do you agree with that statement?

Answer. Reforms that promote, where feasible, labor force participation of people with disabilities and help individuals with temporary disabilities return to work should be encouraged.

Question. There is no question we are facing a looming crisis on multiemployer pensions. Some multiemployer plans—like Central States, which affects 47,000 workers and retirees in Michigan—are at imminent risk of not being able to pay out all of the benefits that workers have earned over a lifelong career, and given up pay raises and other benefits for. When you had your nominations hearing, I asked you how the administration planned to address this issue, and you did not provide any specifics. In fact, your response to my questions for the record on pensions—which I submitted twice—were very generic. I sent you, Secretary Ross, and Secretary Acosta a letter asking again what this administration proposes as a way to secure workers' much-needed and hard-earned pensions. Your response did not outline any plan to address the solvency of the PBGC, or the looming cuts to earned pension benefits.

How does the administration propose to address multiemployer pensions?

Answer. The administration is committed to working with Congress and other stakeholders to develop a fiscally responsible solution that will address the issues that multiemployer pension plans continue to face. For us, fiscally responsible solutions would avoid the need for additional Federal funding.

Question. If the administration does not yet have a proposal, what specific steps are being taken right now to develop one?

Answer. Treasury has been meeting with stakeholders on this issue, and it was discussed at the June 21, 2017 meeting of the PBGC board. Treasury is committed to working with Congress and other stakeholders to develop a fiscally responsible solution that will address the issues that multiemployer pension plans continue to face.

Question. The administration did provide one proposal in the budget to change the way PBGC assesses premiums in an effort to improve its solvency. How would that proposal increase premiums?

Answer. The budget proposes to create a variable-rate premium (VRP) and an exit premium in PBGC's multiemployer program. The VRP would require plans to pay additional premiums based on their level of underfunding, as is done in the single-employer program. An exit premium assessed on employers that withdraw from a plan would compensate the insurance program for the additional risk imposed on it when employers exit. Premium rate changes would be phased in over the 10-year budget window. PBGC would have limited authority to design waivers for some or all of the variable rate premium assessed to terminated plans or ongoing plans that are in critical status, if there is a substantial risk that the payment of premiums will accelerate plan insolvency resulting in earlier financial assistance to the plan. Aggregate waivers for a year would be limited to 25% of anticipated total multiemployer variable rate premiums for all plans. In my capacity as a Board member of the PBGC, I will continue to work with the other Board members to continually evaluate various options for working with distressed multiemployer and single-employer plans.

Question. What would be the impact of those increased premiums on employers and employer participation in multiemployer pension plans?

Answer. The proposal is not expected to have a significant effect on employer participation in multiemployer plans. The inclusion of waiver authority is intended to limit the negative impacts that increased premiums could have on certain plans in critical status.

Question. Why does this proposal not address the very low PBGC guarantee level for multiemployer pension benefits?

Answer. The budget proposal does not include changes to PBGC guarantee levels for either the multiemployer or single-employer programs. In my capacity as a board member of the PBGC, I will continue to work with the other board members to evaluate various options for working with distressed multiemployer and single-employer plans.

Question. Your tax reform proposal maintains the mortgage interest deduction, but significantly increases the standard deduction. This would cause about 25 million homeowners to lose the value of the mortgage interest deduction, because a married couple would need to have a home loan of at least $608,000 (almost triple the mortgage on a median U.S. home) before their mortgage interest deduction would be more than the standard deduction. In fact, between the impact these proposals would have on the mortgage interest deduction and your administration's consideration of eliminating the deduction for State and local taxes, taxes could actually go up for some homeowners.

What impact do you believe your proposal would have on housing prices and the housing market as a whole?

Answer. If families choose a doubled standard deduction, their tax bills will be lower than they would be if the current-law standard deduction continued. In addition, the doubled standard deduction would *lower* the tax bills not only of the families that you mention but also of both home-owning families that do not itemize today and renters, who cannot claim the mortgage interest deduction at all today but could dedicate their tax savings toward building up down payments for "starter homes." These reductions in middle-class families' taxes will buoy the housing market through economic growth.

Limiting deductions for home mortgage interest and real property taxes would likely have only a modest effect on the price of housing, even in the very short run. Moreover, in the long run, the price of housing is likely to be relatively insensitive to changes in tax policy.

QUESTIONS SUBMITTED BY HON. JOHN THUNE

Question. On May 17, 2017, I introduced the Investment in New Ventures and Economic Success Today Act (S. 1144). The bill is an approach that will allow businesses, farms, and ranches in South Dakota and across the country to recover their capital investments faster—for many expensing them immediately. The administration's tax reform framework focuses on the other main tool we can use in tax reform to foster economic growth—reducing tax rates. How does the administration see expensing and faster cost recovery fitting into the President's tax reform framework?

Answer. We have been working with the Congress on many aspects of tax reform intended to promote economic growth, including some type of accelerated cost recovery. I am confident that Congress will ultimately produce legislation that provides economic growth and middle-income tax relief for Americans across the country, including South Dakota.

Question. Last month, you and Director Cohn released the President's framework for tax reform. At that time, you indicated that you would be holding listening sessions and discussions with taxpayers, businesses, Congress, and other stakeholders. Can you share with the committee some of the feedback you have been receiving with respect to the President's framework and any other areas that need to be addressed in tax reform?

Answer. I have spent a great deal of time this year working on tax reform and that includes meeting with members of Congress, both Republicans and Democrats, as well as meeting with workers and business owners in different parts of the country. The one thing that nearly everyone agrees on is the need to make our tax code simpler and fairer so that it creates economic growth and provides a tax cut to middle-income Americans. As the tax reform process continues, I am confident Congress will pass legislation that accomplishes these goals.

Question. Under the President's April 21st executive order, you are in the process of identifying regulations within the Treasury Department that impose undue financial burden and complexity. I believe there are a number of final regulations that were promulgated by the last administration that should be on that list. It is unclear, however, how you plan on handling regulations that were proposed but not finalized—ones like the estate tax valuation discount regulations that the Obama administration proposed in August of 2016. These regulations, if finalized, would make it more difficult for owners of family farms and businesses to pass them on to future generations and significantly increase the estate-tax burden on family businesses. Mr. Secretary, as part of your review of regulations, will you include proposed regulations? In addition, will you withdraw those proposed regulations that were not finalized in order to give taxpayers confidence that these proposals will not move forward without at least being reproposed?

Answer. The Treasury Department's review of post-2015 regulations pursuant to the President's April 21, 2017, executive order has included all regulations—final as well as proposed and temporary regulations. For each regulation that we determine meets the criteria of the executive order, we will determine separately for each such regulation whether it should be withdrawn, reproposed, or finalized with changes made in accordance with the usual regulatory process and in response to the public comments received.

Question. I was pleased to see that the administration's tax-reform framework seeks to preserve the incentive for charitable giving. Stakeholders have raised concerns, however, that increasing the standard deduction could create disincentives for charitable giving. Have you looked at that potential interaction? Are there other steps we can take to encourage charitable giving so the generosity of Americans can continue to be put to work in our communities helping those in need?

Answer. We have made clear that it is important to have a tax incentive for charitable giving. A reformed tax system has multiple goals, including simplicity, fairness, and efficiency, all broadly conceived. An increased standard deduction, in combination with reduced tax incentives that favor the wealthy or special interests, seem to us to help advance these goals. We do not anticipate that increasing the standard deduction will cause former users of the itemized deduction to markedly change their charitable giving.

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

What the American people demand of us is bipartisan cooperation on taxes, health care, and the many other issues that affect their daily lives. Yet what the new administration has offered is a one-page tax cut proposal that's shorter than the typical drug store receipt and a budget that looks like it was written by people who believe working families and seniors have it too easy.

The tax one-pager puts forward numbers that don't come close to adding up. The math behind this tax plan would make Bernie Madoff blush. So without realistic tax numbers to analyze, I want to focus my remarks on two specific points.

First, the administration's economic team says the President's focus is a middle-class tax cut. If this plan was built for a middle-class tax cut, then Trump Tower was built for middle-class housing.

On one side of the ledger, there's not much detail on how the Trump tax plan would help working families or the middle class, just vague, open-ended promises.

Contrast that with how it treats the very fortunate, very few. Eliminating the estate tax and opening a new, mile-wide loophole for the wealthy to exploit pass-through status is a prescription for more inequality in America.

Right here in this room, Mr. Mnuchin and I agreed on the now-legendary Mnuchin Rule of "no absolute tax cut for the rich." But after what we've seen in the tax plan and the budget, we'll throw that in the dustbin alongside the Trump promise not to cut Medicare, Medicaid, and Social Security.

Now to the second point. The Trump economic team is dusting off the old, disproven idea that tax cuts pay for themselves. There's not a reputable economist out there who will tell you that. But you don't have to take my word for it, you can look back at history.

Just in the last few years, Kansas slashed rates for the wealthy and businesses, zeroing them out in some cases. They sold the plan by saying it would launch the State's economy into the stratosphere. Instead, its revenues have cratered. Kansas is struggling to keep its schools open and basic services running.

Go back a little further to the early 2000s and the Bush tax cuts. Those tax cuts didn't pay for themselves either.

Look back to Ronald Reagan—that noted tax-and-spend liberal. He passed a big, regressive tax cut in 1981. But lo and behold, in 1982 and 1984, he had to raise new revenue to make up for the deficits that were caused.

Bottom line, the pay-for-itself argument behind this tax plan holds up about as well as the flat-Earth theory, except people still try to defend it.

The only way to pass lasting, job-creating tax reform that's more than an economic sugar-high is for it to be bipartisan. Tax reform is not a haphazard exercise, throwing together a set of bullet points in the wake of a critical op-ed written by campaign advisors. It takes a lot of careful consideration to write a bipartisan tax reform bill, and I know, because I've written two of them.

The focus ought to be on writing an economically responsible proposal that will create good-paying, red, white, and blue jobs without heaping a new burden on the middle class. That's the kind of reform that will win the support of both sides and will last. Thank you, Chairman Hatch.

AMERICA'S HEALTH INSURANCE PLANS ET AL.

April 12, 2017

The Honorable Donald J. Trump
President of the United States
The White House
1600 Pennsylvania Avenue, NW
Washington, DC 20050

Dear Mr. President:

As providers of healthcare and coverage to hundreds of millions of Americans, we share many core principles and common priorities. We believe that every American deserves affordable coverage and high-quality care. We stand ready to work with the Administration and all members of Congress to keep this commitment.

A critical priority is to stabilize the individual health insurance market. The window is quickly closing to properly price individual insurance products for 2018.

The most critical action to help stabilize the individual market for 2017 and 2018 is to remove uncertainty about continued funding for cost sharing reductions (CSRs). Nearly 60 percent of all individuals who purchase coverage via the marketplace—7 million people—receive assistance to reduce deductibles, copayments, and/or out-of-pocket limits through CSR payments. This funding helps those who need it the most access quality care: low- and modest-income consumers earning less than 250 percent of the federal poverty level. If CSRs are not funded, Americans will be dramatically impacted:

- Choices for consumers will be more limited. If reliable funding for CSRs is not provided, it may impact plan participation, which would leave individuals without coverage options.

- Premiums for 2018 and beyond will be higher. Analysts estimate that loss of CSR funding alone would increase premiums for all consumers—both on and off the exchange—by at least 15 percent. Higher premium rates could drive out of the market those middle-income individuals who are not eligible for tax credits.

- If more people are uninsured, providers will experience more uncompensated care which will further strain their ability to meet the needs of their communities and will raise costs for everyone, including employers who sponsor group health plans for their employees.

- Hardworking taxpayers will pay more, as premiums grow and tax credits for low-income families increase, than if CSRs are funded.

We urge the Administration and Congress to take quick action to ensure CSRs are funded. We are committed to working with you to deliver the short-term stability we all want and the affordable coverage and high-quality care that every American deserves. But time is short and action is needed. By working together, we can create effective, market-based solutions that best serve the American people.

Respectfully,

America's Health Insurance Plans
American Academy of Family Physicians

American Benefits Council
American Hospital Association
American Medical Association
Blue Cross Blue Shield Association
Federation of American Hospitals
U.S. Chamber of Commerce

cc: The Honorable Thomas E. Price, M.D., Secretary of Health and Human Services; The Honorable Steven T. Mnuchin, Secretary of the Treasury; The Honorable Mick Mulvaney, Director of the Office of Management and Budget; The Honorable Seema Verma, Administrator, Centers for Medicare and Medicaid Services

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NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS AND
CENTER FOR INSURANCE POLICY AND RESEARCH

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May 17, 2017

Mick Mulvaney
Director
Office of Management and Budget
301 G Street, SW
Washington, DC 20024

Dear Director Mulvaney:

On behalf of the nation's state insurance commissioners, the primary regulators of U.S. insurance markets, we write today to urge the Administration to continue full funding for the cost-sharing reduction payments for 2017 and make a commitment that such payments will continue, unless the law is changed. Your action is critical to the viability and stability of the individual health insurance markets in a significant number of states across the country.

State regulators have had numerous discussions with health insurance carriers in their states about rates and participation in the individual market in 2018. As you know, there is increasing concern that more carriers will pull out of this market and rates will continue to rise, leaving consumers with fewer and more expensive options, if they have any options at all. This is not a theoretical argument—carriers have already left the individual market in several states, and too many counties have only one carrier remaining. The one concern carriers consistently raise as they consider whether to participate and how much to charge in 2018 is the uncertainty surrounding the federal cost-sharing reduction payments.

As long as the court case, *House v. Price*, remains unresolved and federal funding is not assured, carriers will be forced to think twice about participating on the Exchanges. Even if they do decide to participate, state regulators have been informed that the uncertainty of this funding could add a 15–20% load to the rates, or even more.

The time to act is now. Carriers are currently developing their rates for 2018 and making the decision whether to participate on the Exchanges, or even off the Exchanges, in 2018. Assurances from the Administration that the cost-sharing reduction payments will continue under current law will go a long way toward stabilizing the individual markets in our states while legislative replacement and reform options are debated in Congress.

Sincerely,

Theodore K. Nickel
NAIC President
Commissioner
Wisconsin Office of the Commissioner of Insurance

Julie Mix McPeak
NAIC President-Elect
Commissioner
Tennessee Department of Commerce and Insurance

Eric A. Cioppa
NAIC Vice President
Superintendent
Maine Bureau of Insurance

Raymond G. Farmer
NAIC Secretary-Treasurer
Director
South Carolina Department of Insurance

COMMUNICATIONS

THE ADVERTISING COALITION

Executive Summary

We appreciate the opportunity to submit these comments on behalf of The Advertising Coalition (TAC) to be included in the Committee on Finance hearing on the Fiscal Year 2018 Budget Proposals for the Department of Treasury and Tax Reform. TAC includes national trade associations whose members are advertisers, advertising agencies, broadcast companies, cable operators and program networks, and newspaper, magazine and online publishers. Our coalition represents perhaps the single broadest constituency of advertisers, advertising agencies, and media-related businesses in this country engaged in protecting the free flow of advertising content and volume. As a direct correlation to that objective, TAC members are vitally interested in assuring that any reform of the Tax Code preserves the current ability of businesses to deduct the cost of advertising as an ordinary and necessary business expense.

While we agree with the general goal of lowering the statutory corporate tax rate, we believe that it would be counterproductive and in direct conflict with 104 years of established tax policy to impose limits on the deduction for advertising in an effort to "pay for" such changes. The stated goals of tax reform are to make the U.S. more competitive, stimulate growth and simplify the tax code, but burdening advertising with additional tax liabilities would not further any of these important initiatives. Our concerns are not merely hypothetical as former Ways and Means Chairman Dave Camp included a $169 billion tax on advertising in his 2014 comprehensive reform proposal (the Tax Reform Act of 2014).

