ECONOMIC ANALYSIS

# Say Bye-Bye to Reform: Obama Becomes Clinton

*By Martin A. Sullivan — martysullivan@comcast.net*

There has been no shortage of encouraging words about tax reform from the White House. Just last week the press office apprised us:

> Over the nearly three decades since the last comprehensive reform effort, the tax system has been loaded up with special deductions, credits, and other tax expenditures that help well-connected special interests, but do little for our Nation's economic growth. The President's framework will close these loopholes and simplify the tax code so *businesses* can focus on investing and creating jobs rather than filling out tax forms. [White House, ''Fact Sheet: President Obama's Blueprint to Support U.S. Manufacturing Jobs, Discourage Outsourcing, and Encourage Insourcing'' (Jan. 25, 2012); emphasis added.]

In his 2011 State of the Union address, President Obama told the nation:

> Over the years a parade of lobbyists has rigged the tax code to benefit particular companies and industries. Those with accountants or lawyers to work the system can end up paying no taxes at all. But all the rest are hit with one of the highest corporate tax rates in the world. It makes no sense, and it has to change. So tonight, I'm asking Democrats and Republicans to simplify the system. Get rid of the loopholes. Level the playing field. And use the savings to lower the corporate tax rate for the first time in 25 years — without adding to our deficit.

Immediately after the speech, Treasury started work on a corporate tax reform plan. The staff gave a boost to the lobbying industry by meeting with all interested parties. The rumor around town was that Treasury had a white paper describing a revenue-neutral corporate reform plan with a rate of 26 percent. But nothing was ever released.

This was generally consistent with other favorable soundings on tax reform. In 2010 two commissions working under the president's sponsorship addressed the issue. In August 2010 the President's Economic Recovery and Advisory Board trumpeted the need for reform:

> The tax code has become more complex and unstable over the last two decades, in part because legislators have increasingly used targeted tax provisions to achieve social policy objectives normally achieved by spending programs. . . . Beyond [the] direct costs that can be measured in time, money, and revenue lost to non-compliance, the complexity of the tax system is a tremendous source of frustration to American taxpayers, reduces the tax system's transparency, and undermines trust in its fairness. [The President's Economic Recovery and Advisory Board, ''The Report on Tax Reform Options: Simplification, Compliance, and Corporate Taxation'' (Aug. 2010).]

And in December 2010 the report from the Bowles-Simpson commission urged that tax reform be given a prominent role in efforts to reduce the deficit:

> The current tax code is riddled with $1.1 trillion of tax expenditures: backdoor spending hidden in the tax code. Tax reform must reduce the size and number of these expenditures and lower marginal rates for individuals and corporations — thereby simplifying the code, improving fairness, reducing the tax gap, and spurring economic growth. Simplifying the code will dramatically reduce the cost and burden of tax preparation and compliance for individuals and corporations.

Unfortunately, all words and no action. Despite these statements and others like them, there is really no commitment from the Obama administration for broad-based tax reform. The administration's lack of interest in comprehensive reform is evident in its non-endorsement of any of the recommendations of the commissions responsible for the last two quotes. The first two quotes tell us that Obama is only interested in corporate tax reform.

So shouldn't tax reformers at least be happy the president backs a corporate overhaul? Well, no. Obama's efforts along these lines have been more mischievous than sincere. The administration's insistence that corporate tax reform be revenue neutral doomed the effort from the start, and the high-IQ economics team surely understood that. Because tax breaks are heavily tilted in favor of manufacturing, any base-broadening reform would come at the expense of that sector. The redistribution of the corporate tax burden would create an untenable split in the business community, and the whole effort would collapse.

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| Democratic President Tax Policies | |
|---|---|
| **Clinton 1992** (From Bill Clinton and Al Gore, *Putting People First: How We Can All Change America*) | **Obama 2012** (From President Obama's January 25, 2012, State of the Union address and supporting materials) |
| "Eliminate tax breaks for American companies that shut down their American plants and ship our jobs overseas." | "It is time to stop rewarding businesses that ship jobs overseas, and start rewarding companies that create jobs right here in America." |
| "Tax Fairness — Increase rate on the top 2 percent." | "Right now, we're poised to spend nearly $1 trillion more on what was supposed to be a temporary tax break for the wealthiest 2 percent of Americans." |
| "Make permanent the research and development tax credit to reward companies that invest in groundbreaking technologies." | "The President has proposed to make permanent the Research and Experimentation Tax Credit, while enhancing and simplifying the credit." |
| "Provide a targeted investment tax credit to encourage investment in the new plants and productive equipment here at home that we need to compete in a global economy." | "Extend for all of 2012 a provision that allows business to expense the full cost of their investments in equipment, spurring investment in the United States." |
| "Small businesses create most of the new jobs in this country and they need to flourish if we are all to prosper. . . . Offer a new enterprise tax credit that provides a 50 percent tax exclusion for those who take risks by making long-term investments in new business." | "Most new jobs are created in start-ups and small businesses. So let's pass an agenda that helps them succeed. . . . Expand tax relief to small businesses that are raising wages and creating good jobs." |

## The Opposite of Tax Reform

It wouldn't be so bad if Obama simply remained a lackadaisical supporter of tax reform. But his proposals are actually moving us in the opposite direction. As the election approaches, he and his advisers are feeling the need to dish out new tax breaks. So the president who on national television shouted at Congress to "get rid of the loopholes" now wants to add a bunch of new loopholes of his own.

