

THE PRESIDENT'S FISCAL YEAR 2016 BUDGET
PROPOSAL WITH U.S. DEPARTMENT OF THE
TREASURY SECRETARY JACOB J. LEW

HEARING
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED FOURTEENTH CONGRESS

FIRST SESSION

FEBRUARY 3, 2015

Serial No. 114-FC03

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PUBLISHING OFFICE

22-331

WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
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**THE PRESIDENT'S FISCAL YEAR 2016 BUDGET
PROPOSAL WITH U.S. DEPARTMENT OF THE
TREASURY SECRETARY JACOB J. LEW**

TUESDAY, FEBRUARY 3, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to call, at 10:03 a.m., in Room 1300, Longworth House Office Building, Hon. Paul Ryan [Chairman of the Committee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
Tuesday, January 27, 2015
No. FC-03

CONTACT: (202) 225-3625

Chairman Ryan Announces Hearing on the President's Fiscal Year 2016 Budget Proposal with U.S. Department of the Treasury Secretary Jacob J. Lew

House Committee on Ways and Means Chairman Paul Ryan (R-WI) today announced that the Committee on Ways and Means will hold a hearing on President Obama's budget proposals for fiscal year 2016. **The hearing will take place Tuesday, February 3, 2015, at 10:00 a.m. in Room 1300 of the Longworth House Office Building.**

Oral testimony at this hearing will be from the invited witness only. The sole witness will be the Honorable Jacob J. Lew, Secretary, U.S. Department of the Treasury. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Tuesday, February 17, 2015.** For questions, or if you encounter technical problems, please call (202) 225-3625 or (202) 225-2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.
2. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.
3. Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available online at <http://www.waysandmeans.house.gov/>.

Chairman RYAN. All right. The Committee will come to order. The hearing will come to order.

Welcome to the Committee on Ways and Means hearing. This is not the Agriculture hearing. Welcome to the Committee on Ways and Means hearing on President Obama's budget proposal with our U.S. Treasury Secretary, who is sitting far away down there, Secretary Lew. Our hearing room is under construction. So these are the temporary quarters for us. So we are not necessarily used to the room.

Before we get started, I want everyone to please be advised that Members may submit written questions to the Treasury Secretary to be answered later in writing. Those questions and your answers will be made part of the formal record.

We also understand that Secretary Lew has a hard stop at 1 o'clock. So I am going to run this tight so we can get to as many people as possible, but wherever we cut off, we will start with that Member in the queue the next time we pick up with the next hearing, just to make sure, just to try and play it fair like that.

So Secretary, I want to say something. We got your budget yesterday. I have to say, as a former Budget Chairman, I am a little miffed. Four years in a row, which was when I was Chair of the Budget Committee, 4 years in a row, you are late with your budget, and the minute I leave, you produce it on time. What gives?

In all seriousness, the one positive thing I would like to say is that the budget is finally on time. And to those of us in the budget world, that clock means a lot. It sets the tempo for Congress. It means a lot of things, and so congratulations on finally giving us a budget on time.

That said, the irony wasn't lost on me that the Administration submitted their budget on Groundhog Day, because it is the same thing every year, even a little worse. You have raised taxes by \$1.7 trillion over the past 6 years. Now you want to raise them again by \$2.1 trillion. You want to tax savings and investment in small businesses. Sooner or later, you are going to start looking for money in the couch cushions.

So I just want to take an opportunity here to make something really clear. We are not going to raise taxes on the American people. They are working harder and harder to get ahead and they are falling behind. Wages are stagnating. They deserve a break, not another tax increase. The last thing this economy needs is another whopping tax increase. The kicker is, with even all of these tax increases, you don't even balance the budget, not even in 10 years, because you don't get spending under control.

So I am disappointed in this proposal, but as far as I am concerned, I would rather spend time not focusing on our differences. Let's instead try to find some time and a way to see if there is some common ground. I think there may be some opportunities to do that.

The first thing that comes to my mind is trade. We all agree that trade is good for America, because more trade means higher pay. And so our top priority is to put in place Trade Promotion Authority. To get the best trade deals possible, we have to be in the best position possible, and that is what TPA helps us do. So I will be interested to hear how the Administration is helping us get TPA across the finish line.