Historically, Congress has reviewed the operation of the Tax Code and proposed revenue raising measures that involved limiting or eliminating nonproductive, revenue losing provisions such as tax expenditures identified by the Joint Committee on Taxation or the Office of Management and Budget. The deduction for the cost of advertising, however, has been an accepted business expense since the adoption of the corporate Tax Code, along with the deduction of other business operating expenses such as rent, salaries and office supplies. This deduction has never been characterized as a tax expenditure or in any way inconsistent with sound tax policy. However, it has become the focus of tax reform for the same reason that Willie Sutton once explained why he robbed banks. "I rob banks because that's where the money is."

One of the unintended consequences of the proposed tax on advertising is that it would result in less information being available to consumers through Internet publishers, newspapers, magazines, radio and television stations and networks, and cable network, and operators. Advertising is essential to the operation and even the survival of our national independent providers of news and information, particularly in rural and smaller communities. Reducing the advertising revenue received by these media outlets would reduce their ability to make information available and would weaken a core underpinning of our democracy an informed electorate.

A tax on advertising such as what was proposed in the Camp legislation would not only damage the advertising and media industries, but also would negatively affect the jobs and sales generated by advertising's ripple effect throughout the economy. A 2015 study conducted by the world-renowned economics and data analysis firm IHS Economics and Country Risk ("IHS") determined that every $1 spent on advertising generates nearly $19 in economic activity (sales), and that every million dollars in advertising supports 67 American jobs. In 2012, advertising drove $5.8 trillion of the $36.7 trillion in U.S. economic output and supported 20 million of the

142 million jobs in the United States.[1] These figures demonstrate that every form of advertising—ranging from newspapers, magazines, and television to the Internet—strengthens business and triggers a cascade of economic activity that stimulates job creation and retention throughout the U.S. economy.

The nation's businesses that advertise would annually feel the brunt of a Camp-like proposal, leaving them with fewer resources to commit to advertising spending year after year. The resulting decrease in advertising purchases would, as described above, cause a chain reaction throughout the economy and sharply affect media companies that depend on advertising as a critical source of revenue for daily operations. Given the complex role of advertising in the economy, this type of tax policy would work counter to the key objectives of tax reform of making the Tax Code simpler and more efficient, and fostering a pro-growth environment.

A tax on advertising is neither supported by sound economic policy nor informed tax policy. Two leading experts on the role of advertising, Nobel laureates in Economics Dr. Kenneth Arrow and Dr. George Stigler, concluded that "Proposals to change the tax treatment of advertising are not supported by the economic evidence," and that any policy of making advertising more expensive would cause a decisive decline in advertising spending.[2] In addition to helping businesses communicate the benefits of their products and services, advertising is a critical driver of U.S. economic activity and should remain a fully deductible expense, just like salaries, rent, utilities, and office supplies.

Advertising Consistently Has Been Defined as an Ordinary and Necessary Business Expense

The treatment of business advertising costs as an ordinary and necessary business expense under Section 162 of the Tax Code has been upheld in the U.S. Tax Court,[3] supported by a Revenue Ruling from the Internal Revenue Service,[4] as well as endorsed by Dr. Arrow and Dr. Stigler.[5] The commitment by leaders in Congress to improve the way the government identifies and collects tax revenues can bring important and productive changes to the Tax Code, including a reevaluation of what constitutes a "tax expenditure," to be more consistent with sound tax policy. However, it is essential to maintain a clear distinction between the definition and treatment of tax expenditures and the need for businesses to deduct ordinary and necessary business expenses, such as advertising.

The Congressional Budget Act defines tax expenditures as "revenue losses [to the government] caused by provisions of the tax laws that allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[6] In other words, a tax expenditure is a form of federal spending designed to encourage specific behavior. However worthy the objective, a tax expenditure is an exception to sound tax policy. ***Neither the Joint Committee on Taxation nor the Office of Management and Budget has ever classified the deduction for advertising costs as a tax expenditure.***

The deduction for advertising costs is essential to the proper calculation of the net income tax liability of a business. This principle has been upheld by the U.S. Tax Court in the face of challenges from the Internal Revenue Service that have attempted to test this standard over a period of several decades.[7]

Advertising Creates Millions of Jobs and Adds Trillions of Dollars to the U.S. Economy

As the nation's leading advertisers and media companies, members of The Advertising Coalition understand first-hand the extent to which advertising is a powerful tool that not only may be used to promote goods and services, but also helps to educate consumers about the world around them. Advertising also is responsible for generating trillions of dollars in economic activity. IHS Economics and Country Risk, using an economic model developed by Dr. Lawrence R. Klein, the 1980 recipient of the Nobel Prize in Economics, demonstrated how advertising performs as a

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[1] "Economic Impact of Advertising in the United States." IHS Economics and Country Risk. (March 2015).
[2] Arrow, Kenneth, et al. "Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures." Lexecon Inc. (August 1990).
[3] *RJR Nabisco Inc. v. Commissioner,* 76 T.C.M.71 (1998).
[4] *See* Rev. Rul. 92–80, 1992–39 I.R.B.7.
[5] Arrow, Kenneth, et al. "Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures." Lexecon Inc. (August 1990).
[6] Pub. L. 93–344, 88 Stat. 297, enacted July 12, 1974.
[7] *Id. RJR Nabisco Inc.*

key driver of economic activity and a generator of jobs.[8] This macroecomomic model has been employed by the Treasury Department, Commerce Department, Labor Department, and most Fortune 500 companies. IHS concluded in 2015 that the jobs of 14 percent (19.5 million) of all U.S. employees are related to advertising, the sales driven by advertising, and the induced economic activity that occurs throughout the economy as a result of advertising.[9] Additionally, IHS previously established that advertising does not merely shift market share among competing firms, but rather stimulates new economic activity that otherwise would not have occurred. This, in turn, triggers a cascade of economic activity and stimulates job creation and retention throughout the U.S. economy."[10]

The IHS study quantifies the levels of sales and employment that are attributable to the stimulus produced by advertising. It comprehensively assesses the total economic contribution of advertising expenditures across 16 industries, plus government, in each of the 50 states, Washington, DC, and each of the 435 Congressional Districts in the United States. The overall economic impact of advertising consists of the direct impact of advertising dollars and subsequent sales, supplier sales, inter-industry sales, and resulting consumer spending. Each of these effects also creates and maintains new jobs that are needed to support a higher level of production. The IHS analysis quantifies the economic impact of advertising along four dimensions:[11]

- ***Direct Economic Impact.*** This category refers to the dollars and jobs dedicated to developing and implementing advertising in order to stimulate demand for products and services. It includes the work of advertising agencies and the purchase of time and space on a host of media like radio, television, newspapers, magazines, the Internet, and other outlets. This level of impact stimulates transactions such as the sale of an automobile or an insurance policy sold as a direct result of television advertising.
- ***Supplier Economic Impact.*** Advertising-generated sale; set off chain reactions throughout the economy and create sales and jobs supported by first-level suppliers. Using the example of a car sale, this level of impact encompasses activity by the suppliers of raw materials for upholstery, plastic, tires and parts, radio and GPS receivers, and other products and services that are used to produce the vehicle.
- ***Inter-industry Economic Impact.*** In the automobile example, sales to first-level suppliers generate subsequent inter-industry economic activity that creates jobs in a host of related industries, such as rail and truck transportation, gasoline and oil, insurance, and after-market sales of automobile products. The demand for products and services, sales, and jobs at this inter-industry tier depends upon the initial consumer purchase of the automobile, which is facilitated by advertising.
- ***Induced Consumer Spending.*** Every person with a direct, supplier, or inter-industry job also plays the role of consumer in the U.S. economy. They spend a portion of their salaries in the economy on items such as food, consumer goods and services, healthcare, and other needs. This spending initiates multiple rounds of economic activity, stimulates additional sales, and creates jobs.

Leading Economists Have Reinforced Deduction for Advertising

For the past quarter century following enactment of the Tax Reform Act of 1986, a wide range of proposals have been advanced to limit the deduction for advertising costs as a means of raising additional revenue for the federal government. These proposals to change the treatment of advertising as an ordinary and necessary business expense generally have been based on the theories that (1) advertising is durable and generates revenues beyond the period in which the cost is incurred; (2) advertising costs create intangible assets and should, therefore, be capitalized in part, and (3) advertising costs are incurred with a future expectation of income and also should be capitalized in part.

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[8] "Economic Impact of Advertising in the United States." IHS Economics and Country Risk. (March 2015).

[9] "The Economic Impact of Advertising Expenditures in the United States, 2012–2017." IHS Economics and Country Risk, Inc. (June 2013).

[10] *Ibid.*

[11] "Economic Impact of Advertising in the United States." IHS Economics and Country Risk. (March 2015).

In response to the 1987 book of revenue options drafted by the Joint Committee on Taxation that included limits on the deductibility of advertising,[12] TAC worked with Drs. Arrow and Stigler to identify economic policies and data that would provide a counterpoint to proposals to limit this deduction. The American Institute of Certified Public Accountants similarly examined and rejected a proposal to capitalize advertising costs for book income treatment.[13] The analyses of our economic advisers support the principle that advertising costs should continue to be treated as ordinary and necessary business expenses while concluding that theories advocating otherwise are not sustainable.

Durability of advertising. This argument centers on the notion that the benefit of advertising extends beyond the year in which it is purchased, and that it is more appropriate to link advertising expenses and the income they generate by requiring a portion of advertising costs to be deducted in subsequent years. TAC asked Arrow and Stigler, and the economic consulting firm Lexecon, Inc., to explain the role of advertising in the economy and provide their analysis of this theory. Dr. Arrow was awarded the Nobel Prize for Economics in 1972 and Dr. Stigler was awarded the Nobel Prize for Economics in 1982 for research on consumer choice and the role of consumer information in the economy. Together they prepared the "Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures." [14]

Drs. Arrow and Stigler specifically examined a number of economic studies that proposed increasing the cost of advertising to the advertiser. The goal of many of these studies was to demonstrate the longevity of the impact of advertising on sales in order to justify capitalizing all or part of advertising costs. The Nobel economists concluded that these studies on the durability of advertising had reached such different conclusions that they could not be used as a coherent basis for formulating tax policy. Moreover, Drs. Arrow and Stigler found that these studies suffered from technical flaws that rendered their conclusions meaningless. ***Their analysis suggests that most, if not all, advertising is short-lived.***[15] The economists cautioned against changing the tax treatment of advertising, which would make advertising more expensive:

> Since the information conveyed by advertising is valuable, one must be particularly cautious about taxes that would raise the cost, and hence lower the quantity of advertising. Such taxes would reduce the overall flow of economic information available to consumers. As a result, we expect that prices would rise, the dispersion in prices for particular products would increase, and consumers would be less able to find goods that satisfy their preferences. [16]

Intangible assets. Critics of the current deduction for advertising costs have contended that it creates a preference for businesses that invest in advertising rather than tangible assets, and that advertising similarly must be depreciated over time. They also say it raises questions about whether the current deduction of advertising costs results in the creation of intangible assets.

However, the economic research provided by Drs. Arrow and Stigler shows that the intangible asset is the firm's product, not the advertising for the product. The results indicate that advertising only communicates information about the product to customers. Arrow and Stigler said that while some economists have attempted to measure the relationship between a firm's advertising costs and its intangible capital, they incorrectly ignore the fact that there are many economic factors other than advertising that determine a firm's market value. Indeed the value of the firm's product—*e.g.,* its effectiveness or innovativeness—is the firm's true intangible asset. Advertising is only a means by which the firm can exploit fully the value of that asset.[17]

Arrow and Stigler offered the innovative user interface developed by Apple Computer as an example of this point. "The 'Finder,' which it provides on its Apple . . . personal computer . . . has been enormously popular and Apple has exploited its value by advertising its advantages to potential users. As a result of the success of

[12] "A Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means." Joint Committee on Taxation, pp. 138–139 (1987).

[13] "Statement of Position 93–7: Reporting on Advertising Costs." The American Institute of Certified Public Accountants (1993).

[14] K. Arrow, et. al.

[15] K. Arrow, et. al., at p. 23.

[16] *Ibid* at p. iii.

[17] *Ibid* at p. 36.

this product [and other Apple innovations including the iPhone and iPad], Apple's sales have soared, as has its market value. But Apple's advertising [Mac versus PC, et al.] is not the intangible here; it is only a tool for maximizing the value of the true intangible—the interface." [18]

Legal background. The case law supporting the current deduction of business costs had been settled for more than 20 years when the U.S. Supreme Court in 1992 introduced a different viewpoint in *INDOPCO, Inc. v. Commissioner of Internal Revenue.* [19] Prior to INDOPCO, an expense would have been capitalized only if it "create[d] or enhance[d] . . . a separate and distinct additional asset." [20] The Court in INDOPCO held that legal fees and other costs incurred by Unilever United States in the acquisition of INDOPCO, Inc. (formerly National Starch and Chemical Corporation) should be capitalized and not deducted in the year in which they were incurred because the resulting legal structure enhanced the future value of the enterprise.

The decision in INDOPCO focused on the tax treatment of legal fees related to a corporate acquisition—whether they should be deducted in the year incurred or capitalized because they contribute to future company income. The Court's ruling, however, prompted TAC and many other industry groups jointly to ask the Internal Revenue Service (IRS) whether this decision might in the future be extended to advertising expenditures and require any portion of advertising costs to be capitalized. The IRS Office of Chief Counsel responded on September 11, 1992:

> Section 162–1(a) of the Income Tax Regulations expressly provides that "advertising and other selling expenses" are among the items included in deductible business expenses under Section 162 of the Code. Section 1.162–20(a)(2) of the regulations provides, in part that expenditures for institutional or goodwill advertising which keeps the taxpayer's name before the public are generally deductible as ordinary and necessary business expenses provided the expenditures are related to the [business] patronage the taxpayer might reasonably expect in the future. [21]

Congress in 1993 also addressed the treatment of intangible business expenses that are incurred in generating consumer sales. Supporters of a change in the tax treatment of intangible assets advocated that some of these costs should be capitalized. The Omnibus Budget Reconciliation Act of 1993 [22] provided that these costs generally should be amortized ratably over 15 years, but Congress specifically exempted any intangible "created by the taxpayer." [23] The legislation also excluded from amortization "any franchise, trademark, or trade name." [24] In other words, advertising that promotes an intangible asset—such as the brand name of a product—should not be capitalized, but rather may be deducted in the year the cost was incurred.

In the period leading up to the Omnibus Budget Reconciliation Act of 1993, the accounting profession conducted a formal examination of the business accounting standards for the treatment of advertising costs. The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) issued a Statement of Position in 1993 that recommended expensing advertising costs either as incurred or at the first time the advertising takes place, unless the advertising meets criteria for capitalizing direct-response advertising.[25] Because the Congress and the Committee on Ways and Means regularly look to the treatment the accounting profession recommends or requires for guidance in the treatment of business expenses, TAC was pleased that AcSEC affirmed the current deduction of advertising costs.

Conclusion

Decades of legal and policy justifications support the current tax treatment of advertising as an ordinary and necessary business expense, rather than an asset to be capitalized over time. TAC strongly opposes efforts that would tax the business cost

[18] K. Arrow, et. al. "Economic Analysis of Proposed Changes in the Tax Treatment of Advertising Expenditures."
[19] *INDOPCO, Inc. v. Commissioner of Internal Revenue,* 503 U.S. 79 (1992).
[20] *Commissioner v. Lincoln Savings and Loan Association,* 403 U.S. 345, 354 (1971).
[21] Rev. Rul. 92–80, 1992–39 I.R.B. 7, 1992–2 C.B. 57, 1992 WL 224893 (IRS RRU), September 11, 1992.
[22] Pub. L. 103–66,107 Stat. 312, enacted August 10, 1993.
[23] *Ibid,* sec. 197 (c)(2).
[24] *Ibid,* sec. 197 (d)(1)(F).
[25] "Statement of Position 93–7." American Institute of Certified Public Accountants, Accounting Standards Executive Committee. December 29, 1993.

of advertising. Our coalition includes companies and associations of all sizes that share the common goals of protecting the right of companies to advertise, and securing a fair, affordable business tax rate.

