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SENATE REPUBLICAN POLICY COMMITTEE

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Additional Pro-Growth Stimulus Ideas that Congress Should Consider

Introduction

Many economists have concluded that the current bi-partisan stimulus package working its way through Congress will provide a boost to the U.S. economy. The focus of this package has been to deliver stimulus that is timely, targeted and temporary. While such a focus can be appropriate in the short term, the package does not contain some of the pro-growth provisions necessary to stimulate long-term economic growth like those that have been the hallmark of Republican leadership. Recognizing that the private sector is the engine that drives job growth and economic opportunity, this paper contains ideas to stimulate long-term economic growth. Below are ideas that Senate Republicans should consider offering to future legislation.

Permanent Extension of the 2001/2003 Tax Relief

Making the 2001/2003 tax relief permanent is an important objective for two reasons: First, it would continue the provisions stimulating economic growth; and second, it would lower the baseline for enacting fundamental tax reform over the long term. Permanent tax relief, including the 10 percent individual income tax bracket, reductions in the marriage penalty, the expansion of the child tax credit, and lower marginal rates, would provide the economy with certainty that taxes will not be increased. During times of economic uncertainty, the American people, in addition to their stock market, housing, and gas price worries, should not also be saddled with burdensome tax increases.

Lower Cap Gains and Dividends Rate

The 2003 tax relief that lowered the rate on capital investment to 15 percent has been remarkably successful. It has resulted in a dramatic increase in dividend distributions, benefiting all Americans owning dividend-paying stocks, a significant number of whom are far from wealthy. It has also encouraged investors to realize capital gains, unlocking critical capital for business growth and increased employment. Moreover, it has promoted greater economic efficiency and significant reforms in the corporate sector of the economy. The lower tax rates on dividends and capital gains have succeeded in producing two very positive results – an expansion of the supply of capital and a reduction in the cost of that capital. This, in turn, allows American businesses, and in particular small enterprises, to increase investment, productivity, and employment.

Allowing the 2003 tax relief to sunset will have devastating consequences for the economy. Less capital in the private sector will increase financing costs for American businesses, hindering their ability to make capital investments, expand their operations, and provide critical jobs. It will also have a profound stock market effect on both the investor class and also the defined contribution retirement class, both of which depend on dividend income and the value of their investments. As the expiration of the 2003 tax relief approaches, it is imperative that the relief be made permanent, a battle that the U.S. economy cannot afford to lose.

Lower Corporate Rate

The U.S. has the second-highest corporate tax rate among nations in the Organization for Economic Cooperation and Development (OECD) and is one of only two countries that has not reduced its rates since 1994. By lowering the top corporate income tax rate from 35 percent to 25 percent, U.S. companies would be able to retain more of the money they earn, which in turn allows businesses to hire more workers, expand operations, accelerate investment, and compete internationally.

Lowering the corporate rate would enhance the competitiveness of the corporate tax system by reducing the effective tax rate borne by new investment in the United States, U.S. multinationals would feel less pressure to engage in corporate inversions and other forms of profit-shifting, and U.S. companies would be more likely to reinvest foreign earnings in U.S. companies.[1]

Reduce the Capital Gains Rate for Corporations

Under current law, individuals pay a top capital gains rate of 15 percent, but corporations are subject to a 35 percent top rate. Congress should enact a legislative proposal that would also allow corporations to benefit from the 15 percent capital gains rate. Lowering this rate for corporations would unleash private sector investment spurring economic activity and production.

[1] *http://www.taxfoundation.org/research/show/22501.html*

Index Capital Gains for Inflation

Income tax brackets have been adjusted for the cost of living ever since the Reagan tax cuts of 1981, but capital gains continue to suffer from an inflation tax. Such an inflation tax yields a windfall profit for the government but reduces the value of holding long-term capital assets. The failure to index encourages investors to hold on to assets causing market distortion and economic inefficiency. A 1993 study by then Federal Reserve Board Governor Wayne Angell calculated that the average real tax rate on investments from 1972 to 1992 in Nasdaq stocks was 68 percent. It was 101 percent in the S&P 500, 123 percent in the NYSE, and 233 percent in the Dow Jones Industrials. On three of the four major indexes, the average taxes were *higher* than the actual return.

Under current law, the capital gains tax is based on the difference in the original purchase price of the asset and the sale price of the asset. Indexing capital gains to inflation would essentially cut taxes on investment. It would mitigate a government-created obstacle that all investors face when they decide how much money to invest, and it would make it cheaper to move away from under-performing positions. It would also allow investors to make better, more prudent decisions if they are not driven by avoiding adverse tax consequences. Congress should: (1) work to enact legislation that would index for inflation the cost basis used when calculating the capital gains tax on assets acquired before the end of 2008; or (2) encourage President Bush to adopt the legislation by executive order.

Incentivize the Housing Market

Many major metropolitan areas across the country have seen a decline in housing values over the past year. It is anticipated that this slide will continue in 2008. The housing sector is a vital aspect of the U.S. economy and its health is an important indicator to domestic and foreign investors on Wall Street and to families and small businesses on Main Street, which affects consumer confidence among other things. In order to provide assistance to the housing industry, Congress should consider enacting tax incentives, such as tax credits, to homebuyers of certain properties in a way that helps stabilize the housing market.

