A GOOD STARTING POINT:

23 Options from Rep. Dave Camp for Closing Tax Loopholes

AMERICANS FOR TaxFairness

NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

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Credits

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AMERICANS FOR TaxFairness

Americans for Tax Fairness is a diverse coalition of 400 national and state organizations that collectively represent tens of millions of members. The organization was formed on the belief that the country needs comprehensive, progressive tax reform that results in greater revenue to meet our growing needs. ATF is playing a central role in Washington and in the states on federal tax-reform issues.

NATIONAL WOMEN'S LAW CENTER
EXPANDING THE POSSIBILITIES

The National Women's Law Center has worked for 40 years to expand, protect, and promote opportunity and advancement for women and girls at every stage of their lives—from education to employment to retirement security, and everything in between. The Center has been at the forefront of landmark legal and public policy initiatives to improve the lives of women, girls and families since 1972.

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Executive Summary

> *"When it comes to the tax code there is widespread agreement that everyone should play by the same rules… Unfortunately, the tax code has been riddled with lobbyist loopholes that pick winners and losers based on what favors Washington was handing out. It is no wonder that so many Americans are frustrated. Simplifying the broken tax code by eliminating lobbyist loopholes and treating hardworking taxpayers fairly is why we need tax reform."*
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> Rep. Dave Camp, Tax Reform Act of 2014, Executive Summary, p. 5

The tax reform plan developed by Rep. Dave Camp (R-MI) doesn't just talk in abstract terms about closing loopholes. The Tax Reform Act of 2014 identifies specific loopholes in the tax code that should be closed—and the Joint Committee on Taxation (JCT) has estimated how much revenue closing those loopholes would raise.

The Camp plan provides an important service by highlighting special-interest loopholes that should be eliminated from the tax code, changes on which Republicans and Democrats, conservatives and progressives, should be able to agree, even though there are significant differences over the plan as a whole.

The Camp plan would dedicate all of the revenue raised by closing loopholes to cutting tax rates and extending some temporary tax breaks; no revenue would be available for needed investments or to reduce the deficit. After the first ten years, the plan would lose revenue, according to an analysis by Citizens for Tax Justice,[1] threatening further cuts in programs. And, compared to the tax law in effect today, the Camp plan would raise taxes on the lowest-income families—especially single-parents and their children.[2] Nevertheless, closing the tax loopholes that Rep. Camp has identified would be an important step toward tax fairness.

Since 2010, deficit-reduction legislation has reduced the deficit by $4.1 trillion—but 77 percent of the savings come from cuts to programs, and only 23 percent from increased revenue.[3] The "fiscal cliff" deal at the end of 2012 was only a first step toward making the richest Americans pay their fair share of taxes—and corporations have not been asked to contribute a dime in additional revenue.

This report summarizes 23 of the loopholes the Camp tax reform plan would close, along with the JCT estimates of the revenue each would raise. A total of at least $792.6 billion would be raised over 10 years (2014-2023), plus hundreds of billions more that was not able to be itemized based on JCT scoring. If enacted on their own, without the reductions in tax rates that Camp also proposes, these loophole-closing proposals would raise even more over that period.[4]

The report shows how much these giveaways to multinational corporations, multi-millionaire hedge fund managers and other powerful interests cost. And it shows how eliminating these loopholes could move toward a fairer tax system and provide revenue that could be used to protect and strengthen programs decimated by years of budget cuts; make investments to strengthen our economy, create jobs, and expand opportunity; reduce the deficit; or—if Congress choses to extend some temporary business tax cuts—pay for that policy choice.

Not all of the 400 organizations that make up Americans for Tax Fairness necessarily endorse all of these options, and many believe that some of the proposals do not go far enough in closing the targeted loophole. However, they agree that it's past time for Congress to start closing loopholes and eliminating tax breaks for corporations and the wealthy, stop putting the burden of deficit reduction on the middle class and the poor, and start investing in the American people.