Thank you for your consideration of our views.

COMPUTING TECHNOLOGY INDUSTRY ASSOCIATION (COMPTIA)
515 2nd Street NE
Washington, DC 20002
https://www.comptia.org/

Thank you for the opportunity to express our views on this very important subject. On behalf of the Computing Technology Industry Association (CompTIA), I urge members of the Senate Committee on Finance, and the Congress as a whole, to pursue much-needed reforms to our corporate tax code.

The Computing Technology Industry Association is a non-profit trade association serving as the voice of the information technology (IT) industry.[1] With approximately 2,000 member companies, 3,000 academic and training partners, and nearly 2 million IT certifications issued, CompTIA is dedicated to advancing industry growth through educational programs, market research, networking events, professional certifications, and public advocacy.

A competitive tax policy that lowers the corporate rate, employs territoriality, and incentivizes innovation and investment in the United States, is critical for American technology companies to thrive in the United States and the world. Our industry and many others are constrained by an outmoded and complex federal tax code that is in need of overhaul to reflect the dynamism of American ingenuity. The U.S. corporate tax rate is among the highest in the industrialized world, and of the countries that employ a territorial tax system, it is more than 50 percent higher (39 percent) than the next ranking country (23 percent).[2]

Our members support leveling the playing field both domestically and internationally, seeking to eliminate the inequities of the current tax code, including the ever-increasing costs associated with tax compliance. Any corporate tax reform proposals must treat the information technology industry equitably—both large companies, as well as small- and medium-sized businesses. Specifically; CompTIA supports the following principles within the broader context of corporate tax reform:

- **Reduce the corporate tax rate to 20 percent**. U.S. companies are burdened with the highest corporate tax rate among OECD countries, making them less competitive with their foreign counterparts. We support reducing the corporate tax rate to no higher than 20 percent, without increasing taxes on small and medium-sized businesses.
- **Enact a territorial international tax system.** The U.S. is one of a handful of developed countries that taxes corporate earnings on a global basis. This means that a U.S. company's foreign earnings are subject to U.S. tax when repatriated, increasing the foreign tax rate on these earnings to the U.S. rate. We support enactment of a territorial international system that would remove the punitive tax that prevents foreign earnings from being repatriated to the U.S.
- **Tax repatriated profits at a lower rate.** We support legislation that incentivizes U.S.-based companies to reinvest profits back into the U.S. by allowing those repatriated profits to be taxed at a lower rate. Currently, companies are discouraged from repatriating their profits because of the high corporate tax rate that would result.
- **Tax "innovation box profits" at a lower rate than the corporate rate.** We support policies that foster innovation such as a "patent box" to attract and retain domestic intellectual property development and ownership. A lower rate of taxation on innovation would encourage companies to continue to reinvest in domestic IP development while remaining competitive globally.
- **Make the CFC look-through rule permanent.** The territoriality provisions of most other developed countries allow domestically-based companies operating abroad to structure their foreign operations without the additional home country tax of the sort imposed by the U.S. Subpart F rules. In December 2015, the

[1] "About Us." CompTIA. *https://www.comptia.org/about-us.*

[2] "Corporate Income Tax Rates Around the World, 2016." Tax Foundation. August 18, 2016. *https://taxfoundation.org/corporate-income-tax-rates-around-world-2016/.*

rule was extended through FY20 in the FY16 omnibus. Making the CFC look-through permanent would allow U.S. based companies to marshal their capital outside the U.S. in a way that would enable them to compete on a more level playing field with their foreign counterparts.

The last major tax reform occurred in 1986. While many support reform, Congressional debate continues, and timing for action remains uncertain. Such uncertainty hinders growth. The United States has long been the global hub for innovation, but absent broad, commonsense reforms to our tax code, innovation, job, and economic growth could all be stifled, threatening our position as the global leader.

CompTIA welcomes this opportunity to offer our perspective on this issue and others facing the IT industry and nation. The information, communication and technology sector is one of the largest industry sectors in the U.S. economy. The market is $3.7 trillion globally, and $1 trillion in the United States, employing approximately 7 million Americans.[3] To put into perspective, the gross output of the technology sector exceeds that of the legal services industry, the automotive industry, the airline industry, the motion picture industry, the hospitality industry, the agriculture industry and the restaurant industry, just to name a few examples (source: U.S. Bureau of Economic Analysis).

The technology industry not only helps drive economic growth in a multitude of ways, but it continues to significantly enrich how we live, work, and play. We stand ready to work with you, and I am happy to address any questions you may have.

Respectfully,

Elizabeth Hyman
Executive Vice President, Public Advocacy

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June 1, 2017

As the Committee meets with the Secretary of the Treasury to consider budget and tax priorities, the Federation of Exchange Accommodators ("FEA") appreciates this opportunity to provide input regarding tax reform priorities and specifically, the benefits and need for retention of IRC Section 1031 like-kind exchanges, in present form, in any tax reform bill.

Although there is no specific proposal from either the Senate or the Administration currently calling for repeal or replacement of § 1031, the House Ways and Means Committee is evaluating a number of proposals, set forth in the House Republican Conference's "A Better Way" document released in June 2016. Better known as the House Republican Blueprint for Tax Reform, it proposes reduced tax rates and full, immediate expensing with unlimited loss carryforward for all investment and business-use tangible and intangible depreciable personal property assets, including real estate improvements, but not land. We understand that some policymakers believe that if these proposals are enacted, that § 1031 would no longer be necessary. We disagree.

The Blueprint proposals, taken as a whole, do not provide equal benefits, and are not as comprehensive, as the benefits provided to both taxpayers and our economy by § 1031 like-kind exchanges. Even with lower tax rates and immediate expensing, Section 1031 will still be necessary to remove friction from transactions and fill in the gaps.

At its core, IRC § 1031 is a powerful economic stimulator that is grounded in sound tax policy. The non-recognition provision is premised on the requirement that the taxpayer demonstrates continuity of investment in qualifying replacement property with no intervening receipt of cash. There is no profit-taking, and at the conclusion of the exchange, the taxpayer is in the same tax position as if the relinquished asset was never sold.

[3] "Cyberstates 2017." CompTIA. March 2017. *http://cyberstates.org/#*.

Since 1921, Federal tax law under IRC § 1031 has permitted a taxpayer to exchange business-use or investment assets for other like-kind business-use or investment assets without recognizing taxable gain on the sale of the old assets. Taxes which otherwise would be due if the transaction was structured as a sale are deferred. Qualifying assets include commercial, agricultural and rental real estate, aircraft, trucks, automobiles, trailers, containers, railcars, agricultural equipment, heavy equipment, livestock, and other assets involved in a broad spectrum of industries, owned by an equally broad spectrum of taxpayers ranging from individuals of modest means and small businesses to large business entities.

Under current law, § 1031 promotes capital formation and liquidity. A macro-economic impact study by Ernst and Young, and a micro-economic impact study on commercial real estate by Dr. David Ling and Dr. Milena Petrova, both published in 2015, concluded that Section 1031 removes the tax lock-in effect and permits taxpayers to make good business decisions without being impeded by negative tax consequences.[1] Like-kind exchanges stimulate economic activity and promote property improvements that benefit communities, increase property values and local tax revenues, improve neighborhoods, and generate a multitude of jobs ancillary to the exchange transactions. These studies quantified that restricting or eliminating like-kind exchanges would result in a decline in GDP of up to $13.1 billion annually, reduce velocity in the economy and increase the cost of capital to taxpayers.[2] A 2016 Tax Foundation report estimated a significantly larger economic contraction of approximately $18 billion per year.[3]

Like-kind exchanges benefit the economy in a myriad of ways. Commercial real estate owners, individuals, and businesses of all sizes use like-kind exchanges to trade up from a small rental to a larger apartment building, from a factory or office space that met yesterday's needs to a business facility that positions the business for tomorrow, and upgrade machinery, equipment or vehicles into newer assets that better meet current and future needs. The ability to take advantage of good business opportunities stimulates transactional activity that generates taxable revenue for brokers, lenders, appraisers, surveyors, inspectors, insurers, equipment dealers, manufacturers, suppliers, attorneys, accountants, and more. This transactional velocity also creates opportunities for smaller businesses to acquire entry-level facilities and used equipment from which to launch and grow their fledgling businesses.

Farmers and ranchers use § 1031 to preserve the value of their investments and agricultural businesses while they combine acreage, acquire higher grade land, or otherwise improve the quality of their operations. They rely on § 1031 to defer depreciation recapture tax when they trade up to more efficient farm machinery and equipment. Farmers and ranchers trade dairy cows and breeding stock when they move their operations to a new location.

Immediate expensing does not remove the lock-in effect on a host of real estate owners. Given that improvements would be eligible for immediate expensing, but the value allocated to land would not be deductible, it is important to recognize that land values represent on average, approximately 30% of the value of commercial improved properties, and up to 100% of agricultural land investments. If these property owners are faced with reducing the value of their investments and life savings through capital gains tax when they sell and reinvest in other real estate, even with lower rates, they will likely hold onto these properties longer. The ability to use § 1031 to defer gain recognition removes the lock-in effect, takes the government out of the decision-making process, and permits taxpayers to engage in opportunistic transactions that make good business and investment sense without fear of negative tax ramifications.

Repeal or restriction of like-kind exchanges would be especially troublesome for agricultural and commercial real estate investments in which the land value, relative to the value of improvements, is great. A taxpayer replacing low basis real estate would recognize substantial capital gains that would not

[1] *Economic Impact of Repealing Like-Kind Exchange Rules,* Ernst and Young (March 2015, Revised November 2015) available at *http://www.1031taxreform.com/1031economics/;* and *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate,* David C. Ling and Milena Petrova (March 2015, revised June 22, 2015), available at *http://www.1031taxreform.com/ling-petrova/*.

[2] Ernst and Young LLP, *Economic Impact* at (v), and Ling and Petrova, *Economic Impact,* at 6.

[3] *Options for Reforming America's Tax Code,* Tax Foundation (2016), p. 79, available at *https://taxfoundation.org/options-reforming-americas-tax-code/*.

be fully offset by the proposed expensing deduction for improvements on equal value replacement real estate if the improvements are minimal in value or non-existent, as in the case of agricultural land, or if the property is located in an area with high land to improvement ratios. Without additional cash to cover both the tax liability and the new investment, loss of § 1031 would result in a government-induced shrinkage of agricultural and commercial real estate investment, retarding ability for growth as well as diminishing the net worth of farmers, ranchers, and real estate investors.

Like-kind exchanges make the economics work for conservation conveyances of environmentally sensitive lands that benefit our environment, improve water quality, mitigate erosion, preserve wildlife habitats, and create recreational green spaces for all Americans. Farmers, ranchers, and other landowners reinvest sale proceeds from conservation conveyances through § 1031 like-kind exchanges into more productive, less environmentally sensitive land. These socially beneficial conveyances are dependent upon the absence of negative tax consequences.

Many taxpayers benefitting from like-kind exchanges are not ultra-high net worth individuals or large corporations. These individual taxpayers do not have use for a large net operating loss carryforward from the unused expense deduction for real estate improvements. They do not have sufficient related income to offset the expense, thus they would realize minimal benefit. These taxpayers would face a massive amount of depreciation recapture upon sale, for which they may not have sufficient liquidity, or may not have set aside enough cash to satisfy, creating further personal challenges, locking them in, and putting other wealth building options out of reach. The tax-deferral provisions of Section 1031 fill this gap by permitting full reinvestment of sales proceeds into like-kind property.

Retiring taxpayers benefit by exchanging their most valuable asset, their farm, ranch, or apartment building, for other real estate that doesn't require a 24/7/365 workday, without diminishing the value of their life savings. With a § 1031 exchange, farmers and ranchers can downsize or divest their agricultural operations, landlords can eliminate the "3 Ts" of tenants, toilets, and trash, and these retirees can reinvest in other income producing real estate, such as a storage unit facility, or a triple net leased commercial property. The loss of § 1031 would result in a direct reduction of the retirement savings of these taxpayers whose work has provided food for our nation and affordable living space for other Americans.

Unlike the Blueprint, Section 1031 provides a mechanism for asset sales and replacement purchases that bridge 2 tax years. Absent § 1031, taxpayers would be forced to acquire new assets prior to year-end, or be faced with recapture tax on the Year 1 sale and less equity available for the replacement purchase in Year 2. This would create a disincentive to engage in real estate and personal property transactions during the 4th quarter, resulting in tax-driven market distortions. Seasonal businesses in particular can benefit from exchanges in which assets are divested in late autumn and replaced in early spring, at the start of the new season, thereby eliminating off-season storage and debt-service expenses, without any tax-induced cash-flow impairment.

Retention of § 1031 in present form eliminates potential expensing abuse. The proposal to fully expense real estate improvements in the year of acquisition, with an unlimited carryforward, provides a tremendous incentive at acquisition for a taxpayer to inflate the value of improvements, so as to maximize the write-off. Conversely, upon sale, there would be great incentive to minimize the value of the buildings and over-allocate value to the land, thus minimizing recapture tax on the improvements at ordinary income tax rates, and benefiting from lower capital gains tax rates on the land.

Appraising is not an exact science. There are different methodologies, and a considerable amount of subjectivity, particularly when there is a scarcity of market activity and relevant data upon which to rely. Given the multiple variables that can impact land and structure values, appraisals can vary widely. A taxpayer with a clear incentive could easily game the system to maximize tax benefit and minimize taxes owed on disposition. Section 1031 eliminates this conflict and simply encourages reinvestment of the full value.

Professional Qualified Intermediaries simplify like-kind exchanges and promote compliance with tax laws. Treasury regulations provide rules and a safe harbor for taxpayers engaging in nonsimultaneous exchanges under § 1031 that involve different buyers and sellers.[4] In these delayed, multiparty exchanges (which constitute the majority of like-kind exchanges), the taxpayer is prohibited from having receipt of or control over the sale proceeds from the relinquished property prior to receiving replacement property, or termination of the exchange.

The Qualified Intermediary ("QI") is the independent third party that receives the sale proceeds from the relinquished property buyer, holds and safeguards the funds for the benefit of the taxpayer, and then disburses the funds to the seller of the replacement property. Although a QI occasionally takes title to the exchanged properties, typically the QI is only assigned into the chain of contracts, and the safe harbor treats the transaction, for tax purposes, as if the exchange occurs between the QI and the taxpayer. Agents, such as the taxpayer's attorney, accountant, broker, or employee, and parties related to the taxpayer, are disqualified from acting as a Qualified Intermediary.

- Professional Qualified Intermediaries facilitate § 1031 like-kind exchanges, for a nominal fee, by providing necessary documentation, and by holding, safeguarding, and disbursing the exchange funds for qualifying like-kind replacement property.
- FEA member QIs are subject matter experts in § 1031 exchanges. Our members serve as a valuable resource to taxpayers and their advisors, providing a simple, streamlined process, and promoting compliance with tax rules.
- Qualified Intermediaries do not act as brokers, deal makers, or advisors to the taxpayer—doing so would disqualify them from serving as a QI.
- Qualified Intermediaries are subject to exchange facilitator laws in nine states.

Capital-intensive businesses rely upon like-kind exchanges and affordable access to debt to build and expand. Both tax-deferral and interest deductibility are important economic drivers that stimulate transactional activity, capital investment and growth in the United States.

In summary, like-kind exchanges remove friction from business transactions and stimulate economic activity that would not otherwise benefit from the proposed Blueprint. Section 1031 facilitates opportunistic investment of capital and community improvement. Like-kind exchanges assist the recycling of real estate and other capital to its highest and best use in the marketplace, thereby creating value and improving economic conditions for local communities, rural and urban. Landowners and other businesses would be disadvantaged if they had neither the option of a tax deferred like-kind exchange nor expense deductions for asset acquisition and interest on related debt.