At best, he is setting a bad example. Perhaps the White House believes it is exempt from the usual criticism of the inefficiency and unfairness of tax breaks because its tax breaks are not proposed by lobbyists. But so far we have seen no studies that show that tax breaks concocted on Pennsylvania Avenue have special features that make them less harmful than those from K Street.

During his two terms as president, Bill Clinton never pursued tax reform. Tax complexity didn't concern him. The subtle benefits of tax neutrality were too bland to capture his interest. Besides, that would have required spending political capital. No, instead of working for the tax system, Clinton put the tax system to work for him.

Instead of expanding government spending that Republicans would fight tooth and nail, Clinton expanded tax expenditures that Republicans viewed as tax cuts. Clinton adviser Gene Sperling gives a nice example of this in his 2005 book, *The Pro-Growth Progressive: An Economic Strategy for Shared Prosperity*:

> The Clinton administration used tax incentives for investment and job creation to encourage poor communities to devise strategies for their economic future. . . . Because these pro-growth progressive policies relied on incentives to bring new capital and business financing into low-income neighborhoods, they drew support not only from Representative Charles Rangel and Reverend Jesse Jackson, but at times from Jack Kemp and Speaker of the House Dennis Hastert.

Yes, clever politics. But what a mass of complexity! And certainly not pro-growth. Any jobs created directly from targeted tax cuts were offset by job losses elsewhere in the economy. That is not a partisan statement. That is basic economics. Neutrality may be one of the dullest terms ever uttered, but it is still powerful economics. Only in exceptional circumstances do violations of tax neutrality promote growth. Just because these tax breaks are well intentioned and targeted to sympathetic causes does not make them exceptional.

> ***It's not just their complexity that's awful. Obama's targeted tax breaks are also lousy economics — more likely to kill jobs than create them.***

During his eight years in office, Clinton made dozens of little proposals. Each one carried a potent political message. Each one was part of a larger mosaic of themes that included fairness, energy security, education, environmental protection, and community development. Each was complex. Many were temporary. And probably none ever truly was a net job creator because the resulting increases in compliance costs and economic efficiency were a drain on growth.



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Now, as he enters what promises to be a nasty reelection fight, Obama's approach to tax policy is looking more than ever like Clinton's. He will give nothing more than lip service to tax reform.

The similarities between Clinton's and Obama's tax policies are striking. (See table.) No doubt this is in large part due to both presidents' heavy reliance on Sperling for economic advice. Sperling served in various capacities in the White House through all eight years of the Clinton presidency. (By all accounts, he was the ghostwriter of the 1992 Clinton-Gore economic manifesto entitled *Putting People First*.) He now serves as director of the National Economic Council for Obama.

### Complexity and Inefficiency

Details on Obama's new "Blueprint to Support U.S. Manufacturing Jobs" will be released sometime in mid-February as part of his fiscal 2013 budget. But his State of the Union address and materials released concurrently by the White House give us the general idea. First, there are the big-picture items. Obama wants a 10-month extension of the 2 percentage point payroll tax cut Congress extended for only two months in December. He wants a 30 percent minimum tax on millionaires. And then there is something called a "framework for corporate tax reform" that includes a minimum tax on overseas profits of U.S. multinationals.

Beyond these items that will soak up most of the press attention, there are the targeted provisions. They include new tax benefits for "advanced manufacturing technologies," for moving expenses of companies shifting operations into the United States, for investment in communities that have suffered a "major job loss event," and for "clean energy manufacturing." He wants more taxes on moving expenses when jobs are moved overseas and on intangibles when they are shifted offshore. He wants to extend 100 percent expensing (for one year) and the research credit (permanently). These are the items that are contrary to all notions of tax reform.

Just as with Clinton's parade of tax breaks, the growing list of Obama's special benefits includes features that are absurdly complex. The president wants to double the tax deduction currently available to manufacturing in the case of "advanced manufacturing technologies." It has been difficult enough to figure out how to differentiate manufacturing from other businesses under section 199. What in the world is "advanced manufacturing technology"? Are we talking about technologically advanced production processes or about technologically advanced products? If a product or production line includes advanced technology, is the entire product or production line eligible for the benefit, or just the components with the advanced technology features?

The questions are endless. There will certainly be major disputes between the IRS and taxpayers. We can add a nice, new chapter to the book on everything we hate about tax law.

