Congress of the United States
JOINT COMMITTEE ON TAXATION
Washington, DC 20515–6453

OCT 27 2011

MEMORANDUM

TO:

FROM: Thomas A. Barthold

SUBJECT: Revenue Estimates

The attached tables are in response to your request for estimates of repealing or modifying corporate tax expenditures and an estimate of the lowest possible corporate income tax rate that could be enacted through legislation that is revenue neutral for C corporations in conjunction with the repeal or modification of these provisions.

The attached tables generally follow the order of Table 1 published in Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2010-2014* (JCS-3-10), December 15, 2010. Tax expenditures listed in that publication that primarily affect individuals or pass-through entities are excluded from the attached tables. A number of the tax expenditure items on the attached tables affect both C corporations and pass-through entities.

Table #11-1 133 provides the revenue effects of the repeal or modification of certain corporate tax expenditure provisions, including the portion that is claimed by partnerships, S corporations, and other pass-through entities. Table #11-1 134 includes only the revenues attributable to C corporations and excludes the portion attributable to pass-through entities. Table #11-1 134, which excludes revenues attributable to activities conducted in pass-through entities, shows the lowest possible corporate income tax rate that is revenue neutral for C corporations. In both tables, not all provisions are estimated at this time although the estimates do include almost all of the major corporate tax expenditure provisions.

As we have previously reported to you, it is not always obvious what tax rules would be applicable when certain tax expenditures are eliminated. In the attached tables we have made some judgments. As another example, we have assumed that elimination of the tax expenditure related to the geological and geophysical costs of oil and gas companies would result in those costs being amortized and recovered over a seven-year period (Table #11-1 133, item II.20.).

Please note that these estimates are very preliminary as we continue to upgrade our models relating to corporate tax reform. Also, note that the estimated revenue effects for some of the reform provisions do not include effects of anticipatory actions that we expect taxpayers would take with sufficient advance notice of the reforms. Further, while some major interaction

TO: Page 2
SUBJECT: Revenue Estimates

effects are included in these estimates, such as interactions with rates, we have not yet estimated all possible interactions that may exist between provisions.

Also please note that the estimated revenues attributable to C corporations are based on the current division of business entities among sole proprietorships, pass-through entities, and C corporations. Should a corporate tax reform proposal target only C corporations and leave the treatment of tax expenditures unchanged for other business entities, the revenue gains from C corporations will potentially be significantly reduced as business entities change their form or structure to minimize their tax liabilities. In addition, there are potentially significant administrative and compliance implications of partial repeal of tax expenditures that likely affect the revenue effect.

Should all of the provisions which we have estimated in the attached table be repealed, the lowest top corporate income tax rate which achieves revenue neutrality for C corporations is estimated to be 28 percent. In estimating the revenue from the repeal or modification of each tax expenditure, and determining this revenue neutral rate, we have assumed that no transition relief is provided for any revenue raising provision. We have assumed that almost all of the provisions would be effective for taxable years beginning after 2011. The estimated 28 percent tax rate could change as estimates are refined, if provisions are added or removed from the list, and as any transition relief is developed for revenue raising provisions.

Finally, there are several provisions that do not change the total value of nominal deductions permitted to the taxpayer, but rather change the years in which such deductions may be claimed. For example, limiting depreciation deductions to the alternative depreciation system rather than the MACRS depreciation system changes the timing of deductions rather than the total nominal value of the deductions. The 10-year budget estimates for such provisions are significantly larger than the long-run effects where all vintages of investment are depreciated under the new regime. Similarly, the estimate in Table #11-1 134 (itemV.18.b) regarding the repeal of the inventory valuation method of the lower of cost or market value, shows that all the revenue raised from repeal accrues prior to fiscal year 2019, with little revenue estimated to be raised in fiscal year 2019 or thereafter. Therefore, we also emphasize that while we estimate that a rate of 28 percent would achieve revenue neutrality for C corporations within the 10-year budget window, this rate would not necessarily be revenue neutral under a longer budget horizon.

Attachment: Tables #11-1 133 and #11-1 134