Full, Immediate Expensing

Under current law, businesses can only take limited deductions in pieces, over several years. In an effort to speed up the benefit to businesses, the current economic stimulus package includes increased expensing amounts. However, legislation that would allow businesses to immediately expense, or fully deduct on their tax returns, the costs of assets they purchase for their business in the year that they buy such assets would provide them with the incentives they desperately need to grow and expand. Furthermore, it would take the current proposals relating to bonus depreciation and Section 179 for small business to their logical conclusion. By uncapping and accelerating the expensing, businesses would be encouraged to purchase assets with which to grow a business.

Allowing small-business owners to immediately expense critical investments is key to the expansion of the economy. It puts money back into the hands of small-business owners so they can hire new workers and purchase new equipment.

Net Operating Losses

It is uncertain whether the current short term stimulus legislation will include a net operating loss (NOL) provision, similar to that which was included in the Senate Finance mark. Providing businesses that have losses, which are unable to take advantage of expensing provisions, the ability to apply NOLs can provide an immediate infusion of capital that would stabilize the economy, particularly in distressed industries, such as housing.

Establish a Repatriation Window

In 2004, the American Jobs Creation Act (AJCA) included a temporary tax provision that allowed U.S. companies to repatriate accumulated foreign earnings as a cash dividend at a reduced tax rate. The legislation reduced the tax rate by 85 percent, from 35 percent to 5.25 percent. Establishing a new repatriation window would: (1) enable more U.S. companies to invest significant earnings that otherwise would not be invested in the United States; (2) relieve U.S. multinational companies from severe business burdens imposed by a U.S. corporate tax rate that is the second highest in the world and a U.S. tax system that is one of the few that tax worldwide earnings of their companies; and (3) provide a sizeable, cost-effective source of capital to be injected into the U.S. economy, increase U.S. banking system liquidity, and ease capital concerns. The first repatriation window brought back $360 billion to be reinvested in the United States. A survey of the first repatriation window indicates that 25 percent of the repatriated earnings were used for U.S. capital investment, 23 percent for hiring and training of U.S. employees, 14 percent for U.S.-based research and development, and 13 percent for reduction of U.S. debt.

Death Tax Repeal or Reform

In 2001, Congress enacted a phaseout of the federal estate or “death” tax, with its complete repeal scheduled to occur for one year in 2010 with the pre-2001 levels springing back into effect in 2011. There are numerous costs that the death tax imposes on Americans, including lifetime estate-planning costs, compliance costs at death, and deterrent costs to saving, investing, and entrepreneurship. The result of the abovementioned costs is a loss of economic opportunity. The death tax is a disincentive for Americans who work hard, save, and invest for the future.

Congress should work towards a plan that repeals the death tax outright; however, past attempts to make the death tax permanent have failed to garner the necessary 60 votes to override a filibuster in the Senate. So, if the political climate makes it next to impossible to achieve full repeal, then Congress should look towards a compromise. A compromise holds the potential for breaking the logjam and providing some much needed certainty: drop the tax rate to 15 percent and increase the exemption to $5 million per person. By lowering the tax rate to 15 percent, the compromise would link the death tax with the current capital-gains tax rate. By doing so, Americans will not be forced to pay more in death than they would if they had sold property prior to their death. Without the death tax, substantial capital would be channeled back into the economy, fueling investment, employment, and overall economic growth.

Provide Small Publicly Traded Companies With Regulatory Relief

Section 404 of the Sarbanes-Oxley (SOX) Act has often been cited as having a negative impact on capital markets competitiveness. Section 404 requires public companies to assess the adequacy of the company's internal control over financial reporting. This is the most costly aspect of the legislation for companies to implement. The cost of complying with Section 404 disproportionately impacts smaller companies. For example, during 2004 U.S. companies with revenues exceeding $5 billion spent .06 percent of revenue on SOX compliance, while companies with less than $100 million in revenue spent 2.55 percent.

Furthermore, research indicates that Section 404 may be lengthening the time that it takes for companies to get to the public markets and even compelling some companies to choose foreign markets or private placements. Commentators have suggested that the SEC and the Public Company Accounting Oversight Board (PCAOB) are not moving quickly enough and that the proposed guidance will likely not have its desired effect.

According to options discussed at a Republican Policy Committee-sponsored roundtable discussion on capital markets on May 21, 2007, Congress could enact legislation to provide regulatory relief to public companies, either in the form of a “small-business carve out” from Section 404 for companies with income below a certain threshold or by allowing companies to “opt-out” of Section 404 provided proper disclosure is made to shareholders. Either option would allow companies to better reinvest their resources in a manner that would grow the business and create jobs and would make the United States more competitive in the global marketplace and grow the U.S. economy.

Conclusion

In addition to the options currently being debated in the stimulus bill, Congress should be cognizant of additional pro-growth options that are designed to provide economic activity with immediate application and sustained, long-term positive implications.