23 Options from Rep. Dave Camp for Closing Tax Loopholes

2014-2023, $ Billions

Corporate & Accounting Tax Reforms	
Repeal last-in, first-out (LIFO) method of inventory	$79.1
Repeal lower of cost or market method of inventory	$3.8
Limit net operating loss deduction	$70.5
Repeal/modify like-kind exchange rule	$40.9
Amortization of certain advertising expenses	$169.0
Amortization of research and experimental expenses	$192.6
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Limit interest deduction for financing offshore investments	$24.0
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Close the S corporation loophole	$15.3
Tax some income from carried (profits) interests as ordinary income	$3.1
Limits on Some Fossil Fuel Tax Breaks	
Repeal percentage depletion rules for oil and gas	$5.3
Repeal passive activity exception for oil and gas	$0.1
Individual Tax Reforms	
Limit the value of deductions and exclusions for high-income taxpayers (savings unavailable separately)	NA
Limit the deduction for excessive compensation for corporate executives	$12.1
Limit the exclusion of capital gain from “flipping” houses	$15.8
Limit the mortgage interest deduction (savings unavailable separately)	NA
TOTAL	$792.6

Sources:

Rep. Camp’s tax reform plan, the Tax Reform Act of 2104, is available at:
http://waysandmeans.house.gov/uploadedfiles/ways_and_means_section_by_section_summary_final_022614.pdf.

The Joint Committee on Tax revenue estimates, “Estimated Revenue Effects of the ‘Tax Reform Act of 2014’” are available at https://www.jct.gov/publications.html?func=startdown&id=4562. All JCT revenue estimates are for 2014-2023; however, most provisions do not take effect until 2015, so most represent nine years of revenue.

Corporate & Accounting Tax Reforms

Repeal last-in, first-out (LIFO) method of inventory (Sec. 3310)[5]

Under current law, businesses can manipulate their inventory accounting to make their profits (and taxable income) appear smaller. Instead of assuming that the first item added to inventory was the first item sold (first-in, first-out, or FIFO), the company can treat the last item acquired as the first item sold (last-in, first-out, or LIFO). The option to use LIFO accounting is particularly beneficial to the oil and gas industry. For example, a company buys some oil at $60 a barrel and more at $75 a barrel, and sells it at $85 a barrel. Using LIFO, it can report profit of just $10 a barrel instead of $25 a barrel. LIFO, which has been described as an inefficient and unnecessary subsidy for certain businesses, is not allowed by International Financial Reporting Standards.

The Camp bill would repeal the LIFO inventory accounting method (closely held businesses would be subject to a reduced tax rate of 7 percent to compensate for reduced cash flow).

Revenue: $79.1 billion (p. 7, III.D.10)

Repeal lower of cost or market method of inventory (Sec. 3311)

The current "lower of cost or market" rule is a special accounting rule that allows qualifying businesses to choose whether to value inventory at its cost or market value, whichever is lower, resulting in apparently smaller profits—and lower tax.

The Camp bill would repeal the "lower of cost or market" method of accounting.

Revenue: $3.8 billion (p. 7, III.D.10)

Limit net operating loss deduction (Sec. 3106)

Under current law, a net operating loss (NOL) generally is the amount by which a taxpayer's current-year business deductions exceed its current-year gross income. NOLs may be carried back two years and forward 20 years to offset taxable income, but may not reduce AMT income by more than 90 percent.

The Camp bill would limit the NOL carryover or carryback to 90 percent, conforming to the current-law AMT rule.

Revenue: $70.5 billion (p. 5, III.B.6)

Repeal/modify like-kind exchange rule (Sec. 3133)

When capital assets are sold or exchanged, capital gain or loss is generally recognized. Under current law, however, no gain or loss is recognized when business or investment property is exchanged for "like-kind" business or investment property. The rule was intended to enable farmers to exchange acreage and exempt other small scale and informal barter transactions from tax and reporting requirements. However, it has spread to commercial real estate developers, art collectors, and major corporations, enabling them to sell property at an appreciated price without paying capital gains taxes.
The Camp bill would repeal the rule.

Revenue: $40.9 billion (p. 6, III.B.33)

Amortization of certain advertising expenses (Sec. 3110)

Currently, the tax treatment of advertising expenditures is not addressed specifically in the Internal Revenue Code, but the IRS generally allows taxpayers to treat those as ordinary and necessary businesses expenses, deducting the full cost upfront.