We are grateful for the opportunity to cooperatively work with you and your staff to provide productive, constructive, practical input toward achieving the goal of a fairer, simpler, pro-growth tax reform plan.

Sincerely,

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[4] 26 CFR 1.1031(k)–1.

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The National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) respectfully submit this statement for the record for the Senate Finance Committee's May 25, 2017 hearing titled "Fiscal Year 2018 Budget Proposals for the Department of Treasury and Tax Reform."

For more than 20 years, the National Multifamily Housing Council (NMHC) and the National Apartment Association (NAA) have partnered in a joint legislative program to provide a single voice for America's apartment industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. NMHC represents the principal officers of the apartment industry's largest and most prominent firms. As a federation of nearly 170 state and local affiliates, NAA encompasses over 72,000 members representing more than 8.4 million apartment homes throughout the United States and Canada.

Background on the Multifamily Housing Sector

Prior to addressing the multifamily housing industry's recommendations for tax reform, it is worthwhile to note the critical role multifamily housing plays in providing safe and decent shelter to millions of Americans, as well as the sector's considerable impact on our nation's economy.

Today, 111 million Americans, over one-third of all Americans, rent their housing (whether in an apartment home or single-family home).[1] There are 18.7 million renter households, or over 15 percent of all households, who live in apartments (buildings with five or more units).[2] On an aggregate basis, the value of the entire apartment stock is $3.3 trillion.[3] Our industry and its 38.8 million residents contributed $1.3 trillion to the national economy in 2013 while supporting 12.3 million jobs.[4]

The U.S. is on the cusp of fundamental change in our housing dynamics as changing demographics and housing preferences drive more people away from the typical suburban house. Rising demand is not just a consequence of the bursting of the housing price bubble. In the 5 years ending 2016, the number of renter households was up by 5.8 million; homeowners were up by 1.3 million. Going back 10 years, there were 9.9 million new renter households and approximately 1.6 million new owner households. In other words, the growth in renter households precedes the 2008 housing crisis.[5]

Changing demographics are driving the demand for apartments. Married couples with children now represent only 21 percent of households. Single-person households (28 percent), single-parent households (9 percent) and roommates (6 percent) collectively account for 43 percent of all households, and these households are more likely to rent.[6] Moreover, the surge toward rental housing cuts across generations. In fact, nearly 73 million Baby Boomers (those born between 1946 and 1964), as well as other empty nesters, have the option of downsizing as their children leave the house and many will choose the convenience of renting.[7] Over half (56.6 percent) of the net increase in renter households from 2006 to 2016 came from householders 45 years or older.[8]

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[1] 2015 American Community Survey, 1-Year Estimates, U.S. Census Bureau "Total Population in Occupied Housing Units by Tenure."

[2] 2015 American Community Survey 1-Year Estimates, U.S. Census Bureau, "Tenure by Units in Structure."

[3] NMHC estimate based on a report by Rosen Consulting, updated June 2014.

[4] National Multifamily Housing Council and National Apartment Association.

[5] NMHC tabulations of 2016, 2011, and 2006 Current Population Survey, Annual Social and Economic Supplement, U.S. Census Bureau.

[6] 2015 Current Population Survey, Annual Social and Economic Supplement, U.S. Census Bureau, "America's Families and Living Arrangements: 2015," Households (H table series), table H3/Family Groups (FG series), table FG6.

[7] "Annual Estimates of the Resident Population by Single Year of Age and Sex for the United States: April 1, 2010 to July 1, 2015," U.S. Census Bureau. Baby Boomers are defined as those born 1946 through 1964.

[8] NMHC tabulations of 2016 Current Population Survey, Annual Social and Economic Supplement, U.S. Census Bureau.

Unfortunately, the supply of new apartments is falling well short of demand. An estimated 300,000 to 400,000 units a year must be built to meet expected demand; yet, on average, just 244,000 apartments were delivered from 2012–2016.[9] Furthermore, according to Harvard's America's Rental Housing, the number of renter households could rise by more than 4.4 million in the next decade (depending upon the rate of immigration).[10]

The bottom line is that the multifamily industry provides housing to tens of millions of Americans while generating significant economic activity in communities nationwide. Changing demographics and growing demand will only cause the industry's footprint to expand in the coming years. As will be described below, tax policy will have a critical role to play in ensuring the multifamily industry can efficiently meet the needs of America's renters.

Key Priorities for Tax Reform

Owners, operators, and developers of multifamily housing, who favor pro-growth tax reform that does not disadvantage multifamily housing relative to other asset classes, have a considerable stake in the outcome of the debate over how to reform and simplify the nation's tax code. Industry participants pay federal tax at each stage of an apartment's lifecycle. Federal taxes are paid when properties are built, operated, sold or transferred to heirs.

In providing our recommendations, which we respectfully make below, we are guided by the principle that real estate relies on the free-flow of capital and that investment decisions are driven by after-tax rates of return rather than by statutory tax rates standing alone. Thus, the number of layers of taxation, the marginal rate of tax imposed on income, cost recovery rules, investment incentives and taxes imposed when properties are sold, exchanged or transferred to heirs are all critical in assessing the viability of an investment. In developing reform proposals, we recommend that the Finance Committee and Congress certainly consider—but also look well beyond—lowering statutory tax rates and focus on the ability of a reformed system to efficiently allocate capital and drive job-creating business investment. As is outlined in the pages below, NMHC/NAA believe that any tax reform proposal must:

- Protect pass-through entities from higher taxes or compliance burdens;
- Ensure depreciation rules avoid harming multifamily real estate;
- Retain the full deductibility of business interest;
- Preserve the ability to conduct like-kind exchanges;
- Maintain the current law tax treatment of carried interest;
- Preserve and strengthen the Low-Income Housing Tax Credit;
- Maintain the current law estate tax; and
- Repeal or reform the Foreign Investment in Real Property Tax Act to promote investment in the domestic apartment industry.

NMHC/NAA recognize that the Ways and Means Committee is considering the House Republican Tax Blueprint that would move the nation from the current income tax toward a cash-flow tax.[11] This proposal would dramatically alter current-law cost recovery rules, principally, by providing for the full expensing (instead of depreciation) of property held for investment (except land) and denying the deductibility of business interest. The multifamily industry's recommendations for tax reform that are made below are provided in the context of reforming the current-law income tax. The multifamily industry continues to analyze the House Republican Blueprint and is committed to working with the entire Congress to consider a full range of options to achieve a viable plan. Following the discussion of our tax reform priorities, the multifamily industry offers a few preliminary thoughts on how the Blueprint may impact cost recovery should the Finance Committee decide to consider a similar proposal.

Priority 1: Tax Reform Must Not Harm Pass-Through Entities

The multifamily industry is dominated by "pass-through" entities (*e.g.,* LLCs, partnerships and S corporations) rather than publicly held corporations (*i.e.,* C corporations). Indeed, over three-quarters of apartment properties are owned by pass-through entities.[12] This means that a company's taxable income is passed through to the owners, who pay taxes on their share of the income on their individual tax

[9] U.S. Census Bureau, New Residential Construction, updated February 2016.
[10] Harvard Joint Center for Housing Studies, "America's Rental Housing" (2015).
[11] "A Better Way: Our Vision for a Confident America," *Tax,* June 24, 2016.
[12] U.S. Census Bureau and U.S. Department of Housing and Urban Development, *Rental Housing Finance Survey,* 2012.

returns. This treatment contrasts with the taxation of large publicly held corporations that generally face two levels of tax. Those entities remit tax at the corporate level under the corporate tax system. Shareholders are then taxed upon the receipt of dividend income.

In addition to pass-through entities, a significant number of industry participants are organized as REITs. So long as certain conditions are satisfied, REITs pay no tax at the entity level. Instead, REIT shareholders are taxed on distributed dividends.

The multifamily industry opposes any tax reform effort that would lead to higher taxes or compliance burdens for pass-through entities or REITs. For example, while many are calling for a reduction in the nation's 35 percent corporate tax rate, flow-through entities should not be called upon to make up the lost revenue from this change. Additionally, the multifamily industry would be extremely concerned by proposals that would arbitrarily limit the ability of current and future pass-through entities to fully utilize lower tax rates and other benefits tax reform may provide.

Priority 2: Ensure Depreciation Rules Avoid Harming Multifamily Real Estate

Enabling multifamily developers to recover their investment through depreciation rules that reflect underlying economic realities promotes apartment construction, economic growth, and job creation. Tax reform should ensure that depreciation tax rules are not longer than the economic life of assets by taking into account natural wear and tear and technological obsolescence.

In this regard, NMHC/NAA recommend that the Finance Committee consider a recent study that suggests the depreciation of multifamily buildings should certainly be no longer than the current-law 27.5-year period and perhaps shorter. In particular, David Geltner and Sheharyar Bokhari of the MIT Center for Real Estate in November 2015 published a paper *Commercial Building Capital Consumption in the United States,* which represents the first comprehensive study on this topic in nearly 40 years.[13] By including capital improvement expenditures, the MIT study finds that residential properties net of land depreciate at 7.3 percent per year on average, which is a significantly faster rate than previously understood. Translated into tax policy terms, *we believe this data shows that the current-law 27.5-year depreciation period overstates the economic life of an underlying multifamily asset by nearly 9 years.*

The apartment industry would be particularly concerned by proposals to extend the depreciation period of multifamily buildings, such as those made in the past to set multifamily depreciation periods at 40 or even 43 years. These proposals, which would create an arbitrary and discriminatory cost recovery system that does not reflect the economic life of actual structures, would have a devastating effect on the apartment industry's ability to construct new apartment buildings, particularly when, as noted above, supply continues to fall short of demand. Extending the straight-line recovery period for residential rental property from 27.5 years to 43 years, for example, would reduce a multifamily operator's annual depreciation deduction by 36 percent. This result would diminish investment and development in multifamily properties, drive down real estate values and stifle the multifamily industry's ability to continue creating new jobs. Put another way, the proposal would significantly impact cash flows and investment returns that are at the heart of a developer's analysis of whether a particular project is economically viable.

Furthermore, it is not just property owners who would suffer the consequences of depreciation periods that do not reflect the economic life of underlying assets. For example, pension plans and life insurance companies, which provide retirement and income security to millions of working Americans and retirees, could be harmed as their real estate investments lose value. Local governments would also see lower revenues as the value of multifamily properties decline, leaving a smaller amount of property taxes to finance core services including law enforcement and schools. In this regard, the Tax Foundation found that in fiscal year 2014, property taxes accounted for 31.3 percent of state and local tax collections, more than general sales taxes, individual income taxes, and corporate income taxes.[14]

Finally, a note is warranted regarding so-called deprecation recapture. Under current law, when a multifamily property is sold, there are two types of taxes that

[13] David Geltner and Sheharyar Bokhari, MIT Center for Real Estate, *Commercial Buildings Capital Consumption in the United States,* November 2015.
[14] Tax Foundation, *Facts and Figures, How Does Your State Compare?,* 2017, p. 14.

apply. First, gain from the sale of the property is taxed as a capital gain, typically at a rate of 20 percent for a general partner and 23.8 percent for a limited partner. Second, the portion of the gain attributable to prior depreciation deductions is generally subject to a 25 percent tax. This second tax is referred to as depreciation recapture.

NMHC/NAA believe that depreciation recapture taxes as they stand today can have a pernicious effect on property investment and should be made no worse. After decades of operations, many multifamily owners have a very low tax basis in their properties. If sold under current law, owners would have to pay large depreciation recapture taxes. To avoid this huge tax bill, many current owners of properties with low tax basis will not only avoid selling their properties, but they will also be reluctant to make additional capital investments in properties. The result is deteriorating properties that are lost from the stock of safe, affordable housing. The other alternative is for the long-time owners to sell their properties to an entity that is able to pay a large enough sales price to cover the recapture taxes. To make their investment pay off, however, the new owner will likely convert the property to higher, market-rate rents, meaning a loss of our nation's affordable housing stock.

Therefore, either scenario can have the same result: the possible loss of hundreds of thousands of affordable housing units. Increasing depreciation recapture taxes will exacerbate this result and further discourage owners from selling these properties to entities that can retain them as affordable housing.

Finally, the multifamily industry would like to commend Senators Thune and Roberts for introducing the Investment in New Ventures and Economic Success Today Act of 2017 (S. 1144). By enhancing and making permanent section 179 small business expensing and 50-percent bonus depreciation, the bill would encourage multifamily firms to increase investment. We particularly support the bill's provision to modify current-law section 179 rules to enable property used in rental real estate, such as appliances and furnishings, to qualify for this incentive.

Priority 3: Retain the Full Deductibility of Business Interest

Under current law, business interest is fully deductible. However, efforts to prevent companies from overleveraging are leading to an examination of whether the current 100-percent deduction for business interest expenses should be curtailed. Unfortunately, curtailing this deductibility would greatly increase the cost of debt financing necessary for multifamily projects, curbing development activity.

As mentioned above, over three-quarters of multifamily properties are owned by pass-through entities. Although such entities can access some equity from investors, they must generally borrow a significant portion of the funds necessary to finance a multifamily development. A typical multifamily deal might consist of 65 percent debt and 35 percent equity. Because such entities often look to debt markets, which lend money at a rate of interest, to garner capital, the full deductibility of interest expenses is critical to promoting investment. Indeed, according to the Federal Reserve, as of December 31, 2016, total multifamily debt outstanding was $1,186.7 billion.[15] Reducing the full deductibility of interest would undoubtedly increase investment costs for owners and developers of multifamily housing and negatively impact aggregate construction.

In addition to harming the multifamily industry, it is instructive to note that modifying the full deductibility of business interest would be precedent setting. Drs. Robert Carroll and Thomas Neubig of Ernst and Young LLP concluded in their analysis, *Business Tax Reform and the Tax Treatment of Debt:*

> The current income tax generally applies broad income tax principles to the taxation of interest. Interest expenses paid by borrowers are generally deductible as a business expense, while interest income received by lenders is generally includible in income and subject to tax at applicable recipient tax rates. With this treatment, interest income is generally subject to one level of tax under the graduated individual income tax rates. This is the same manner in which most other business expenses, such as wages payments to employees, are taxed, and also follows the practice in other developed nations.[16]

[15] Board of Governors of the Federal Reserve System, *Mortgage Debt Outstanding,* by type of property, multifamily residences, 2016Q4, March 2017.

[16] Drs. Robert Carroll and Thomas Neubig, *Business Tax Reform and the Tax Treatment of Debt: Revenue neutral rate reduction financed by an across-the-board interest deduction limit would deter investment,* Ernst and Young LLP, May 2012, p. 3.

Priority 4: Preserve the Ability to Conduct Like-Kind Exchanges

Since 1921, the Internal Revenue Code has codified the principle that the exchange of one property held for business use or investment for a property of a like-kind constitutes no change in the economic position of the taxpayer and, therefore, should not result in the imposition of tax. This concept is codified today in section 1031 of the Internal Revenue Code with respect to the exchange of real and personal property,[17] and it is one of many non-recognition provisions in the Code that provide for deferral of gains.[18]

Like-kind exchanges play a significant role and are widely used in the multifamily industry. Current-law like-kind exchange rules enable the smooth functioning of the multifamily industry by allowing capital to flow more freely, which, thereby, supports economic growth and job creation. Multifamily property owners use section 1031 to efficiently allocate capital to optimize portfolios, realign property geographically to improve operating efficiencies and manage risk. By increasing the frequency of property transactions, the like-kind exchange rules facilitate a more dynamic multifamily sector that supports additional reinvestment and construction activity in the apartment industry.

According to recent research by Drs. David C. Ling and Milena Petrova regarding the economic impact of repealing like-kind exchanges for real estate and the multifamily industry in particular: [19]

- Assuming a typical 9-year holding period, apartment rents would have to increase by 11.8 percent to offset the taxation of capital gains and depreciation recapture income at rates of 23.8 percent and 25 percent, respectively.
- Whether based on the number of transactions or dollar volume, multifamily properties, both large and small, are the property type most frequently acquired or disposed of with an exchange.
- Nearly 9 in 10 (88 percent) of commercial properties acquired by a like-kind exchange result in a taxable sale in the very next transaction. Thus, like-kind exchange rules are not used to indefinitely defer taxes.
- Governments collect 19 percent more taxes on commercial properties sold following a like-kind exchange than by an ordinary sale.