Next, we have to fix this broken Tax Code. We want to fix it for everybody, but with this Administration, in the past, we haven't had very high hopes, but you have gradually, grudgingly taken a few steps, in my opinion, in the right direction, though, in my opinion, you also need to move it a little farther.

For years you talked about fixing the Tax Code for corporations but not for families and small businesses. More recently, after this Committee's constant insistence that tax reform cannot give an unfair advantage to big public companies over closely-held, family-owned businesses, the Administration is now finally talking about helping small businesses as well. Even though your specific proposals have been far from adequate, at least it is a step in the right direction.

Now the Administration is taking a few more baby steps in the right direction by proposing a few ways to simplify the Tax Code for middle class families. So it is progress, not a lot, but we will take it. So I would be interested to hear what you have to say about tax reform. If we can find common ground, we need to explore it, but I will tell you right now, what the President is proposing for small businesses organized as pass-throughs, you know, sole proprietorships, partnerships, S corporations, it just doesn't go far enough. It just doesn't cut it. Small businesses, they are the engine of our economy, and this Committee is not going to do just anything. This Committee is not going to leave them behind. This Committee has to make sure that they are part of the solution.

The Tax Code has to work for everybody, especially families and small businesses. We need to make it simpler, we need to make it fair, and we need to make it flatter. We need to make it more globally competitive. We need to create more jobs. That is the way to create jobs and build a healthy economy. So we want to work with this Administration. We want to explore common ground. We have two big opportunities here potentially on tax and on trade, and so we would like to get this done. Let's see if we can find a way of working together, and with that I would like to yield to the distinguished Ranking Member, Mr. Levin.

Mr. LEVIN. Thank you very much, Mr. Chairman.

Welcome, Mr. Secretary. As the Chairman said, you are further away. We will try to make this more personal, though.

I wanted to start on a personal note to recognize the fact that someone who has served as our staff director on Health, Cybele Bjorklund, this is her last hearing. I don't know where Cybele is. Are you here?

Ms. BJORKLUND. I am here.

Mr. LEVIN. You are back here. Cybele, thank you for all of your work.

Again, welcome, Mr. Secretary. This Administration first presented a budget to Congress 6 years ago. Back then, in the months of February and March of 2009, just weeks after President Obama took office, the economy lost more than 1.5 million jobs; the most in any 2-month period since World War II. Today the economy has experienced significant growth with 58 consecutive months of private sector job gains. Over the past 4 years, the United States has put more people back to work than Europe, Japan, and all of the world's major advanced economies combined. That is hardly a "stagnant economy." Republicans try to minimize that dramatic turnaround, but are instructed to revisit what their party's Presidential nominee in 2012 promised to achieve by the end of his first term in office. Mitt Romney said, "I can tell you that over a period of 4 years, by virtue of the policies that we put in place, we would get the unemployment rate down to 6 percent and perhaps a little lower."

Today, nearly 2 years before that deadline, the unemployment rate has dropped to 5.6 percent. The ongoing challenge that we confront, a challenge that has persisted for the last three decades, dating back to the Reagan years, is how to ensure that middle class families are not left out of the growth of our economy that is now being experienced and will be experienced in the future.

The President's budget takes direct aim at that challenge. It includes proposals to support working families by making child care more accessible, guaranteeing paid sick leave, and making permanent extensions of vital provisions, including the EITC, the Child Tax Credit, and the American Opportunity Tax Credit. It combines changes in the international tax structure and provisions for the long-term needs of our Nation's infrastructure. It closes tax loopholes that predominantly benefit a select few.

These proposals are not envy economics. They are everyone's economics. They are not the economics of envy. They are the economics of working for all, not just the very wealthy. Through a fiscally responsible replacement for the sequester, the President's budget would allow us to invest in education, medical research, and other domestic priorities, as well as provide the resources that Social Security, Medicare, and the IRS need to serve the American people, and would provide for the ever-changing needs of our military as it confronts new challenges.

I hope the Republicans give these and other proposals presented within the President's budget, Mr. Chairman, the full and serious consideration that they deserve.