The Camp bill would make 50 percent of certain advertising expenses currently deductible and 50 percent amortizable over a 10-year period. The rule would phase in for tax years beginning before 2018. The proposal would permit taxpayers to expense the first $1,000,000 of advertising expenditures, reduced to the extent advertising costs exceed $1,500,000 and completely phased out once advertising costs exceed $2,000,000. All of these thresholds would be adjusted for inflation.

Revenue: $169 billion (p. 5, III.B.10)

Amortization of research and experimentation expenses (Sec. 3108)

Under current law, taxpayers may elect to treat certain research or experimentation (R&E) expenses in connection with a trade or business as ordinary and necessary business expenses, deducting the full cost upfront. Those deductions must be reduced by the taxpayer's research tax credit.

The Camp bill provides that all R&E expenses be amortized over a five-year period, beginning with the midpoint of the tax year in which the expenditure is paid or incurred. The requirement would be phased in slowly over several years, unless the taxpayer elects to apply the five-year rule to all expenses immediately.

Revenue: $192.6 billion (p. 5, III.B.8)

Limit business entertainment expenses (Sec. 3126)

Currently, taxpayers may deduct up to 50 percent of expenses related to meals and entertainment directly related to the taxpayers' trade or business.

Under the Camp bill, the 50-percent limitation would apply to expenses for food or beverages and to qualifying business meals, with no deduction allowed for other entertainment expenses.

Revenue: $14.7 billion (p. 5, III.B.26)

Limit use of cash method of accounting (Sec. 3301)

Current law limits the use of the cash method of accounting by C corporations with gross receipts of $5 million or more. However, sole proprietors and personal service corporations—including large law, accounting, and lobbying firms—can use the cash method regardless of their gross receipts.

The Camp bill would require businesses with gross receipts of more than $10 million, except for farming businesses, to use the accrual method of accounting.

Revenue: $23.6 billion (p. 7, III.D. 1)

Repeal deduction for local lobbying expenses (Sec. 3102)

Current law allows a deduction for lobbying expenses with respect to legislation before local or Indian tribal government bodies. (Other lobbying and political expenditures are disallowed.)

The Camp bill would disallow the deduction for lobbying local governments and Indian tribal governments.

Revenue: $0.6 billion (p. 4, III.B.2)

International Tax Reforms

Limit interest deduction for financing offshore investments (Sec. 4212)

Under current law, companies can take immediate deductions against their U.S. taxes for expenses associated with their offshore operations while deferring indefinitely the U.S. taxes on the resulting offshore profits.

The Camp bill would limit the interest the U.S. corporations can deduct using a complicated formula, but would still allow corporations to take deductions against untaxed income. (Other proposals would go further and disallow the interest deduction until the profits from the investment are subject to U.S. tax.)

Revenue: $24 billion (p. 12, IV.B.8)

Insurance & Financial Industry Tax Reforms

Impose excise tax on systemically important financial institutions (Sec. 7004)

Sections 113 and 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act define a systemically important financial institution (SIFI) as (1) any bank holding company with at least $50 billion in total consolidated assets or (2) any non-bank financial institution designated for SIFI treatment by the Financial Stability Oversight Council. Under current law, there is no excise tax that applies to the assets of SIFIs.

The Camp bill would require SIFIs to pay a quarterly excise tax of 0.035 percent of total consolidated assets in excess of $500 billion, indexed after 2015 for increases in the GDP.

Revenue: $86.4 billion (p. 15, VII.4)

Reform the tax treatment of derivatives (Sec. 3401)

Due to a special rule in the tax code, certain derivatives traders pay a "blended" rate on their income—60 percent at favorable long-term capital gains rates and 40 percent at ordinary income rates. Although investors must generally hold assets for one year in order to enjoy low-rate capital-gain treatment, traders who buy and sell derivatives are eligible for the blended rate even if they buy and sell instantly. The loophole was carved out a generation ago to protect investors in commodities futures whose purpose was to protect long-term profits, not engage in short-term speculation. But because of changes in the financial markets, a trader can own stock index futures for 10 minutes and get the favorable tax treatment.

