Corporate Tax Code Rewrite Threatened by House GOP

Cutting corporate taxes remains an ideological centerpiece of the GOP agenda. Yet Republicans are arguing so vociferously over which corporate taxes to cut that they are having trouble moving the tax bill to the House floor, even as Europe threatens to launch the largest trade war in history if Congress fails to act by Jan. 1.

The House Ways and Means Committee approved on Oct. 28 the corporate tax code overhaul, which repeals a problematic export tax break and replaces it with $140 billion in new business tax cuts. But the same problem that delayed committee action for months now keeps it from the House floor — a rebellion by Republicans who say the bill does too little for domestic manufacturers. Democrats, even conservatives who favor tax cuts, have no intention of helping as record budget deficits grow.

House Ways and Means Chairman Bill Thomas, R-Calif., substantially rewrote his bill (HR 2896) to meet the demands of Republicans on his panel who complained that Thomas initially gave too much to corporations with overseas operations. All 24 committee Republicans voted for the revised bill, while 15 Democrats opposed it.

But a growing number of Republicans who are not on the committee are lining up against the bill, according to Small Business Committee Chairman Donald Manzullo, R-Ill. He claims that the bill still fails to encourage U.S. manufacturers to create jobs at home instead of overseas.

Manzullo has the signatures of 19 fellow House GOP members to support his position. Thomas cannot lose more than 11 votes and expect to have a 218-vote majority for passage. Republicans expect little, if any, support from Democrats.

"A bill like that should not be taken to the floor," said Manzullo, whose industrial northern Illinois district is one of the most economically depressed in the nation, with 11 percent unemployment in the city of Rockford. "Members who have lost factories in their district should not be put in the position of voting for a bill like this."

Thomas contends that the $36 billion in tax cuts on overseas income for multinational corporations in his bill are necessary to "improve the international competitiveness" of U.S. companies, which he says bear higher tax rates than their global rivals. "If our tax system puts us at a disadvantage, we need to change that," Thomas said.

There is no indication of when the legislation might hit either floor. Though a companion bill (S1637) is through the Senate tax-writing committee, Senate Majority Leader Bill Frist, R-Tenn., has not scheduled it for floor consideration. Thomas said he will consult with House GOP leaders about a floor strategy on their side of the Capitol. "I only know what I was to do — move it through the committee," he said.

Publicly, party leaders say they hope to pass the bill before the 2003 session ends. "We feel good about the bill, and we want to get it done this year," said Rules Committee Chairman David Dreier of California. And Speaker J. Dennis Hastert of Illinois has publicly endorsed the revised Thomas bill, content that it includes sufficient manufacturing breaks for key Illinois corporations, Caterpillar Inc. and Boeing Co.

That should be music to the ears of the European Union. A central provision of the bill would repeal a $5 billion-a-year export tax break, known as the extraterritorial income exclusion, that the World Trade Organization deems a prohibited trade subsidy. The European Union is threatening to impose $4 billion in punitive tariffs on U.S.

By Jill Barshay

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Concerns that the bill does not stress domestic job creation may prevent it from reaching the House floor.

CQ PHOTO / SCOTT J. FERRELL

Manzullo, shown here during a House Small Business hearing on Sept. 10, is leading a revolt among some House GOP members against the corporate tax bill.

Comparison of Corporate Tax Cut Bills

The House Ways and Means Committee on Oct. 28 approved, on a party-line 24-15 vote, a corporate tax code bill (HR 2896) sponsored by committee Chairman Bill Thomas, R-Calif., that would repeal a tax benefit for exporters that has run afoul of international trade law, and in return would provide new tax cuts to a variety of companies, some with international operations. A Senate bill to repeal the export tax provision that includes fewer new tax cuts and seeks to make them revenue-neutral by raising other taxes was sponsored by Finance Committee Chairman Charles E. Grassley, R-Iowa, and ranking member Max Baucus, D-Mont. It was approved by their panel Oct. 1 on a 19-2 bipartisan vote. A comparison of the two bills follows.