One of the many outstanding issues in the Trans-Pacific negotiations, currency manipulation, is mainly in the purview of Treasury. Over the past decade, currency manipulation by foreign governments has resulted in an increase in unfairly traded imports into the United States. It has made it more difficult for U.S. exporters to compete in foreign markets. It has cost us millions of middle class jobs. The TPP includes a number of former currency manipulators, such as Japan and other countries, including China, Korea, and Taiwan, who have been in the past manipulating their cur-

rencies. Each of these countries is party to the IMF, which already prohibits currency manipulation, and has developed deadlines to define when it occurs. The problem is that the IMF lacks any enforcement provision. That is why I propose taking the existing IMF guidelines and building on them so they can be addressed through the TPP.

I have heard concerns that the U.S. monetary policy might be at risk if we put such a provision in the TPP. The IMF guidelines clearly spell out that U.S. monetary policy, including quantitative easing, is not currency manipulation. The first factor is protracted large-scale interventions in currency markets, and the United States has not engaged in that. The second factors have in it an excessive amount of foreign exchange reserves. I could go through each factor, but suffice it to say, that the IMF has explicitly supported each round of U.S. quantitative easement since the great recession. U.S. monetary policy would not be put at risk by addressing currency through the TPP.

I look forward to discussing with my colleagues, Mr. Chairman, on a bipartisan and bicameral basis, and with the Administration, how to include a strong and enforceable currency manipulation provision as well as tackling the other major outstanding issues in the TPP that I outlined late last month in a document that I called *A Path Toward an Effective TPP Agreement*.

Thank you, Mr. Secretary, for your dedication and your service to our Nation for many years, going back to the days when you were still much younger working for Tip O'Neill, and I am very happy to welcome you back before this Committee.

Thank you, Mr. Chairman.

Chairman RYAN. Thank you. Thank you, Mr. Levin.

Secretary Lew, thank you for your time today. Your entire written testimony will be included in the record. If you could try to summarize it in 5 minutes so we can—because we know you have a hard stop at—try to summarize it in 5 minutes so we can get to our questioning, we would appreciate it. The time is yours.

**STATEMENT OF THE HONORABLE JACOB J. LEW, SECRETARY,
U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC**

Secretary LEW. Thank you very much, Chairman Ryan, Ranking Member Levin, Members of the Committee. It is good to be with you here this morning to discuss the President's budget, and Mr. Chairman, I know this is the first time I have appeared since you have taken over the gavel of this Committee. I congratulate you and look forward to working together on a bipartisan basis to get things done.

A year ago, President Obama said that 2014 would be a breakthrough year for our economy, and the evidence is now clear that over the past 12 months, America has made great strides. We are seeing real progress in job creation, economic growth, family wealth, energy independence, manufacturing, exports, retirement accounts, the stock market, healthcare costs, graduation rates, and the deficit. The fact is our businesses created nearly 3 million jobs last year, the most jobs in any year since the late 1990s. This capped off roughly 5 years of jobs growth, the longest stretch of

jobs growth in our Nation's history, and the creation of 11 million new jobs.

In addition, the unemployment rate dropped to its lowest rate in 6½ years, and our economy continued to expand with healthy growth in the second, third and fourth quarters of 2014 and forecasts projecting above-trend growth in 2015.

From a global perspective, we continue to outperform our trading partners, many of which are still trying to climb out of the vast hole created by the global economic crisis. At the same time, with the Affordable Care Act in place, about 10 million Americans now know the financial security of health insurance and healthcare prices rose at their lowest rates in decades.

The automobile industry continued its rebound in 2014, even as we marked the official end to the auto industry rescue, and American taxpayers recovered more money than we invested.

Finally, thanks to the Administration's all-of-the-above energy strategy, we moved closer to energy independence than we have been in decades, and gas prices fell, providing a shot in the arm for families and small businesses. So today our Nation has turned the corner on a number of fronts. As we know, this resurgence has not reached every American. For too many hard-working men and women in this country, it is still too hard to get ahead and earn enough to raise a family, afford child care, pay for college, buy a home, and secure retirement.

The President's budget meets these challenges by offering real solutions to grow the economy, strengthen the middle class, and make paychecks go farther.