The Camp bill would generally mark derivative financial transactions to market at the end of each tax year and treat gains or losses as ordinary income or loss.

Revenue: $15.7 billion (p. 8, III.E.1)

Reduce tax avoidance by insurance companies (Sec. 3701)

Insurers commonly shift U.S.-earned profits to affiliated reinsurers based in Bermuda or other tax havens. The Camp bill would restrict this activity.

Revenue: $8.7 billion (p. 11, III.H.1)

Restrict generous tax treatment of corporate-owned life insurance (Sec. 3501)

Businesses can generate substantial tax savings with arrangements that involve taking out insurance policies on their employees or owners. While nominally "insurance," many of these policies are effectively investment vehicles: a business buys insurance, has the insurer invest the premiums on its behalf, and then receives tax breaks on the resulting gains. The company can generally deduct the cost of the premiums. Some of the most aggressive uses of corporate-owned life insurance involve companies trying to maximize those deductions.

The Camp bill would tighten the tax rules related to corporate-owned life insurance.

Revenue: $7.3 billion (p. 8, III.F.1)

Repeal special treatment of Blue Cross/Blue Shield organizations (Sec. 3509)

Under current law, an organization may be eligible for tax-exempt status as a social welfare organization only if no substantial part of its activities consists of providing commercial-type insurance. When this restriction was enacted in 1986, a special transition rule was provided for Blue Cross/Blue Shield organizations; nearly 30 years later, it gives them preferential tax treatment.

The Camp proposal would repeal this transition rule.

Revenue: $4.0 billion (p. 9, III.F.9)

Tax Reforms of Pass-Through Entities

Close the S corporation loophole (Sec. 1502)

An S corporation is a "pass-through" entity, which means that it does not pay corporate tax on its profits. Instead, those profits are passed through to shareholders, who pay personal income taxes on them. Many S corporation shareholders receive both wages from the firm and a share of firm profits, but they pay payroll taxes only on their wages. This gives them an incentive to underreport their income that consists of wages in order to reduce their payroll tax liability.

The Camp bill provides that partners and S corporation shareholders who materially participate in the trade or business of the partnership or S corporation would treat 70 percent of their combined compensation and distributive share of the entity's income as net earnings from self-employment (and thus subject to payroll taxes) and the remaining 30 percent as earnings on invested capital not subject to payroll taxes.

Revenue: $15.3 billion (p.3, I.F.15)

Tax some income from carried (profits) interests as ordinary income (Sec. 3621)

Partners in private investment firms receive much of their compensation for providing asset management services in the form of an interest in the profits of the partnership, rather than as salary. Under current law, this income is subject to the lower personal income tax rate of 20 percent rather than 39.6 percent.

The Camp bill would treat a portion of such compensation as ordinary income, rather than capital gains. Other proposals would go further and eliminate this preferential tax treatment for private investment fund managers.

Revenue: $3.1 billion (p. 10, III.G.18)

Limits on Some Fossil Fuel Tax Breaks

Repeal percentage depletion rules for oil and gas (Sec. 3130)

Generally, businesses are allowed to write off (gradually deduct) the actual costs of property over its useful life. If oil companies had to do the same, they would write off the cost of oil fields until they were depleted. However, under the percentage-depletion method, oil and gas companies get to deduct a flat percentage of gross revenues each year. Because percentage depletion, unlike cost depreciation, is computed without regard to how much the taxpayer paid for the property, the percentage depletion deductions can exceed the taxpayer's cost and could reduce to zero all federal tax liability.

The Camp bill would repeal percentage depletion.

Revenue: $5.3 billion (p. 6 III.B.30)

Repeal passive activity exception for oil and gas (Sec. 3131)

Under current law rules, the "passive loss" rules limit the creation of tax shelters by limiting the use of deductions and credits from passive trade or business to offset other income. However, there is an exception for passive interests in oil and gas properties.

The Camp bill would repeal this exception.

Revenue: $0.1 billion (p. 6, III.B.31)

Individual Tax Reforms

Limit value of deductions and exclusions for high-income taxpayers (Sec. 1001)

Under current law, because deductions reduce taxable income they are more valuable to taxpayers in higher tax brackets. A taxpayer in the 35 percent bracket who pays $10,000 in mortgage interest receives a deduction worth $3,500; a taxpayer in the 15 percent bracket paying the same $10,000 receives a deduction worth $1,500.