Then Obama wants to provide tax credits in communities with a "major job loss event," such as a military base closing or a substantial downsizing of operations by a private employer. How many jobs must be lost to qualify? Do offsetting increases elsewhere in the community result in disqualification? Where do we draw boundary lines around a

**Kerry's 2004 Reform Proposal: A Preview of Obama 2012?**

On March 26, 2004, Sen. John F. Kerry, D-Mass., who was then seeking the Democratic nomination for president, released his plan for domestic job creation. It had four major components.

First, there was a reduction in the corporate tax rate from 35 percent to 33.25 percent. President Obama is expected to propose a reduction in the corporate tax rate as part of his framework for corporate tax reform.

Second, Kerry proposed the repeal of deferral of taxation of foreign profits, except for those generated by foreign subsidiaries selling goods or services to foreign customers. Obama will soon release details of a sweeping international tax reform, including a minimum tax on foreign profits. In his 2012 State of the Union address, Obama said: "It is time to stop rewarding businesses that ship jobs overseas, and start rewarding companies that create jobs right here in America. Send me these tax reforms, and I will sign them right away."

Third, Kerry proposed a two-year tax credit for increases in employment by small businesses and by industries threatened by international competition. On January 31 the White House announced Obama's plan for a 10 percent income tax credit on new payroll for small businesses — through either hiring or increased wages — added in 2012.

Fourth, Kerry proposed a one-time, one-year reduced corporate tax rate of 10 percent for the earnings of foreign subsidiaries repatriated to their U.S. parent companies. The administration has consistently opposed a second repatriation holiday. But it could agree to some relief as a concession to the business community that will surely oppose the rest of Obama's international tax reforms.



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community? Do pre-effective-date job loss events qualify? Again, the questions are endless.

And finally, the president wants to give tax credits for moving expenses when a company is moving jobs into the United States and disallow deductions for moving expenses when a company moves jobs out of the United States. Are we talking about just the expenses of moving physical property? Or are we talking more broadly about the far more extensive costs of relocation, which could include training and hiring new workers (at the new location), severance pay for laid-off workers (at the old location), consulting and legal fees (at both locations), costs of building and remodeling (at the new location), and the costs of scrapping old equipment (at the old location)?

It's not just the complexity that's awful. Obama's targeted tax breaks are also lousy economics. Defining what is qualified and what isn't can be costly from an administrative and compliance standpoint. It results in arbitray line-drawing. One type of manufacturing gets a tax benefit while another does not. Some investments in areas with job losses get tax breaks while other productive investments get none. Some types of moving expenses are subsidized but others are not. All of this distorts economic decision-making. It's like pouring sand into the gears of our economic engine.

Like Clinton, Obama is adopting a tax program that is the opposite of tax reform. And as with Clinton, the approach is more likely to kill jobs than create them. ■

## U.S. Government Indicts Swiss Bank for Aiding Tax Fraud

*By Robert Goulder — rgoulder@tax.org*

Federal prosecutors in Manhattan on February 2 charged Wegelin & Co., a Swiss private bank, with conspiracy to conceal assets and evade taxes, the first time the U.S. government has indicted a foreign bank for facilitating criminal tax fraud.

The bank is alleged to have conspired with U.S. taxpayers and other third parties to hide more than $1.2 billion in secret bank accounts and evade federal income taxes on the resulting income. It is believed the assets were transferred to Wegelin immediately following the U.S. government's 2007-2008 crackdown against Swiss banking giant UBS. (For the indictment, see *Doc 2012-2177* or *2012 TNT 23-57*. For a Justice Department release, see *Doc 2012-2175* or *2012 TNT 23-40*. For the government complaint against Wegelin, see *Doc 2012-2176* or *2012 TNT 23-56*.)

Wegelin, based in St. Gallen, was founded in 1741 and is Switzerland's oldest banking institution. As of the end of 2010, the bank held $25 billion in assets under management. It operates no branches outside Switzerland, but like many other foreign banks, it can access the U.S. banking system via correspondent accounts. U.S. law enforcement authorities on February 2 seized more than $16 million from a correspondent account operated out of the UBS branch in Stamford, Conn.

Wegelin is also named in a superseding indictment for conspiracy to evade taxes that is pending before the U.S. District Court for the Southern District of New York. The superseding indictment involves three of Wegelin's client advisers — Michael Berlinka, Urs Frei, and Roger Keller — who allegedly helped clients evade U.S. taxes through undisclosed Swiss bank accounts linked to a chain of private foundations and sham corporations in Hong Kong, Liechtenstein, Panama, and other jurisdictions. (For prior coverage, see *Tax Notes*, Jan. 9, 2012, p. 164, *Doc 2012-160*, or *2012 TNT 3-2*.)

> ***Wegelin Bank was 'undeterred by the crystal clear warning they got when they learned that UBS was under investigation for the identical practices,' said Bharara.***

IRS Commissioner Douglas Shulman praised the Wegelin indictment as a positive development in the agency's long-term battle against illegal tax evasion. "Today's indictment is another step in our



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