This budget is built around the basic idea that hard work should pay off. It is practical, not partisan, and it lays out clear steps to reign in spending and eliminate wasteful tax breaks so we can reduce taxes for working families as well as many businesses and manufacturers.

What is more, this budget replaces the across-the-board cuts from sequestration and makes sensible investments to increase our economy's competitiveness while maintaining a responsible fiscal path.

As we know, not long ago some were predicting that the President's policies would explode our deficits. A little history, though, makes clear the opposite is true. In the 1990's, when I was Budget Director, I oversaw three budget surpluses in a row, and we were on a path to pay down our national debt, but when this Administration took office in 2009, there was a very different reality. After years of runaway spending, including tax cuts for the most well off and two wars that were not paid for, and then the financial crisis, our deficits reached a post-World War II high. The President moved to right our Nation's fiscal shift. With his balanced economic approach, the agreements forged with Congress and a growing economy, the deficit has fallen by almost three-quarters, the swiftest downward arc since the period of demobilization following World War II.

The deficit is projected to decline even further in the next fiscal year, and today we are putting forward a plan to lower our deficits to about 2½ percent of GDP over the 10-year budget window.

Our Nation's improved financial footing has occurred even as Congress was able to undo a portion of sequestration in recent years, replacing these cuts with more sensible and balanced savings. Still nothing has been done to address these dangerous cuts in 2016. Without Congressional action, vital funding for our national defense and key priorities like education, infrastructure, and research will be severely cut back.

The President's budget provides a path to eliminate sequestration while achieving the President's longstanding commitment to a responsible and balanced fiscal approach. In other words, it charts a specific way forward to not only keep our fiscal house in order, but to also create room for pro-growth economic policies which are needed to keep our Nation stronger in the future.

One pro-growth strategy of tax reform is to restore basic fairness and efficiency to our system. By scrapping loopholes and tax breaks that reduce the taxes for the most fortunate Americans but do not help our economy, we can provide critical tax relief for the middle class and those struggling to join the middle class. Our economy should work for everyone, and everyone should shoulder their fair share to maintain our Nation's fiscal health.

This budget also places a serious focus on achieving bipartisan business tax reform so that America is the best place in the world for businesses to locate, grow, and create the kind of good high-paying jobs that support middle class families.

This plan shows how Members of both parties can reach a common ground and realize the shared objectives of simplifying the system, removing wasteful tax preferences and distortions, and lowering tax rates so that we no longer have a system in which some businesses pay nothing while others pay the highest rates in the developed world. It is time to stop rewarding corporations and industries that have the best lobbyists and most creative accountants, and start strengthening businesses that build, hire, and invest here in the United States.

It is also time to make inversions, a loophole that allows U.S. companies to lower their taxes after they buy foreign businesses, a thing of the past, and this budget does that. A more fair and efficient tax system will help create good middle class jobs and grow our economy.

We know that with business tax reform, there will be one-time transition revenues. The President wants to use some of these one-time revenues to make long overdue repairs to our Nation's roads, bridges, ports, and airports. The need to rebuild our infrastructure is irrefutable, and that is why this budget tackles our infrastructure challenges by creating an extended period of sustained funding for a 6-year Surface Transportation bill and starting an innovative new bond program that will ignite more public/private partnerships in cities and States across the country.

Of course, keeping our comeback on track, building on the momentum we have made and making it possible for every American to get ahead is going to require strategies that are both bold and effective, and that is what this budget is about. It proposes a series of targeted investments that have been proven to make a difference. It invests in education by expanding student loans, strengthening tax incentives, and making community college free

for those who earn it. It invests in America's workers by starting apprenticeship grants, enhancing job-training programs, and boosting the Earned Income Tax Credit. It invests in working families by increasing the Child Care Tax Credit, providing tax relief for families when both parents are holding down jobs, and allowing more working Americans to earn paid leave. It invests in retirement security by making it easier for employees to automatically save for the future, and businesses to provide 401(k)s to their employees, and invests in innovation by creating more advanced manufacturing institutes, starting cutting-edge medical research initiatives, and bringing broadband access to more communities.