ISSUE	HOUSE BILL	SENATE BILL
Total tax cuts	$140 billion* over 10 years.	$112 billion over 10 years.
Additional revenue	$80 billion* from eliminating export tax break, extending Customs user fees and closing some tax shelters.	$113 billion from eliminating export tax break, extending Customs user fees and curtailing tax shelters.
Tax reduction for manufacturers	$61 billion cut for manufacturing companies, by reducing the top income tax rate for such companies to 32 percent from 35 percent.	$60 billion tax cut for manufacturers by allowing them to deduct 9 percent of profits from taxable income, effectively lowering their top rate to 32 percent from 35 percent. (The deduction structure allows many companies to report a larger balance sheet to shareholders.)
Who would qualify	Manufacturers as well as film distributors, software firms, agricultural businesses, construction companies, miners, oil and gas refiners, and some architectural and engineering firms. Foreign-owned manufacturers and U.S. multinationals would enjoy the full tax break.	Same industries as House bill (except for engineering and architectural services). Also grants the break to businesses structured as S-corporations,cooperatives, partnerships and sole proprietorships. Multinational and foreign-owned factories would not get the full tax break until 2013.
Who would not qualify	S-corporations, farm cooperatives, partnerships and sole proprietorships, thus excluding most small manufacturers and farmers.	Engineering and architectural firms.
Phase-in schedule	Tax cut begins in 2004, with full implementation in 2007.	Tax cut begins in 2004, with full implementation for manufacturers in 2009. Multinationals and foreign-owned firms get full cut in 2013.
Repeal of export tax break, known as the extraterritorial income exclusion	Export tax break phased out over three years, giving exporters a partial tax break based on their actual exports in 2004, 2005 and 2006. Long-term leases, such as Boeing's airplane leases, would be grandfathered for the length of the contract — some as long as 20 years. Cost: $12 billion.	Export tax break phased out over three years, giving exporters a partial tax break based on their 2002 exports, whether or not they continue to export. Long-term leases, such as Boeing's airplane leases, would be grandfathered for the length of the contract — some as long as 20 years. Cost: $10 billion.
Tax breaks for overseas income of multinationals	$36 billion, including a cut for offshore sales offices in Europe, and $21 billion in expanded use of foreign tax credits. Most of these cuts would take effect after 2008.	$39 billion, including expanded use of foreign tax credits beginning in 2005, with some phasing in as late as 2010.
Other domestic tax cuts	$32 billion, including 3 percentage point rate cut for corporations with profits less than $20 million; investment tax break for small businesses, elimination of fish restoration fund tax on fishing tackle boxes, among many special interest provisions.	$5.5 billion, including a break allowing unprofitable companies to carry back losses for three years.

* Totals for the House bill do not match Joint Committee on Taxation revenue table, which lists tax cuts of $128 billion and offsets of $68 billion. For a direct comparison with the Senate bill, the House figures were broken out into more detail to show that the repeal of the export tax break raises $55 billion and its three-year phaseout costs $12 billion. The Joint Tax table simply lists a net revenue gain of $43 billion for the export tax repeal.

SOURCE: Joint Committee on Taxation and Congressional Quarterly research

goods imported into Europe — the largest retaliatory sanctions in history — if the U.S. fails to comply by year's end. *(CQ Weekly, p. 2079)*

EU Battles Could Continue

Thomas' bill would not comply with international trade rules because the legislation would allow U.S. exporters to continue to receive a tax subsidy for the next three years, according to testimony by John Veroneau, general counsel in the U.S. Trade Representative's office. Veroneau said his office would try to get the EU to accept the new corporate tax structure, if enacted.

Moreover, two senior House GOP aides were wary about a floor vote in the next week. "I don't see a scenario where any Democrats will vote for the bill," said one aide.

With House Republicans divided, Democrats are united in their opposition to the tax bill. The staff of the most senior Democrat on the Ways and Means panel, Charles B. Rangel of New York, is in discussions with Manzullo's office on forming an alliance to defeat the Thomas bill, according to a Rangel aide. Rangel had successfully joined forces with Rep. Philip M. Crane, R-Ill., on the tax writing panel to force changes to Thomas' bill that were significant enough to appeal to Crane. *(CQ Weekly, p. 2628)*

Democrats are primarily opposed to the bill's cost. Rangel and other Democrats complain that $80 billion in revenue offsets in the Thomas bill are insufficient. They assert that the bill's true cost is much higher than the 10-year, $60 billion price tag affixed by the Joint Committee on Taxation, because many of the costliest cuts do not kick in until midway through the decade.