Additional research suggests that like-kind exchanges play such a critical role in driving investment that repealing the ability to conduct them would harm the economy even if the resulting revenue were used to reduce tax rates. Indeed, Ernst and Young LLP estimates that repealing like-kind exchange rules and using the resulting revenue to enact a revenue-neutral corporate income tax rate reduction or a revenue-neutral business sector income tax reduction (*i.e.,* encompassing both C corporations and flow-through entities) would reduce Gross Domestic Product by $8.1

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[17] Section 1031 permits taxpayers to exchange assets used for investment or business purposes, including multifamily properties, for other like-kind assets without the recognition of gain. The tax on such gain is deferred, and, in return, the taxpayer carries over the basis of the original property to the new property, losing the ability to take depreciation at the higher exchange value. Gain is immediately recognized to the extent cash is received as part of the like-kind exchange, and the taxes paid on such gain serve to increase the newly acquired property's basis. Congress has largely left the like-kind rule unchanged since 1928, though it has narrowed its scope.

The like-kind exchange rules are based on the concept that when one property is exchanged for another property, there is no receipt of cash that gives the owner the ability to pay taxes on any unrealized gain. The deferral is limited to illiquid assets, such as real estate, and does not extend to investments that are liquid and readily convertible to cash, such as securities. Furthermore, the person who exchanges one property for another property of like-kind has not really changed his economic position; the taxpayer, having exchanged one property for another property of like-kind is in a nearly identical position to the holder of an asset that has appreciated or depreciated in value, but who has not yet exited the investment.

[18] Under the tax code, the mere change in value of an asset, without realization of the gain or loss, does not generally trigger a taxable event. In such situations, the proper tax treatment is to defer recognition of any gain and maintain in the new property the same basis as existed in the exchanged property. This is similar in concept to other non-recognition, tax deferral provisions in the tax code, including property exchanges for stock under Section 351, property exchanges for an interest in a partnership under section 721, and stock exchanges for stock or property under section 361 pursuant to a corporate reorganization.

[19] David C. Ling and Milena Petrova, *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate,* June 2015.

billion each year and $6.1 billion each year, respectively.[20] Put another way, a tax rate reduction financed by repealing like-kind exchange rules would, on a net basis, harm the economy.

Ernst and Young LLP summed up its analysis of how repealing like-kind exchanges would impair investment by concluding, "While repealing like-kind exchange rules could help fund a reduced corporate income tax rate, its repeal increases the tax cost of investing by more than a corresponding revenue-neutral reduction in the corporate income tax rate and reduces GDP in the long-run."[21] This result, of course, moves in the opposite direction of one of the stated goals for tax reform put forward by many of its proponents.

Priority 5: Maintain the Current Law Tax Treatment of Carried Interest

A carried interest, also called a "promote," has been a fundamental part of real estate partnerships for decades. Investing partners grant this interest to the general partners to recognize the value they bring to the venture as well as the risks they take. Such risks include responsibility for recourse debt, litigation risks, and cost overruns, to name a few.

Current tax law, which treats carried interest as a capital gain, is the proper treatment of this income because carried interest represents a return on an underlying long-term capital asset, as well as risk and entrepreneurial activity. Extending ordinary income treatment to this revenue would be inappropriate and result in skewed and inconsistent tax treatment vis-à-vis other investments. Notably, any fees that a general partner receives that represent payment for operations and management activities are today properly taxed as ordinary income.

Taxing carried interest at ordinary income rates would adversely affect real estate partnerships. At a time when the nation already faces a shortage of affordable rental housing, increasing the tax rate on long-term capital gains would discourage real estate partnerships from investing in new construction. Furthermore, such a reduction would translate into fewer construction, maintenance, on-site employee and service provider jobs.

Notably, former House Ways and Means Committee Chairman Camp recognized the devastating impact that a change in the manner in which carried interest is taxed would have on commercial real estate when he specifically exempted real estate from a change he sought to the taxation of carried interest in his Tax Reform Act of 2014.[22]

Finally, some in Congress see the tax revenue generated by the carried interest proposal as a way to offset the cost of other tax changes. Enacting a bad tax law, such as changing the taxation of carried interest, merely to gain revenue to make other tax changes, is a distorted view of good tax policy, which demands that each tax proposal be judged on its individual merits.

Priority 6: Preserve and Strengthen the Low-Income Housing Tax Credit

The Low-Income Housing Tax Credit (LIHTC) has a long history of successfully generating the capital needed to produce low-income housing while also enjoying broad bipartisan support in Congress. This public/private partnership program has led to the construction of nearly 3 million units since its inception in 1986.[23] The LIHTC program also allocates units to low-income residents while helping to boost the economy. According to a December 2014 Department of Housing and Urban Development study, *Understanding Whom the LIHTC Program Serves: Tenants in LIHTC Units as of December 31, 2012,* the median income of a household residing in a LIHTC unit was $17,066[24] with just under two-thirds of residents earning 40 percent or less of area median income.[25] Finally, the National Association of Home Builders reports that, in a typical year, LIHTC development supports approxi-

[20] Ernst and Young LLP, *Economic impact of repealing like-kind exchange rules,* March 2015 (Revised November 2015).
[21] Ibid.
[22] H.R. 1, *Tax Reform Act of 2014,* Section 3621, Ordinary income treatment in the case of partnership interest held in connection with performance of services.
[23] National Council of State Housing Agencies, *2016 Housing Credit FAQ,* February 25, 2016. *https://www.ncsha.org/resource/2016-housing-credit-faq.*
[24] Department of Housing and Urban Development, *Understanding Whom the LIHTC Program Serves: Tenants in LIHTC Units as of December 31, 2012,* December 2014, p. 23.
[25] Ibid, p. 24.

mately: 95,700 jobs; $3.5 billion in federal, state, and local taxes; and $9.1 billion in wags and business income.[26]

Maintaining and bolstering the LIHTC's ability to both construct and rehab affordable housing is critical given acute supply shortages. Indeed, the Harvard Joint Center for Housing Studies estimated that there were only 58 affordable units for every 100 very low-income households (those earning up to 50 percent of area median income in the United States in 2013.[27]

The LIHTC has two components that enable the construction and redevelopment of affordable rental units. The so-called 9 percent tax credit supports new construction by subsidizing 70 percent of the costs. Meanwhile, the 4 percent tax credit can be used to subsidize 30 percent of the unit costs in an acquisition of a project or new construction of a federally subsidized project and can be paired with additional federal subsidies.

Developers receive an allocation of LIHTC's from state agencies through a competitive application process. They generally sell these credits to investors, who receive a dollar-for-dollar reduction in their federal tax liability paid in annual allotments, generally over 10 years. The equity raised by selling the credits reduces the cost of apartment construction, which allows the property to operate at below-market rents for qualifying families; LIHTC-financed properties must be kept affordable for at least 15 years, but, in practice, a development receiving an allocation must commit to 30 years. Property compliance is monitored by state allocating agencies, the Internal Revenue Service, investors, equity syndicators and the developers.

First and foremost, Congress should retain the LIHTC as part of any tax reform legislation. In so doing, Congress must take care to offset any reduction in equity LIHTC could raise attributable to a reduction in the corporate tax rate. Furthermore, NMHC/NAA reminds Congress that tax-exempt private activity multifamily housing bonds, are often paired with 4 percent tax credits to finance multifamily development, and that such tax-exempt bonds should be retained in any tax reform legislation as they play a critical role in making deals viable to investors.

Second, Congress should also look to strengthen the credit by both increasing program resources so that additional units can be developed or redeveloped and making targeted improvements to the program to improve its efficiency Congress could increase program authority by allocating additional tax credits. Additionally, a part of the LIHTC that could benefit from a targeted adjustment involves program rules that require owners to either rent 40 percent of their units to households earning no more than 60 percent of area median income (AMI) or 20 percent to those earning no more than 50 percent of AMI. If program rules were revised to allow owners to reserve 40 percent of the units for people whose average income is below 60 percent of AMI, it could serve a wider array of households.

In this regard, the multifamily industry strongly supports the Affordable Housing Credit Improvement Act of 2017 (S. 548) and commends Senators Cantwell and Hatch for its introduction. We also thank Finance Committee Senators Wyden, Bennet, Heller and Portman for their cosponsorship. Finally, we would also urge the Committee to strongly consider the Middle-Income Housing Tax Credit Act of 2016 (S. 3384) that Ranking Member Wyden introduced during the 114th Congress to address the shortage of workforce housing available to American households. We believe that this bill would be a worthy complement of measures to expand and improve LIHTC.

Priority 7: Preserve the Current Law Estate Tax

As part of the American Taxpayer Relief Act of 2012 (Pub. L. 112–240), Congress in January 2013 enacted permanent estate tax legislation. The Act sensibly made permanent the $5 million exemption level (indexed for inflation) enacted as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. 111–312) and set a top tax rate of 40 percent. Crucially, it also retained the stepped-up basis rules applicable to inherited assets. As many apartment executives prepare to leave a legacy to their heirs, it is vital to have clarity and consistency in the tax code with regard to estate tax rules. For this reason, the apart-

[26] Robert Dietz, *The Economic Impact of the Affordable Housing Credit,* National Association of Home Builders, Eye on Housing, July 15, 2014. *http://eyeonhousing.org/2014/oz/the-economic-impact-of-the-affordable-housing-credit/*.

[27] Harvard Joint Center for Housing Studies, "The State of the Nation's Housing 2015: Housing Challenges" (2015), available at *http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/jchs-sonhr-2015-ch6.pdf.*

ment industry remains supportive of the permanent estate tax legislation passed in early 2013.

There are three key elements to the estate tax: (1) the exemption level; (2) the estate tax rate; and (3) the basis rules. While all three elements can be important for all types of estates, estates with significant amounts of depreciable real property are especially concerned with how various types of basis rules may affect them.

- *Exemption Levels:* The estate tax exemption level is, in simplified terms, the amount that a donor may leave to an heir without incurring any federal estate tax liability. In 2017, there is a $5.49 million exemption.
- *Tax Rates:* The estate tax rate applies to the value of an estate that exceeds the exemption level. The maximum rate is 40 percent.
- *Basis Rules:* The basis rules determine the tax basis to the recipient of inherited property. There are generally two different ways that basis is determined—stepped-up basis and carryover basis. The estate tax today features stepped-up basis rules, and under this regime, the tax basis of inherited property is generally reset to reflect the fair market value of the property at the date of the decedent's death. By contrast, under carryover basis, the tax basis of the inherited properties is the same for heirs as it was for the donor. This includes any decreases in tax basis to reflect depreciation allowances claimed by the donor in prior years. Retaining a stepped-up basis rule is critical for estates that contain significant amounts of depreciated real property as it helps heirs reduce capital gains taxes and maximize depreciation deductions.

Priority 8: Reform the Foreign Investment in Real Property Tax Act to Promote Investment in the Domestic Apartment Industry

The Foreign Investment in Real Property Tax Act (FIRPTA) (Pub. L. 96–499) serves as an impediment to investment in U.S. commercial real estate, including multifamily housing. The FIRPTA regime is particularly pernicious because it treats foreign investment in real estate differently than investment in other economic sectors and, thereby, prevents commercial real estate from securing a key source of private-sector capital that could be used to develop, upgrade, and refinance properties. Congress should enact tax reform that either repeals FIRPTA or, at the very least, further mitigates its corrosive effect on foreign investment in U.S. real estate.

Under current law, the U.S. does not generally impose capital gains taxes on foreign investors who sell interests in assets sourced to the U.S. unless those gains are effectively connected with a U.S. trade or business. This means that a foreign investor generally incurs no U.S. tax liability on capital gains attributable to the sale of stocks and bonds in non-real estate U.S. companies.

FIRPTA, however, serves as an exception to the general tax rules and imposes a punitive barrier on foreign investment in U.S. real estate. Under FIRPTA, when a foreign person disposes of an interest in U.S. real property, the resulting capital gain is automatically treated as income effectively connected to a U.S. trade or business. Thus, the foreign investor is subject to a withholding tax on the proceeds of the sale only because it is associated with an investment in U.S. real estate.

In addition to levying tax, FIRPTA mandates onerous administrative obligations that further deter foreign investment in U.S. real estate. First, the buyer of a property must withhold 15 percent of the sales price of a property sold by a foreign investor so as to ensure taxes are collected. Second, if they overpay tax through the withholding, foreigners investing in U.S. real estate must file tax returns with the IRS to receive a refund of the overpayment.

The taxes and administrative burdens FIRPTA imposes have negative consequences for U.S. commercial real estate and the multifamily industry. Because foreign investors can avoid U.S. tax and reduce their worldwide tax burden tax by investing in U.S. securities or in real estate outside of the U.S., they may simply choose not to invest in U.S. real estate. This is particularly harmful to an apartment industry that relies on capital to finance and refinance properties. Furthermore, because it is the sale of a U.S. property interest that triggers FIRPTA, foreign investors may hold on to U.S. real estate sold for tax considerations.

Repealing FIRPTA would ensure that tax considerations will not prevent capital from flowing to the most productive investments. Such reform could unlock billions in foreign capital that could help to both drive new investment and refinance real estate loans. If outright repeal proves impossible, Congress should consider additional targeted reforms to the FIRPTA regime. NMHC/NAA were particularly pleased that Congress in late 2015 enacted legislation to both provide a partial exemption from FIRPTA for certain stock of real estate investment trusts and exempt from the application of FIRPTA gains of foreign pension funds from the disposition of U.S. real property interests.[28]

The House Republican Tax Blueprint and Cost Recovery

As noted above, the recommendations discussed in previous sections relate to reform of the current-law income tax. The House Republican Tax Reform Blueprint released in June 2016 represents a fundamental change in the way multifamily real estate would be treated for tax purposes. While it would reduce tax rates for the flow-through entities (*e.g.,* LLCs, partnerships, and S corporations) that dominate the multifamily industry, the proposal, by moving from an income tax toward a cash-flow tax, dramatically alters the manner in which owners and investors recover their expense. Under current law, multifamily real estate is depreciated over 27.5 years, all business interest may be deducted and properties can be like-kind exchanged to keep investment dollars in the real estate sector. In contrast, the House Republican proposal would provide for the immediate expensing of all assets—other than land—while denying interest deductibility. It is silent on like-kind exchanges.

The multifamily industry is continuing to evaluate the impact the House Republican proposal would have on the development of existing and future multifamily housing. In the interim, we would offer the following preliminary observations should the Finance Committee consider a similar proposal.

First and foremost, the interest on debt, which has been fully tax deductible for 100 years, plays a critical role in developing multifamily real estate. Given the prevalence of the pass-through structure of ownership, multifamily entities are heavily reliant on debt markets—as opposed to equity markets that corporations access through the issuance of stock—to finance development. Accordingly, reducing the full deductibility of interest would, standing alone, increase investment costs for owners and developers of multifamily housing and negatively impact aggregate construction.

Second, it is unclear whether the benefits of full expensing would fully offset the loss of interest deductibility. This result is dependent on factors that include whether an entity is able to use the full value of an investment deduction in the year it is generated, the cost of capital, how much leverage a particular investor may choose to employ and statutory tax rates. In this regard, if the value of a deduction must be carried forward in the form of a net operating loss (NOL), it may be less beneficial. The House Republican tax plan proposes to allow NOLs to be carried forward indefinitely and to increase them by an interest factor that accounts for inflation and a real return on capital. It is uncertain how that real return on capital will be determined, but the formula will be critical. Given that a multifamily building may cost millions of dollars to construct, it is likely that many developers will have to recognize NOLs. If a real rate of return on capital is determined by reference to Treasury bonds, this will be substantially less valuable than a formula that references returns in equities markets. Until the Ways and Means Committee makes clear how NOLs will be calculated, the multifamily industry will be unable to fully analyze the proposal.