In concert with these pro-growth strategies, this budget calls on Congress to send measures to the President's desk that will help our economy now and far into the future. This includes raising the minimum wage, fixing our broken immigration system, and passing Trade Promotion Authority.

The strategies I have described are part of the President's plan to help improve the lives of millions of hard-working Americans while meeting our responsibilities to future generations. The task before us now is to put political brinksmanship aside and find areas of compromise and common ground, and I am certain that we can get this done.

I look forward to working with each and every Member of this Committee so we can deliver for the American people, and I look forward to answering your questions today.

Thank you very much.

[The prepared statement of Secretary Lew follows:]

*** EMBARGOED FOR DELIVERY***

**Written Testimony of Treasury Secretary Jacob J. Lew
before the House Committee on Ways and Means
on the President's Fiscal Year 2016 Budget Proposal
February 3, 2015**

Chairman Ryan, Ranking Member Levin, and Members of the Committee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year 2016 Budget.

The President's Budget invests in the American people and our country by promoting inclusive economic growth, increasing job creation, and expanding opportunity. While our economic recovery is well established, we have more work to do to make sure the gains are shared more broadly — what we call Middle Class Economics.

The President's Budget achieves \$1.8 trillion of deficit reduction over 10 years, primarily from much-needed reforms to our health, tax, and immigration systems. Under this Budget, deficits decline to about 2.5 percent of GDP over the 10-year budget window, down 75 percent from the Great Recession peak of 9.8 percent of GDP. At the same time, this Budget shows that investing in growth and opportunity go hand in hand with putting the nation's finances on a strong and sustainable path. The President strongly believes that now is the time to invest in America's future in order to drive inclusive economic growth and opportunity, secure the nation's safety, and put the nation's finances on the road to a more sustainable fiscal outlook. We believe our Budget does just that.

This Budget makes needed investments in key priorities while maintaining a responsible fiscal course. For a stronger economic future, we propose a fully paid-for increase in the discretionary budget caps to make room for a range of domestic and security investments, including increased investments in education, job training, research, manufacturing, infrastructure and national defense. At the same time, we want to simplify and improve our tax code to make the paychecks of working families go further, ensure the wealthiest pay their fair share, and fix our broken business tax system in order to promote long-term growth and broad-based prosperity while using one-time transition revenue to pay for much needed investments in our nation's infrastructure.

Introduction

When the President took office six years ago, the federal government's fiscal outlook was bleak. The economy was shrinking at its fastest rate in 50 years and shedding more than 800,000 private sector jobs per month. Unemployment peaked at 10 percent in 2009, a level not seen in over 25 years. Health care spending was on an unsustainable path, and the deficit hit a post-World War II high.

Since that time, the policies put in place by this Administration and Congress have helped produce a sustained economic recovery and unprecedented decline in the deficit, putting us on a sustainable fiscal path. In 2014, our economy achieved a number of important milestones. We have seen nearly five years of private sector job growth — a new record. In 2014, we added more jobs than any year since the late 1990s. For the first time in two decades, the United States is producing more oil than it imports, and we are now the world's leading producer of petroleum

and natural gas. The manufacturing sector continues the strongest period of job growth since the 1990s. And rising home prices have restored nearly \$5 trillion in home equity to homeowners. By virtually any metric, our economy is stronger and continuing to gain strength.

From fiscal year 2009 to 2014, the deficit as a share of GDP fell by two-thirds, a rapid decline by historical standards. Over the past several decades, only the period of demobilization following the end of World War II saw a faster pace of fiscal consolidation. In fact, the deficit for fiscal year 2014 came in almost one percentage point lower than we anticipated in our Budget one year ago. This year's Budget expects that the deficit will decline to 2.5 percent of GDP in fiscal year 2016 and achieve primary balance in 2022.

Strong growth combined with the Administration's policy choices have dramatically improved our fiscal trajectory. Unfortunately, the political environment in Washington in the early part of this decade, governing from crisis to crisis, has held back the recovery that otherwise would have created more jobs for working Americans. When Congress allowed the sequestration cuts to become law, they caused a notable drag on the economy — those that took effect in March 2013 reduced the Gross Domestic Product by 0.6 percentage points and cost 750,000 jobs, according to the Congressional Budget Office. In 2011 and again in 2013, the full faith and credit of the United States was used as a bargaining chip, driving down consumer confidence and driving up uncertainty in the business and international communities. Over the past year, we have seen real progress in returning to regular order in conducting fiscal policy. I am hopeful that the bipartisan progress will continue with the kind of compromise that nurtures growth and preserves our sustainable fiscal path.