Based on a $12 billion cost for the year 2013 alone, the liberal Center on Budget and Policy Priorities estimates that the 10-year cost would be about $96 billion without budget "gimmicks."

No one expects legislation to be signed into law by the European deadline. The question is how much legislative movement Congress must show this year to avert a trade war.

Special Interests

Democrats also poke holes in the special-interest provisions littered through the bill. Rangel claimed that most profit-making companies — eight of 10, he said — would "get nothing" from the Thomas tax cuts.

BoxScore

Bill:
HR 2896 — To repeal an export tax break and replace it with new business tax cuts on domestic manufacturing and overseas income.

Latest Action:
House Ways and Means Committee approved HR 2896, 24-15, on Oct. 28.

Next Likely Action:
Neither the House nor Senate has scheduled floor votes.

Reference:
Background, CQ Weekly, pp. 2628, 2555, 2428, 2342, 2200, 2090, 2079.

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Even cuts that appear broad-based on the surface, such as a 3 percentage point cut for all companies, regardless of their industry, with taxable incomes of under $20 million, turned out to benefit just 144,000 companies. That's about 7 percent of the nation's 2.2 million corporations, according to the JCT. Eighty percent of the current export subsidy goes to 15 companies, including Boeing and Caterpillar. They will continue to receive an outsized share of the $12 billion phaseout.

Hollywood would be one of the bill's big beneficiaries. Lobbying on behalf of the movie studios was Kenneth Kies, a former chief of staff of the Joint Committee on Taxation and a former Ways and Means tax counsel. Movies would not only qualify for the manufacturing tax cut, which lowers their rate from 35 percent to 32 percent, but studios would get a huge tax break on their foreign receipts — an increasingly sizable part of their revenue, often surpassing domestic receipts.

The bill includes a special $535 million provision exempting a large chunk of royalty income from U.S. taxes on movies shown abroad. Royalty income is often not taxed in foreign countries, leaving many of these dollars not taxed altogether. In reaction to Democratic protests that it would subsidize so-called "runaway" productions made in Canada and other countries, Republican tax writers on the day of the markup limited the tax cut to movies in which at least half of the filming was done in the United States.

Services firms in the architectural and engineering industries also were included in the manufacturing tax break. Responding to Democratic complaints, Republican tax writers clarified that these firms, including Bechtel National Inc. and Halliburton, could not claim this tax break on offshore projects, such as contracts in Iraq. Still, they would be able to reap at least $280 billion from the new manufacturing tax cut, according to JCT.

Makers of fishing tackle boxes received a $32 million tax cut to eliminate a 10 percent excise tax on their wares. Rep. Jerry Weller, an Illinois Republican on Ways and Means, has been seeking the break for his corporate constituent, Plano Moulding Co., since 1998.

"You go to the same aisle in the Wal-Mart and you can pick up any type of box that looks the same as a tackle box, but it's not subject to the tax," said Weller spokesman Ben Fallon.

Rods, reels and other angler necessities still would be subject to the tax under the corporate tax bill. But sonar devices suitable for finding fish are also exempt from the excise tax under the bill, a result of efforts by another GOP tax writer, Jim Ramstad of Minnesota.

The excise tax goes to fish restoration programs.

Paul D. Ryan, R-Wis., took care of a big bow and arrow maker in his district with a $7 million tax cut to eliminate a 12.4 percent excise tax on each arrow. "We do not tax imports. U.S. manufacturers of arrows are fleeing to Korea and China," he said. The excise tax goes to wildlife restoration programs.

The distilled spirits industry obtained two separate tax breaks totaling more than $400 million over 10 years.

And on the day of the markup, a final tax break was slipped in to give the mutual fund industry a $577 million tax benefit on selling funds abroad, reducing the withholding tax on dividend distributions to foreign investors.

With the House stalled, trade sanctions loom. Even while Europe was demanding a final repeal of the offending export tax break, senators had been hoping that a House vote would be enough to demonstrate a good-faith legislative attempt at a repeal. Yet the question remains as to whether a lack of further action will cause the Europeans to act — and to what effect. ◆