Third, it is critical to view cost recovery rules as a whole instead of in isolation. As noted above, current tax law, provides for depreciation, interest deductibility, and like-kind exchanges. While expensing under the Blueprint may, in some cases, provide for a de facto like-kind exchange, this is not the case for land. Under the proposal, land, which can represent 15 percent to 25 percent of the cost of a typical multifamily deal, may not be expensed. Moreover, interest on land purchases may not be deducted. Thus, the tax treatment of land is materially worse under the House Republican tax plan than under current law that allows for interest deductibility. Although the Blueprint is silent on like-kind exchanges, members may wish to address this problem by retaining like-kind exchanges for land or continuing to allow interest deductibility on land.

Finally, while tax reform focuses on future investment, it is absolutely vital that policymakers do not diminish the value of current assets or adversely impact capital flows serving existing assets and the real estate industry. For this reason, transition rules to any future tax system will arguably be as essential as any new tax rules.

[28] Public Law 114–113, Consolidated Appropriations Act, 2016, Division Q, Protecting Americans from Tax Hikes Act of 2015.

This is especially true when it comes to how interest, depreciation and basis will be treated on existing multifamily debt.

According to the Federal Reserve, as of December 31, 2016, total multifamily debt outstanding was $1.19 trillion. The multifamily industry strongly believes that debt serving existing assets should continue to be fully tax deductible as an ordinary and necessary business expense. Depreciation deductions on existing assets should also continue to be allowed as under current law. Furthermore, owners of existing assets should be able to use current-law basis rules. Basis should not be reset to zero on the date of enactment as some have proposed. Any action to curtail interest deductions, diminish depreciation deductions or reduce basis attributable to existing assets has the capacity to greatly increase tax burdens and potentially lead existing multifamily investments to be uneconomic. This would greatly harm our industry's ability to house working Americans.

Conclusion

NMHC/NAA look forward to working with the Finance Committee, as well as the entire Congress, to craft tax reform legislation that would promote economic growth and the nation's multifamily housing needs. In communities across the country, apartments enable people to live in a home that is right for them. Whether it is young professionals starting out, empty nesters looking to downsize and simplify, workers wanting to live near their jobs, married couples without children or families building a better life, apartment homes provide a sensible choice. We stand ready to work with Congress to ensure that the nation's tax code helps bring apartments, and the jobs and dollars they generate, to communities nationwide.

PUERTO RICO MANUFACTURERS ASSOCIATION (PRMA)

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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) and note that I also speak on behalf of the largest employer in Puerto Rico. 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.

We recognize that the only solution is economic growth and Tax Reform will play a key role. Puerto Rico needs more jobs and taxpayers.

First, it's important to note that jobs in Puerto Rico are American jobs facing unique competitive challenges. Tax reform can make or break our economy and we wish to work with you to ensure Puerto Rico can compete with our foreign competition for jobs and investment.

As Congress considers moving forward on the issues of reforming the tax code we wish to provide some background on the importance of manufacturing to our overall economy, which, in a large part is the product of Federal Tax Code's unique treatment of U.S. companies operating in Puerto Rico. **We also ask for your consideration and inclusion of our concerns during your deliberations over Tax Reform. We believe that you would agree that a net tax increase on products produced in Puerto Rico will have a detrimental effect not only on the economy of Puerto Rico but the entire U.S. supply and values chain.**

Puerto Rico has been part of the U.S. Customs Zone since enactment of the Jones Act in 1917 and today, after a century of customized Federal policies, we are a key component of the U.S. supply and values chain due to the major role of American manufacturing in Puerto Rico.

We note that Puerto Rico struggles with an economy that has shrunk 15% since 2006, Tax Reform can make or break our ability to once again grow our economy and reverse the brain drain and massive population loss as our U.S. Citizens in Puerto Rico relocate elsewhere in search of better opportunities.

RECENT DECISIONS BY CONGRESS

Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) and imposed a federally appointed Oversight Board to oversee a resolution to our local government's fiscal crisis. This places an even greater level of importance on the need for economic growth initiatives which jumpstart our weakened economy in order to generate new tax revenues to ensure the schools stay open and debts are repaid.

PROMESA also created a Bipartisan Bicameral Congressional Task Force on Puerto Rico to recommend measures to revitalize our economy and clearly Puerto Rico's manufacturing sector is best positioned to play the lead role. Notably, Tax Reform and its impact on Puerto Rico's vulnerable economy was given priority.

The Task Force makes the following recommendations in its report to Congress:

- The Task Force believes that Puerto Rico is too often relegated to an afterthought in congressional deliberations over federal business tax reform legislation.
- The Task Force recommends that Congress make Puerto Rico integral to any future deliberations over tax reform legislation. The Task Force recommends that Congress continue to be mindful of the fact that Puerto Rico and the other territories are U.S. jurisdictions, home to U.S. citizens or nationals, and that jobs in Puerto Rico and the other territories are American jobs.
- The Task Force is open to the prospect of Congress providing U.S. companies that invest in Puerto Rico with more competitive tax treatment as long as appropriate guardrails are designed to ensure the company is creating real economic activity and employment on the island.

TAX POLICY HAS DRIVEN PUERTO RICO'S ECONOMY SINCE THE 1920s

Puerto Rico has been part of the U.S. since 1898 and today is the home for 3.5 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. And frankly, it's important to note that Puerto Rico is highly dependent on manufacturing due to 90 years of targeted Federal tax policy designed to foster and attract manufacturing. These policies were ended in 2006 and contributed to the depressed economy now suffered by Puerto Rico which has seen a contraction in our economy by 15% and over 500,000 U.S. Citizens residing in Puerto Rico have migrated elsewhere looking for economic opportunity.

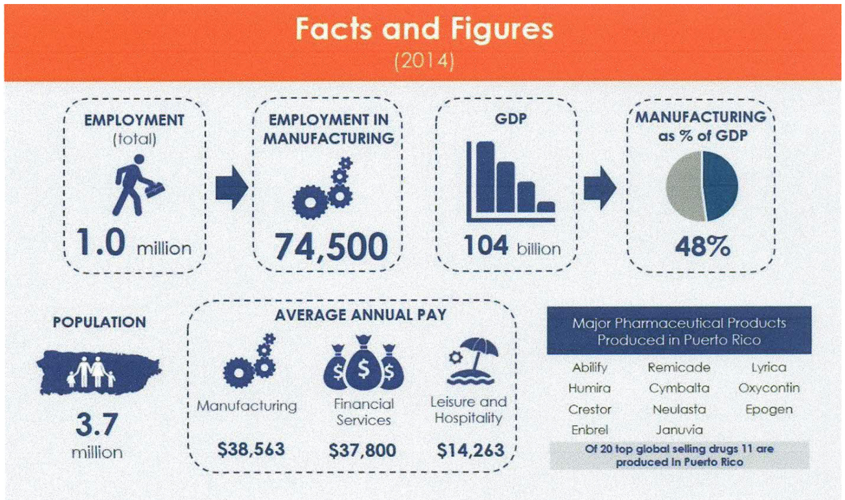
Today, most subsidiaries of U.S. companies operating in Puerto Rico are organized as Controlled Foreign Corporations (CFCs) under the current tax code. However, they are treated as domestic in every other way as they operate under U.S. laws just the same as business operating elsewhere in the U.S. which in turn positions Puerto Rico in a non-competitive position versus our foreign neighbors.

Approximately, 90% of products manufactured in Puerto Rico are included in the U.S. values and supply chain. Being within the U.S. Customs Zone since 1917 (and even before that) no tariffs or levies are imposed on U.S. products produced in Puerto Rico that are consumed in the domestic market.

MANUFACTURING GROWTH AND TRANSITION

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 1940s, direct 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.



Thanks to congressionally driven tax policy, the economic ecosystem has grown from labor-intensive basic manufacturing to a capital-intensive industrialized sector to now a knowledge-based advanced manufacturing model. Because of these tax policies and in spite of the recent economic recession impacting our island for the past 9 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.

By itself, 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 2 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 workforce or about 74,000 people. We estimate an additional 160,000 Puerto Rico residents are indirectly employed by our sector by enterprises providing services and inputs.

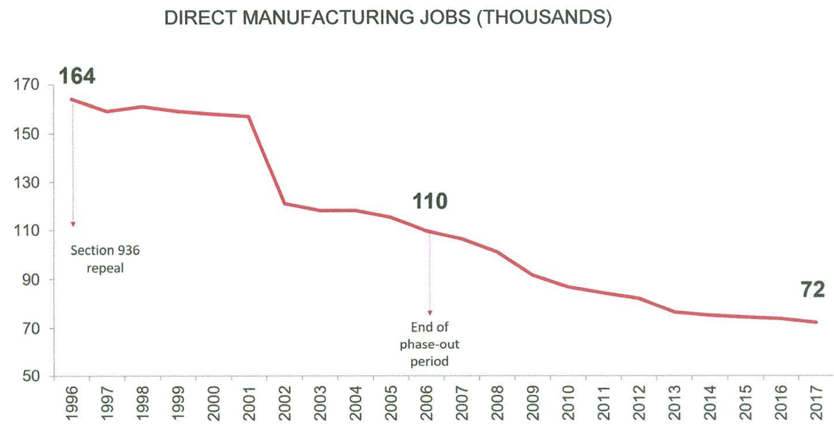
We also estimate an additional 80,000 stateside jobs supported by Puerto Rico's manufacturing companies (CFCs). Therefore, our manufacturing sector has the multiplier effect of contributing 320,000 jobs (direct, indirect and induced) to the U.S. and Puerto Rico economies. For example, one of our member companies reports that it annually transports over $140 million worth of product from Puerto Rico just through the Port of Jacksonville, Florida. The Port of Jacksonville notes that one-half of its annual business volume is due to Puerto Rico.

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 close to 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 "federal poverty threshold" 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 WAS KEY TO FOSTERING 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 its 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 3-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 500,000 U.S. citizens representing approximately 12% 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.

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's deliberations on tax reform.

RECOMMENDATIONS FOR TAX REFORM 2017

We urge full consideration of the impact of tax reform on Puerto Rico's economy and job base. We believe Congress shares a bipartisan 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.

Puerto Rico, by itself and with recent congressional action, has a stable government and excellent infrastructure given the millions of dollars invested in recent years on infrastructure improvements.

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 higher efficiency energy production including liquefied natural gas (LNG), currently, energy is currently generated using imported oil in obsolete government run plants resulting in higher energy costs. A recent comparison with Florida found that energy costs in Puerto Rico are two times that of Florida: on average 23 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 perform well with several factors that are commonly 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 enticing our manufacturing company base so that they relocate their operations from Puerto Rico by offering more attractive tax treatment, lower labor costs, cheaper energy costs, less restrictive regulation and access to the U.S. market. **Any actions taken by Congress that would adversely impact the Puerto Rico operations of U.S. based multinational groups are likely to result in a shift from manufacturing in Puerto Rico to foreign jurisdictions, not to the mainland U.S.,** thus taking jobs away from U.S. citizens both in Puerto Rico and in the U.S. This would be detrimental to the economy of Puerto Rico, detrimental to the economy of the U.S. and detrimental to the goals of the recently imposed PROMESA Fiscal Control Board. We would all lose in that scenario.

Therefore, the ability of Puerto Rico to remain economically competitive internationally and, thus to continue to provide employment to U.S. citizens 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 note that the proposal included in the House Blueprint which provides for border adjustability regarding importation and exportation of products to and from the U.S. market. Further, other proposals may call for the implementation of a tariff also on the importation of products to the U.S. market. Since Puerto Rico has been included in the U.S. Customs Zone for the past 100 years, we would anticipate that the border adjustment provisions in the Blueprint or any other similar scheme not apply to products produced in Puerto Rico. Again, the contrary would produce a net loss both to the U.S. stateside and Puerto Rico economies and harm the U.S. values and supply chain.

Also, as part of our discussions with members of Congress, we have perceived potential interest in modifying the tax rules that currently allow Puerto Rico to be the only jurisdiction in the United States where CFCs employ U.S. Citizens, operating under U.S. law and on U.S. soil. While this seems to be a speculative initiative, we urge that careful consideration be taken in this regard as any such change could have the same detrimental repercussions as the applicability of border adjustment provisions. Until such initiatives become clear, it would be premature to assert any level of impact on Puerto Rico, but whatever the result is, there must be, at least, reasonable transition rules that do not penalize the choices made by companies that have invested in Puerto Rico and that are, in a very real sense, a large component of the fiscal plans that have been laid out for the recovery of Puerto Rico's economy. Again, not doing so, would only produce an unnecessary net loss situation where both the Puerto Rico and U.S. stateside employment base and economies would suffer.

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.

Rodrigo Masses, President

REFORMING AMERICA'S TAXES EQUITABLY (RATE) COALITION

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Thank you, Chairman Hatch and Ranking Member Wyden, for receiving this testimony from the RATE (Reforming America's Taxes Equitably) Coalition, which is comprised of nearly 3-dozen corporations and associations, representing some 30 million workers in all of America's states and territories.

As the Senate Finance Committee begins to take action to reform our broken and outdated tax code for the sake of spurring growth, the RATE Coalition urges a prime focus on reform of the corporate income tax, which is routinely described as the single most detrimental aspect of our current tax system. Corporate tax reform is desperately needed for the sake of spurring growth and ensuring that all corporations are treated equally.

In particular, we wish to point out that for many years now, the United States has had the highest corporate tax rate among the leading economies of the world—a combined 39.1 percent. Here we are speaking of the 35 member-countries of the Organisation for Economic Co-operation and Development (OECD). Surely, for the U.S., in a world characterized by ever more intense economic competition, this is a dubious, even dismal, distinction!

Still, many people do not see the connection between America's high corporate tax rate and her slow economic growth. One of the most frequent responses to this fact is, "Yes, but nobody pays that high rate because there are so many loopholes."

There are two big problems with that response.

First, many corporations—indeed, the vast majority, nationwide—actually *do* pay at or near the high rate, because they are primarily based in the U.S. In fact, the RATE Coalition's member companies pay an average effective federal tax rate of 32 percent. And so, the tax-rate differential puts them at a severe disadvantage in the international arena.

We can quickly see that if our competitors can enjoy greater returns on capital due to their lower tax rate, then they have a significant competitive advantage relative to American firms. And that significant advantage for them translates into a significant *dis*advantage for our companies and, therefore, our workers.

Second, some companies—so far, only a few, but more and more companies are considering the option—are exercising the ultimate tax avoidance strategy and moving their headquarters to other countries where the corporate tax rate is lower. The spate of "inversions" in recent years is testament to the fact that the high corporate tax rate *in and of itself* is driving businesses and jobs away from America.

Thus we can see this anti-competitive U.S. corporate tax rate has handicapped us against our international competitors. The current code has made it more difficult to invest in our American employees and operations, while limiting the value that our member companies have been able to create for our shareholders and stakeholders.

This basic inequity in the tax code can be easily fixed by lowering the corporate tax rate so that it is more competitive with the average of our major trading partners—the OECD countries—which is around 24 percent. (At the same time, RATE believes that other aspects of the code, too, might need adjusting, with an eye toward fairness and simplicity.)

Meanwhile, so long as our rate remains the highest, American employees, shareholders, and suppliers will all be suffering the consequences of our crippling corporate tax rate. Unfortunately, the results will also cripple job creation, dampen economic security, and overall reduce investment in the United States.

For years now, both Democrats and Republicans have supported lowering the corporate tax rate. Indeed, the RATE Coalition, and its allies, have long regarded the 1986 Tax Reform Act as a model of bipartisan problem-solving.

More than 30 years ago, House Democrats joined with Senate Republicans to produce a landmark piece of legislation that was enthusiastically signed into law by a Republican President, Ronald Reagan.