The Camp bill would cap the value of many individual deductions and exclusions at 25 percent, including eligible mortgage interest, contributions to retirement accounts, tax-exempt interest, and employer-provided health insurance.

Revenue: The limitation on the value of exclusions and deductions for high-income taxpayers was not separately scored by JCT. The Camp plan also modifies or repeals a number of deductions or exclusions; JCT scored those provisions as a package and estimated that they would raise $858.4 billion (p. 2, I.E.1). However, a proposal in the Obama budget to cap the value of various deductions and exclusions at 28 percent was estimated to raise hundreds of billions of dollars over 10 years.

Limit deduction for excessive compensation for corporate executives (Sec. 3802)

Currently, there is no meaningful limit on how much corporations can deduct from their income taxes for the business expense of executive compensation. The more they pay their top executives, the less they pay in taxes. As a result, ordinary taxpayers wind up subsidizing excessive executive pay. A Clinton-era reform capped the tax deductibility of executive compensation at $1 million, but with a huge loophole: the cap doesn't apply to "performance-based" pay. This led to the increased use of stock option-based compensation that greatly expanded CEO paychecks—but did not improve performance. Executive compensation experts found that pay arrangements that rely heavily on "performance pay" encourage managers to focus excessively on the short term, motivating them to boost short-term results at the expense of long-term value.

The Camp bill would eliminate the exemption for "performance pay" from the $1 million cap for CEOs and the next four highest paid corporate officers. (Other proposals would go further and close the loophole for all very highly paid executives.)

Revenue: $12.1 billion (p. 11, III.I.2)

Limit the exclusion of capital gain from "flipping" houses (Sec. 1401)

Current law allows taxpayers who file jointly to exclude from income up to $500,000 ($250,000 for other taxpayers) in gains from the sale of a principal residence—property owned by the taxpayer and used as the taxpayer's principal residence for two out of the previous five years. This exclusion can be used every two years.
The Camp bill would require the taxpayer to have used the home as a principal residence for five of the previous eight years, allow the exclusion to be used only every five years, and phase it out for taxpayers with modified adjusted gross income above $500,000.

Revenue: $15.8 billion (p. 2, I.E.2)

Limit the mortgage interest deduction (Sec. 1402)

Under current law, a taxpayer may claim an itemized deduction for mortgage interest on up to $1 million in debt for a principal residence and one other residence.

The Camp bill would reduce the $1 million limitation to $500,000.

Revenue: JCT did not provide a separate score for this proposal.

Conclusion

Many of the loopholes targeted in Rep. Camp's bill and listed in this report are also targeted in President Obama's budget. It's time for Congress to eliminate these special-interest loopholes, make corporations and the very wealthy pay their fair share, and raise the revenue the nation needs to expand opportunity for all.

[1] Robert S. McIntyre, "Camp is Hiding the True Effects of His Tax Plan," TAX NOTES (Apr. 7, 2014), *available at* http://ctj.org/pdf/rsmoncamp.pdf.

[2] *Ibid.*

[3] Richard Kogan and William Chen, Center on Budget & Policy Priorities, *"*Projected Ten-Year Deficits Have Shrunk by Nearly $5 Trillion Since 2010, Mostly Due to Legislative Changes, Recent Spending Cuts Outweigh Tax Increases 3 to 1" (Mar. 19, 2014), *available at* http://www.cbpp.org/files/3-19-14bud.pdf.

[4] Some of these proposals, particularly repeal of last-in, first-out accounting and amortization of advertising and research costs, would raise significantly less revenue in future decades because much of their revenue impact results from a change in the timing of tax payments. However, the cuts in the corporate tax rate would be fully phased in by the second decade, increasing their cost and causing the plan as a whole to lose revenue.

[5] Sections refer to the Tax Reform Act of 2014. Revenue estimates are from Joint Committee on Taxation, JCX-20-14, Estimated Revenue Effects of the "Tax Reform Act of 2014" (2014), *available at* https://www.jct.gov/publications.html?func=startdown&id=4562.