The U.S. economy appears to have entered a period of self-sustaining growth. The economy grew 2.5 percent last year. Private sector forecasters expect the economy will grow roughly 3 percent this year, while the International Monetary Fund recently revised its U.S. growth estimate higher, expecting 3.4 percent growth in 2016. This is substantially faster than all of the other advanced economies combined.

Despite significant progress, we have more to do to fully address our nation's ongoing challenges. The benefits of the growth are not being shared by all Americans. While more Americans have jobs than ever before, there are still millions of Americans in search of work as well as millions of part-time workers in search of full-time opportunities. Despite the drop in the unemployment rate, average hourly earnings have been rising only slowly, and the income of the typical American family has not kept up with inflation — in fact it has trended down for the last 15 years.

With the recovery now well-established, we need to ensure that hard working Americans share the gains. The President's Budget encourages growth and opportunity in the short-run and makes investments that will promote broadly shared growth over the longer term, while remaining dedicated to maintaining fiscal responsibility. While the recovery in the U.S. economy has helped to drive global growth, the rest of the world cannot depend on the United States to be the sole engine of growth. At the recent G-20 meeting in Brisbane, there was agreement that more needs to be done to stimulate domestic demand around the world. Our

strength allows us to maintain our leadership in the global community, and while we must lead by example, we cannot do it alone.

The Bipartisan Budget Act of 2013 reversed a portion of sequestration and allowed for higher investment levels in 2014 and 2015, but it did nothing to alleviate sequestration in 2016. Sequestration imposed arbitrary spending cuts that are bad for our economy and our security. These across-the-board cuts were never even intended to go into effect; rather, they were purposely unpalatable to create pressure to pass balanced, responsible deficit reduction. Congress should not repeat the mistakes of the past by allowing further sequestration cuts in 2016. In the absence of congressional action, non-defense discretionary funding in 2016 will be at its lowest level since 2006, adjusted for inflation, even as the need for pro-growth investments in infrastructure, education, and innovation has only increased due to the Great Recession and its aftermath. Inflation-adjusted defense funding will also be at its lowest level since 2006.

The President's Budget makes needed investments in key priorities, even while setting the nation on a fiscally responsible course. The Budget proposes increasing the discretionary caps in the context of a balanced fiscal plan, while making room for a range of domestic investments that will help move the nation forward. These include investments to strengthen the economy by improving the education and skills of the U.S. workforce, accelerating scientific discovery, and continuing to bolster manufacturing.

The proposals in the President's Budget aim to strike a balance between achieving long-run fiscal responsibility and helping working families get ahead. Among the proposals to help

families, this Budget simplifies and expands child care tax benefits; enhances educational opportunities by partnering with states to make community college and career and technical schools free for responsible students and consolidating and expanding education tax incentives; makes it easy and automatic for workers to save for retirement; and reforms the tax system and raises the minimum wage to better support and reward work. These investments in the middle class are fully paid for by repealing perhaps the single largest income tax loophole, called “stepped-up basis,” raising the top capital gains and dividends rate back to 28 percent — the same rate during the Reagan Administration — and reforming financial sector taxation to discourage excessive borrowing by the largest financial institutions.

The President’s trade agenda is another important component of our strategy to grow the economy and strengthen the middle class. Exports account for a significant portion of our economic growth over the course of the last four years and ninety-eight percent of our exporters are small businesses. Expanding the reach of America’s exports will create new opportunities for our small businesses to grow. I look forward to working with all of you to pass trade promotion authority legislation that creates a level playing field for our businesses and workers.