To this day, the Tax Reform Act stands as a testament to the good that can come when the two parties work together for the common good. That is, *clean up the tax code by lowering the rate and broadening the tax base.* It was good public policy then, and we believe that it's good public policy now.

Admittedly, much has changed over the last three decades, and yet interestingly, the same positive spirit of bipartisan cooperation has continued, albeit often below the radar. We know that Republicans and Democrats have long agreed—sometimes publicly, sometimes privately—that rate-lowering corporate tax reform is a good idea.

Today, the RATE Coalition joins with many others in the hope that 2017 will be the year that the legislative and executive branches can come together to create meaningful tax reform—for the sake of growth, jobs , and, yes, hope.

Members of the RATE Coalition are listed below in alphabetical order:

Aetna
Altria
Association of American Railroads
AT&T
Boeing
Brown-Forman
Capital One
COX Enterprises
CVS Health
Edison Electric Institute
FedEx
Ford
General Dynamics
The Home Depot
Intel
Kimberly-Clark
Liberty
Lockheed Martin
Macy's
National Retail Federation
Nike
Northrop Grumman
Reynolds America
Raytheon
S&P Global
Southern Company
Synchrony Financial
T-Mobile
UPS
Verizon
Viacom
Walmart

The Washington Times, May 16, 2017

CUTTING THE DRAG OF HEAVY CORPORATE TAXES

By Elaine C. Kamarck and James P. Pinkerton

On Thursday, the House Ways and Means Committee will have a hearing examining how tax reform will grow our economy and create jobs.

It's an important issue, perhaps one of the most important topics to be decided by Congress this year.

There is ample evidence that if Congress would reduce the corporate tax rate, it would grow the economy. America leads the world when it comes to taxing its business sector and that leading position is stifling our economy.

We can't promise that slashing the corporate tax rate to make it more competitive with the rest of the world will lead to 4-percent growth, but there are plenty examples to point to where such a policy was implemented and did successfully yield such a result.

In Ireland, the growth rate was 7.2 percent. Their corporate tax rate is set at 15 percent and is scheduled to be cut to 10 percent. In the United Kingdom, the corporate tax rate is 19 percent while the economy grew at about double that of the United States.

Japan had a corporate tax rate similar to the United States and last year had anemic growth similar to ours. The Japanese government decided to join with the Irish and the English and slash their corporate tax rate to levels more competitive with their competitors.

Unless we get our own version of corporate tax reform, we will be left behind, in the dust.

For many years now, America has had the highest corporate tax rate in the world—35 percent. And yet, many people don't see the connection between the high corporate tax rate and America's slow economic growth. One of the most frequent responses to this fact is, "Yes, but nobody pays that high rate because there are so many loopholes."

That's wrong. Most corporations—indeed, the vast majority, nationwide—actually do pay the high rate, and this puts them at a severe disadvantage in the international arena. If our competitors can enjoy greater returns on investment thanks to their lower rate, then they have a significant advantage. And that significant advantage for them translates into a significant disadvantage for our companies, and our workers.

Now some companies—especially the larger ones, with more internal flexibility—do exercise the ultimate tax avoidance strategy and move their headquarters to other countries where the tax rate is lower. The spate of "inversions" in recent years is testament to the fact that the high corporate tax rate in and of itself is driving businesses and jobs away from America.

Thus, businesses that create jobs in America often find themselves taxed at higher rates than those that don't. The RATE Coalition's member companies employ one-third of America's private sector workers, and contrary to the conventional wisdom, our membership pays an average effective federal tax rate of 32 percent.

This anti-competitive U.S. corporate tax rate has handicapped us against our international competitors for too long. It has made it more difficult to invest in our American employees and operations, while limiting the value we're able to create for our shareholders.

So long as our rate remains the highest, American employees, shareholders and suppliers will all be bearing the consequences of our high corporate tax rate—and the result is anemic job creation, dampened economic security, and overall reduced investment in the United States.

For years now, both Democrats and Republicans have supported lowering the corporate tax rate. President Obama spoke about it in most of his State of the Union addresses. And in their first debate back in 2012, Mr. Obama and Republican candidate Mitt Romney agreed on the need to lower the rate.

Former President Bill Clinton is on the record supporting a lower rate. And, of course, President Trump has made it a centerpiece of his tax plan.

Lowering the rate is a simple and fair way to address the fact that America's jobs are disappearing. In this polarized era, it is one important step we can take to get the American economy growing in America again. America's workers need a win. Real tax reform starts with the rate.

Elaine C. Kamarck and James P. Pinkerton are co-chairs of the RATE Coalition

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REAL ESTATE ROUNDTABLE
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As the Senate Committee on Finance meets to consider budget and tax priorities with the Secretary of the Treasury, the 21 undersigned national real estate organizations appreciate the opportunity to share our views on tax reform and commercial real estate. While the comments below broadly represent the views and perspective of the real estate industry, individual property types or investment structures may have unique tax issues and policy concerns more appropriately addressed in separate communications.

OVERVIEW

Real estate is deeply interwoven in the U.S. economy and the American experience, touching every life, every day. Millions of Americans share in the ownership of the nation's real estate, and it is a major contributor to U.S. economic growth and prosperity. Real estate plays a central role in broad-based wealth creation and savings for investors large and small, from homeowners to retirees invested in real estate via their pension plans.

Commercial real estate provides the evolving physical spaces in which Americans work, shop, learn, live, pray, play, and heal. From retail centers to assisted living facilities, from multifamily housing to industrial property, transformations are underway in the "built environment." Investment in upgrading and improving U.S. commercial real estate is enhancing workplace productivity and improving the quality of life in our communities.

Among its vast economic contributions, the real estate industry is one of the leading job creators in the United States, employing over 13 million Americans—more than one in every 10 full-time U.S. workers—in a wide range of well-paying jobs. Real estate companies are engaged in a broad array of activities and services. This includes jobs in construction, planning, architecture, building maintenance, management, environmental consulting, leasing, brokerage, mortgage lending, accounting and legal services, agriculture, investment advising, interior design, and more.

Commercial real estate encompasses many property types, from office buildings, warehouses, retail centers and regional shopping malls, to industrial properties, hotels, convenience stores, multifamily communities, medical centers, senior living facilities, gas stations, land, and more. Conservatively estimated, the total value of U.S. commercial real estate in 2016 was between $13.4 and $15 trillion, a level that matches the market cap of domestic companies on the New York Stock Exchange. Investor-owned commercial properties account for about 90 percent of the total value, with the remainder being owner-occupied. Based on the latest data available from the Federal Reserve, U.S. commercial real estate is leveraged conservatively with about $4.2 trillion of commercial real estate debt.

Industry activity accounts for nearly one-quarter of taxes collected at all levels of government (this includes income, property and sales taxes). Taxes derived from real estate ownership and transfer represent the largest source—in some cases approximately 70%—of local tax revenues, helping to pay for schools, roads, law enforcement, and other essential public services. Real estate provides a safe and stable investment for individuals across the country, and notably, retirees. Over $370 billion is invested in real estate and real estate-backed investments by tax-exempt organizations (pension funds, foundations, educational endowments and charities).

Commercial real estate is a capital-intensive asset, meaning that income-producing buildings require constant infusions of capital for acquisition and construction needs, ongoing repairs and maintenance, and to address tenants' ever-changing technological requirements.

Today's commercial real estate markets are grounded in strong fundamentals, as indicated by vacancy rates near historic lows, positive growth of rents and stable net operating income. By most measures, commercial real estate conditions accurately reflect market supply and demand.[1] While certain policy reforms are clearly warranted (*i.e.,* removing unnecessary barriers to construction lending, addressing Internet sales tax issue), sources of equity and debt capital are largely available for economically viable projects. A broad-based acceleration of economic growth through tax reform would boost real estate construction and development and spur job creation. However, Congress should be wary of changes that result in short-term, artificial stimulus and a burst of real estate investment that is ultimately unsustainable and counterproductive. In order to improve the economy's long-term trajectory, growth must be predicated on sound reforms that change underlying economic conditions.

TAX REFORM

The real estate industry agrees that tax reform is needed and overdue. We should restructure our nation's tax laws to unleash entrepreneurship, capital formation, and job creation. At the same time, comprehensive tax reform should be undertaken with caution, given the potential for tremendous economic dislocation. Tax policy changes that affect the owners, developers, investors and financiers of commercial

[1] The Real Estate Roundtable, *Sentiment Index: Second Quarter 2017* (May 5, 2017), available at: *http://www.rer.org/Q2-2017-RER-Sentiment-Index.*

real estate will have a significant impact on the U.S. economy, potentially in unforeseen ways.

We urge the Finance Committee to be mindful of how proposed changes in commercial real estate taxation could dramatically affect not only real estate investment activities but also the health of the U.S. economy, job creation, retirement savings, lending institutions, pension funds, and, of course, local communities.

Positive reforms will spur job-creating activity. For example, tax reform that recognizes and rewards appropriate levels of risk taking will encourage productive construction and development activities, ensuring that real estate remains an engine of economic activity. Tax reform can also spur job creation, and assist the nation in achieving energy independence, by encouraging capital investments in innovative and energy-efficient construction of buildings and tenant spaces.

Alternatively, some reforms might unintentionally be counter-productive to long-term economic growth. Of major concern are proposals that could result in substantial losses in real estate values. Lower property values produce a cascade of negative economic impacts, affecting property owners' ability to obtain credit, reducing tax revenues collected by local governments and eroding the value of retirees' pension fund portfolios.

Thus, as much as we welcome a simpler, more rational tax code—and any associated improvements in U.S. competitiveness abroad—we continue to urge that comprehensive tax restructuring be undertaken with caution, given the potential for tremendous economic dislocation.

As history illustrates, the unintended consequences of tax reform can be disastrous for individual business sectors and the economy as a whole. A case in point is the Tax Reform Act of 1986, which ushered in a series of over-reaching and over-reactive policies—in some cases on a retroactive basis. Significant, negative policy changes applied to pre-existing investments. Taken together, these changes had a destabilizing effect on commercial real estate values, financial institutions, the federal government and state and local tax bases. It took years for the overall industry to regain its productive footing, and certain aspects of the economy never recovered.

We believe the four principles below should guide and inform your efforts to achieve a significant, pro-growth overhaul of the nation's tax code:

- Tax reform should encourage capital formation (from domestic and foreign sources) and appropriate risk-taking, while also providing stable, predictable, and permanent rules conducive to long-term investment;
- Tax reform should ensure that tax rules closely reflect the economics of the underlying transaction—avoiding either excessive marketplace incentives or disincentives that can distort the flow of capital investment;
- Tax reform should recognize that, in limited and narrow situations (*e.g.,* low-income housing and investment in economically challenged areas), tax incentives are needed to address market failures and encourage capital to flow toward socially desirable projects; and
- Tax reform should provide a well-designed transition regime that minimizes dislocation in real estate markets.

In short, rational taxation of real estate assets and entities will support job creation and facilitate sound, environmentally-responsible real estate investment and development, while also contributing to strong property values and well-served, livable communities.

***A BETTER WAY*—THE HOUSE REPUBLICAN TAX REFORM BLUEPRINT**

Last June, House Ways and Means Committee Chairman Kevin Brady (R–TX), House Speaker Paul Ryan (R–WI), and the House Republican Conference put forward *A Better Way,* a bold tax reform proposal aimed at creating a modern tax code built for economic growth. The drafters made clear that this House Republican Tax Reform Blueprint ("Blueprint") was the "beginning of our conversation about how to fix our broken tax code." Our industry has appreciated the open dialogue and opportunity to work constructively with Members and staff in the House and Senate to ensure that tax reform achieves its full potential.

We support the Blueprint's underlying objectives, including the desire to reform the tax system to promote economic growth, capital formation, and job creation. The comments below are based on our current understanding of the Blueprint, as gathered from meetings and conversations with Members and staff. Many of these perspectives have been transmitted to the tax-writing committees, formally or informally, in recent weeks. Our views and input will continue to evolve as additional information is made available. The comments are offered in the spirit of support for the tax reform effort, and they are aimed at ensuring the legislation successfully spurs economic growth without unintentionally discouraging entrepreneurship or creating unnecessary economic and market risks.

Cash flow taxation and real estate. The Blueprint would replace the existing system for taxing business income with a "destination-based, cash flow" tax system. Rather than taxing businesses on their net income, the Blueprint seeks to tax businesses on their net cash flow. For a domestic business, setting aside important aspects of the proposal that relate to cross-border transactions, the key conceptual change is that the full cost of a new investment would be recovered (deducted) immediately, rather than recovered (depreciated) over the economic life of the investment. The underlying expectation is that the shift to cash flow taxation will spur growth by reducing the tax burden on new investment.

The Blueprint proposes to deviate from cash flow taxation in two key ways that would have critical implications for real estate. First, land would not qualify for immediate expensing, only the value of structures. Second, businesses could not deduct currently their net interest expense. As a result, two major expenses associated with investing in real estate—the cost of the underlying land and the cost of borrowing capital to purchase the real estate—would be excluded from the basic architecture of the cash flow tax system.

- *Treatment of land.* Land represents a major share, on average roughly 30%, of the value of real estate. The Blueprint offers no express rationale for the exclusion of land from immediate expensing. The two suggestions offered informally to-date have been that land is a "non-wasting" asset and "we're not making any more of it." However, the actual economic life of an asset and its status as a manufactured good is irrelevant to a system that seeks to tax net cash flow. Under the Blueprint's own terms, land should qualify for expensing. Denying taxpayers' ability to expense land would create the very same economic distortions that the Blueprint is seeking to remove from the tax code. It would shift resources to other asset classes for reasons that are purely tax-motivated. In addition, it would create new geographic disparities and distortions based on the relative share of land in the cost of real estate.

- *Treatment of net interest expense.* Access to financing and credit is critical to the health of U.S. real estate and the overall economy. The ability to finance productive investment and entrepreneurial activity with borrowed capital has driven economic growth and job creation in the United States for generations. In both an income tax system and a cash flow tax system, business interest expense is appropriately deducted under the basic principle that interest is an ordinary and necessary business expense.

  The Blueprint states that allowing both expensing and interest deductibility "would result in a tax subsidy for debt-financed investment." The Blueprint "helps equalize the tax treatment of different types of financing" and "eliminates a tax-based incentive for businesses to increase their debt load beyond the amount dictated by normal business conditions." The Blueprint suggests less leverage is inherently preferable, "A business sector that is leveraged beyond what is economically rational is more risky than a business sector with a more efficient debt-to-equity composition."

  Repealing or imposing limits on the deductibility of business interest would fundamentally change the underlying economics of business activity, including commercial real estate transactions. This could lead to fewer loans being refinanced, fewer new projects being developed, and fewer jobs being created. Legislation altering the tax treatment of existing debt could harm previously successful firms, pushing some close to the brink of insolvency or even into bankruptcy. Congress should preserve the current tax treatment of business interest. By increasing the cost of capital, tax limitations on business debt could dramatically reduce real estate investment, reducing property values across the country, and discouraging entrepreneurship and responsible risk-taking.

Like-kind exchanges. Under current law, section 1031 of the tax code ensures that taxpayers may defer the immediate recognition of capital gains when property is exchanged for property of a like kind. In order to qualify, a like-kind exchange transaction must involve property used in a trade or business, or held as an investment, and all proceeds (including equity and debt) from the relinquished property must be reinvested in the replacement property. Section 1031 is used by all sizes and types of real estate owners, including individuals, partnerships, LLCs, and corporations. While the Blueprint does not expressly address like-kind exchanges, we understand some policymakers view immediate expensing as a viable replacement for section 1031 of the tax code. We disagree.

Real estate like-kind exchanges generate broad economic and environmental benefits, and Section 1031 should be preserved without new limitations on the deferral of gains. Exchanges spur greater capital investment in long-lived, productive real estate assets and support job growth, while also contributing to critical land conservation efforts and facilitating the smooth functioning of the real estate market. Without Section 1031, many of these properties would languish underutilized and short of investment because of the tax burden that would apply to an outright sale. Recent academic research analyzing 18 years of like-kind exchange transactions found that they lead to greater capital expenditures, investment, and tax revenue while reducing the use of leverage and improving market liquidity.[2] Another study by EY concluded that new restrictions would increase the cost of capital, discourage entrepreneurship and risk taking, and slow the velocity of investment.[3] As currently understood, the Blueprint would not fully replicate the benefits of section 1031, particularly to the extent that the land component of real estate remains ineligible for immediate expensing.

State and local tax deduction. State and local taxes are the principal source of financing for schools, roads, law enforcement, and other infrastructure and public services that help create strong, economically thriving communities. Throughout the country, real estate is the largest contributor to the local tax base. Most state and local taxes, including real estate taxes, are deductible from federal income. Eliminating the deductibility of state and local taxes could disrupt demand for commercial real estate in many parts of the country while raising taxes on millions of Americans. It would shift power away from local communities in favor of the federal government. The deductibility of state and local taxes is grounded in the Constitution, federalism, and states' rights. The state and local tax deduction prevents an erosion of local governance and decision-making by prohibiting the federal government from double-taxing amounts already taxed at the state and local level. The burden of the change will fall disproportionately on those regions that generate the most tax revenue for the federal government—and the reduced demand for commercial real estate in certain regions could lower property values and limit the ability of the industry to continue creating jobs and driving economic growth.

Blueprint impact on real estate investment and development. Economic modeling suggests that the proposed shift to cash flow taxation under the Blueprint would create different results for different taxpayers—even after all real estate has transitioned to the new regime. For investors with other income that can absorb the losses generated by immediate expensing, the Blueprint should increase after-tax returns. For others, as a general matter, the relative after-tax returns on new real estate investment, including construction, would depend heavily on the interest rate that applies to loss carryforwards. Under reasonable financial assumptions related to property costs, operating income, and project expenses, a loss carryforward interest rate of 5.0% would result in after-tax returns on real estate investment that are similar to current returns. In contrast, a loss carryforward interest rate equal to inflation would result in returns that are much lower than those under current law. As interest rates rise or debt-to-equity ratios increase, returns on real estate investment would decline further because of the change in the tax treatment of business interest.

Thus, under the Blueprint framework, the tax burden may fall disproportionately on entrepreneurs and small developers—those most likely to own properties in small and medium-sized markets—because they use greater leverage to finance their activities and lack the deep portfolio of assets to absorb the losses generated from expensing.

Moreover, depending on the structure of the transition rules, the Blueprint could result in substantially lower after-tax returns and reduced property values for existing real estate assets. The impact on existing properties is heavily dependent on the

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[2] Professors David C. Ling (University of Florida) and Milena Petrova (Syracuse University), *The Economic Impact of Repealing or Limiting Section 1031 Like-Kind Exchanges in Real Estate* (June 2015), available at: *http://warrington.ufl.edu/departments/fire/docs/paper_Ling-Petrova_EconomicImpactOfRepealingOrLimitingSection1031.pdf.*

[3] EY, Economic Impact of Repealing Like-Kind Exchange Rules (November 2015), available at: *http://www.1031taxreform.com/1031economics.*

post-enactment treatment of tax basis, as well as the ongoing deductibility of interest on existing and refinanced real estate loans. The structure of any transition relief under the Blueprint is not yet clear.

Economic and market risks. In the past (1981–1986), the accelerated tax depreciation of structures contributed to unsustainable levels of uneconomic, tax-motivated real estate investment and construction. Tax-driven stimulation of real estate construction that is ungrounded in sound economic fundamentals, such as rental income and property appreciation expectations, creates imbalances and instability in real estate markets. The negative consequences could harm state and local communities (through reductions in state and local property tax revenue), the financial security of retirees (through pension investments tied to real estate), and the banking system (through the declining value of real estate on bank balance sheets and systemic risk to the financial system).

Most capital assets other than real estate structures already are recovered on an extremely accelerated schedule. Therefore, the economic risks associated with immediate expensing are largely unique to real estate. According to Treasury Department economists, nearly half of all capital investment by U.S. corporations is in 3-year and 5-year property.[4] According to Goldman Sachs, under current tax policy, 70% of total capital investment is recovered within the first 18 months of use.[5] In addition to its longer life, real estate differs from other fixed capital assets because it is more likely to be sold for a gain. The income it generates often is treated as passive. In short, the tax attributes of real estate diverge greatly from other forms of capital investment.

Lastly, the stock of existing real estate dwarfs in size all other depreciable capital assets. And unlike equipment and machinery, only about 2 percent of the stock is replaced with new construction annually. The large existing stock relative to new construction means that transitioning existing real estate into a cash flow tax system in a manner that treats current owners fairly and avoids severe market disruption and systemic risk would be extraordinarily expensive from the standpoint of lost revenue to the Treasury.

Going forward—addressing the challenges of real estate taxation under the House Blueprint. In light of the unique status of real estate as a long-lived, fixed capital asset and the transition challenges generated by the large stock of existing properties, the tax-writing committees should consider excluding real estate from the basic Blueprint architecture of immediate expensing and interest non-deductibility. Congress should preserve like-kind exchanges, an effective, time-tested tool that helps taxpayers internally mobilize capital to grow and expand their businesses and create jobs. Tax reform legislation could promote investment in manufacturing and other capital-intensive industries through a modified incentive that provides for permanent, immediate expensing of shorter lived assets, such as equipment and machinery. Legislation could reduce the depreciation period for real estate to align more closely with its useful economic life, which is approximately 19 years, according to the Massachusetts Institute of Technology.[6]

Alternatively, if real estate is included in the cash flow tax system, it is critical that the legislation include carefully designed transition rules. The transition rules should ensure the new tax regime does not put the owners of existing real estate assets at an economic disadvantage compared to new construction and new investment; does not result in lower property values and new systemic economic risk; and does not create a lock-up of properties that distorts real estate commerce and undermines productive economic activity.

One approach to transition under consideration would grandfather current depreciation methods and schedules for existing assets. However, this approach would ce-

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[4] James Mackie III and John Kitchen, "Slowing Depreciation in Corporate Tax Reform," *Tax Notes* (April 29, 2013), available at: *http://www.taxnotes.com/tax-notes-today/budgets/slowing-depreciation-corporate-tax-reform/2013/04/30/f2p4* (behind paywall).

[5] David Mericle and Dan Stuyven, "Corporate Tax Reform: Trading Interest Deductibility for Full Capex Expensing" (Goldman Sachs Economics Research, November 30, 2016), available at: *http://static.politico.com/c3/34/c99de58745b29f77b027a0f848d9/goldman-sachs-analysis-of-net-interest-deductibility-and-expensing-provisions-of-tax-reform.pdf.*

[6] Professor David Geltner and Sheharyar Bokhari, *Commercial Building's Capital Consumption in the United States,* (MIT Center for Real Estate, November 2015), available at: *https://mitcre.mit.edu/research-publications/commercial-building-capital-consumption-us;* Andrew B. Lyon and William A McBride, "Tax Policy Implications of New Measures of Building Depreciation," *Tax Notes* (June 20, 2016), available at: *https://www.pwc.com/us/en/tax-services/publications/assets/pwc-tax-implications-of-new-measures-of-building-depreciation.pdf.*

ment in law, for decades, two distinct tax systems for U.S. commercial real estate dependent on when the taxpayer acquired the property. This would result in two separate systems—one that is income-based for the $15 trillion of existing real estate and one that is cash flow-based for future investment. In so doing, Congress risks creating a cascade of new market distortions with unknown and potentially dangerous consequences. It would violate a fundamental principle of good tax policy—treating similarly situated taxpayers the same. It could cause a lock-up of properties that reduces market liquidity, drags down property values, and prevents properties from transferring into the hands of owners that would upgrade and improve the real estate, creating job s in the process.

In short, transition rules must address two powerful forces set in motion under the Blueprint—the loss of interest deductibility and the economic divergence that would result from the proposed acceleration of cost recovery for new investment. Both of these changes are challenges for the transition from one regime to the next.

In fairness to borrowers who made investment decisions in reliance on long-standing tax principles in place since the inception of our tax law, debt on existing real estate should be fully grandfathered for purposes of interest expense deductibility. This relief should extend to debt secured directly by real estate, as well as debt that is effectively backed by real estate, such as bonds issued by REITs. In addition, the transition rules should not discourage the refinancing of existing real estate debt, which accelerates reinvestment, economic activity, and job creation.

With respect to cost recovery, one viable option is to phase in immediate expensing over an extended period, while simultaneously accelerating the recovery of basis in existing assets. An alternative option would implement expensing immediately, but in contrast to the American Business Competitiveness Act (H.R. 4377, 114th Congress), would ensure that current owners get full recognition of their tax basis when selling an existing asset, thus avoiding a "lump sum" tax on all existing real estate.

The importance of a well-designed transition regime cannot be overstated. The stock of existing commercial real estate is more than 12 times the size of total annual private investment in equipment and machinery. The risk of unintended consequences is real and past lessons should inform policymakers' decisions. Congress should approach transition as a primary focus and not a secondary concern.

Other real estate issues in the Blueprint. There are several other areas where policy decisions in the legislative drafting of the Blueprint will have enormous consequences for commercial real estate activity. In brief:

- The 50% capital gains exclusion should fully cover individual gains from real estate investment, including real estate that is directly owned or owned through a pass-through entity;
- With respect to depreciation "recapture," the tax law should recognize that a portion of the income received on the sale of real estate reflects the appreciation of the underlying land and is appropriately taxed at the reduced capital gains rate;
- The reduced tax rate on pass-through businesses should fully extend to partnerships, to distributions from REITs, and to other pass-through entities that generate real estate rental income;
- The new system should continue to encourage taxpayers to reinvest capital and earnings through provisions such as section 1031;
- In order to continue encouraging entrepreneurs and small developers to invest in U.S. real estate, the interest rate on loss carryforwards should include a real return that is sufficient to preserve the value of losses that cannot currently be used; and
- The character of real estate-related income, including carried interest, should continue to be determined at the partnership level and the new regime should continue to recognize that entrepreneurial risk-taking often involves more than just the contribution of capital.

FIRPTA Repeal. The punitive Foreign Investment in Real Property Tax Act (FIRPTA) regime subjects gains on foreign equity investment in U.S. real estate or infrastructure to a much higher tax burden than applies to a foreign investor purchasing a U.S. stock or bond, or an investment in any other asset class. In addition to the tax burden, the withholding and administrative filing requirements associated with FIRPTA are frequently cited by foreign taxpayers as principal reasons for avoiding the U.S. real estate market. FIRPTA is a major impediment to greater private investment in both U.S. real estate and infrastructure.

In 2015, Congress passed the most significant reforms of FIRPTA since its passage in 1980. Congress should build on the recent success by repealing FIRPTA outright as part of tax reform. Unleashed by FIRPTA's repeal, capital from abroad would create jobs by financing new real estate developments, as well as the upgrading and rehabilitation of existing buildings. Architects, engineers, construction firms, subcontractors, and others would be put to work building and improving commercial buildings and infrastructure.

* * *

Because commercial real estate is so ubiquitous, it is sometimes easy to overlook its positive connection to our nation. Commercial real estate is where America lives, works, shops, plays, and invests. The right tax policy can help commercial real estate: create and maintain jobs, lift retirement savings for Americans, reduce energy consumption, and improve the quality of life in local communities.

We are fully committed to working with the Senate Committee on Finance to achieve a bold tax reform outcome that serves the overall economy and appreciate your consideration of these issues. We appreciate your consideration of these comments and look forward to working with you, cooperatively, as tax reform moves forward.

Sincerely,

The Real Estate Roundtable
ADISA—Alternative and Direct Investment Securities Association
American Hotel and Lodging Association
American Institute of Architects
American Land Title Association
American Resort Development Association
American Seniors Housing Association
Appraisal Institute
Asian American Hotel Owners Association
The Building Owners and Managers Association (BOMA) International
CCIM Institute
Federation of Exchange Accommodators
Institute of Real Estate Management
International Council of Shopping Centers
IPA—Investment Program Association
Mortgage Bankers Association
NAIOP, the Commercial Real Estate Development Association
National Apartment Association
National Association of REALTORS®
National Multifamily Housing Council
REALTORS® Land Institute

Sports and Fitness Industry Association (SFIA)

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The Sports and Fitness Industry Association (SFIA) applauds the Senate Finance Committee for holding its hearing on budget proposals issued by the Department of the Treasury and Tax Reform. As the Committee explores bipartisan solutions for tax relief related to individuals and families, we encourage policymakers to broaden the use of health savings accounts and other flexible spending arrangements to promote preventative health care.

The Internal Revenue Service (IRS) currently uses an outdated definition of qualified medical expenses, precluding the use of physical activity as a form of prevention. Given the volume of medical research over the years, legislation has been introduced by Senators John Thune (R–SD), Chris Murphy (D–CT), Johnny Isakson (R–GA) and Joe Donnelly (D–IN), titled the Personal Health Investment Today Act

(S. 482), to update the definition and ultimately, put consumers back in control of their personal health aimed at disease prevention.

The legislation, which is commonly referred to as the "PHIT Act," allows consumers to use their contributions in pre-tax medical accounts, such as health savings accounts (HSAs) and flexible spending accounts (FSAs), for the purpose of physical activity expenses. Not only does this allow Americans the opportunity to actively decide where they spend their hard earned dollars, it also promotes physical exercise as a form of preventive medicine to help reduce the prevalence of many chronic, preventable diseases.

Each year, our country spends billions of dollars on treating the health consequences that result from chronic medical conditions, many of which could be mitigated through physical activity. Research has consistently indicated substantial, positive health benefits are disproportionately attributed to individuals in a more physically active population. Likewise, better health status also results in positive economic benefits to both individuals, as well as our health system at large.

More specifically, a recent Cooper Institute study that utilized Medicare claims data found individuals who are physically fit at the mid-life point showed a 40 percent reduction in subsequent annual healthcare costs, as compared with those of their peers who were less physically active. These findings could mean an average annual cost savings of $5,242 for men and $3,694 for women. In addition, the Robert Wood Johnson Foundation issued a study finding that children who remain inactive are more likely to be inactive adults, whom are then six times more likely to have inactive children. The statistics are staggering and alarming considering we have the least active generation of children ever. With the help of the PHIT Act, however, we can reverse the cycle.

According to the Employers Council on Flexible Compensation (ECFC), the medium household income for an FSA participant is $57,060 and $57,860 for an HSA participant. Despite these average income levels, most participants are within 300 percent of the Federal Poverty Limit (FPL) and eligible for health-care subsidies. HSAs and FSAs are valuable tools. Implemented effectively, they can help hard working families across America and in all income categories save for their health care needs.

Under the PHIT Act, contributions to FSAs, HSAs and other pre-tax arrangements would be limited to $1,000 for individuals and $2,000 for families annually. The current contribution caps on such accounts remain in place.

For families across America incurring increased sports and recreation fees associated with their children's activities, an updated definition of medical care would offer important financial relief. Similarly, a revised definition offers individual working adults wider consumer choice over one's pre-tax medical account as they too practice good preventative health care by staying physically fit.

Finally, the World Health Organization also has weighed in on the subject, finding that for every $1 spent on physical fitness in the U.S., more than $3 are saved in the health-care delivery system. The PHIT Act will help realize these savings and significantly reduce the incidence of costly and preventable disease needed to reverse the current healthcare crisis.

As the esteemed members of the Senate Finance Committee strive to improve our nation's tax system, now is an important time to review existing definitions with an eye toward current health trends. SFIA looks forward to working with the Committee on efforts to improve our nation's health status, including the PHIT Act and other vital tax relief initiatives.

We respectfully submit the enclosed statement. If you have any questions or need additional information, please feel free to contact Tom Cove, SFIA President, at tcove@sfia.org. or visit our website at *www.sfia.org*.