The Budget calls for business tax reform that will be revenue-neutral in the long run, make our companies more competitive, and directly benefit the middle class by paying for a plan to repair and expand our existing infrastructure to support our economy for the next generation with a one-time tax on previously untaxed foreign income. We know that investing in our nation’s physical and human capital will provide the best long-run return for the economy. Moreover, Congress should address the so-called tax extenders in a fiscally responsible manner, including

preventing a tax increase for 26 million working families and students by making permanent the expiring tax credits that benefit them. The Budget increases the resources we are putting toward national security both at home and abroad because economic prosperity and fiscal responsibility cannot come at the expense of our safety.

Taking the right steps today will make our fiscal challenges easier tomorrow. A stronger economy today will ease those fiscal challenges and improve the lives of working Americans. A credible plan, built on the bipartisan cooperation that we have seen recently, is the best way to secure long-run growth.

Reforming the Tax Code

Our framework for business tax reform will simplify compliance for and provide tax relief to small businesses, while tightening our international tax system to close loopholes that strip the U.S. tax base by allowing multinational corporations to avoid paying U.S. taxes.

I continue to believe the best way to achieve reform today is to start with pro-growth business tax reform that protects and strengthens the middle class, lowers rates, simplifies the system, levels the playing field, and eliminates unfair and inefficient loopholes. When we make the switch to a smarter business tax system, there also will be one-time revenue during the transition, and we can use some of that revenue to create jobs rebuilding our roads and bridges, repairing our tunnels, and investing in our transit systems.

It has been almost three years since the President laid out his framework for sweeping business tax reform. Making sure the system works for everybody is as urgent today as it was then. This year, business tax reform represents an opportunity for members of both parties and the Administration to work together to make progress for the American people.

Small businesses are a source of innovations, but their growth can be discouraged by the high costs of complying with complex tax laws. Over 80 percent of all tax compliance costs are borne by small businesses, and the burdens are heaviest on the smallest of the small businesses. While the largest, most complex businesses spend less than one-tenth of one percent of their receipts on the costs of complying with the tax code, a small business with less than \$100,000 in receipts on average spends well more than 10 percent of its receipts on compliance costs. This is unacceptable. While the current tax code contains a number of provisions intended to simplify compliance for small businesses, more can be done. For example, small business expensing allows small businesses to deduct the cost of their investments in equipment and avoid the complexity of depreciation accounting. While the expensing limit had been \$500,000 for a number of years, it recently reverted to \$25,000 for 2015. As part of tax reform that is revenue neutral in the long-run, the President proposes to extend permanently expensing up to \$1 million. This provides significant tax relief to America's small businesses and would allow small business to avoid the complexity of tracking depreciation. The President also proposes to dramatically simplify taxes for small businesses, by allowing all businesses with less than \$25 million in gross receipts to use cash accounting and dispense with an array of other complicated accounting rules. In addition, there are proposals to increase the deductibility of start-up expenses for new businesses and to eliminate capital gains taxation on investments in small

business stock. These changes will reduce compliance costs of small businesses and encourage investment and entrepreneurship.

On the international side, we are proposing reforms that would fix the current broken and inefficient system for taxing the foreign income of U.S. multinational corporations. The current system rewards U.S. companies that locate their operations and shift profits abroad and keep them outside the United States. In fact, as indicated in the President's Framework for Business Tax Reform, certain small countries with very low tax rates have attracted profits of U.S. multinational companies that exceed multiples of the GDP of those countries. Much of the manipulation comes from the ability to defer U.S. tax on certain earnings of foreign subsidiaries until that income is repatriated.

Tax reform must seek to balance the need to reduce tax incentives to locate overseas with the need for U.S. companies to be able to compete overseas for the investments and operations absolutely necessary to serve and expand into foreign markets in ways that benefit U.S. jobs and economic growth. The core of the President's tax plan, which is detailed in this year's Budget, is a global minimum tax. The global minimum tax would ensure that U.S. multinational firms pay at least a 19-percent tax on their foreign earnings as they are earned — rather than deferring the tax for years or forever — while exempting from the minimum tax a return to real activities performed abroad. After this initial payment, foreign earnings could be reinvested in the U.S. without additional tax, which would level the playing field and encourage firms to create jobs here at home.

In addition to the global minimum tax, our international tax reform proposals would address the ability under current law for multinational firms to erode the U.S. base with excessive interest deductions and take further steps to stem corporate tax inversions, building on the Treasury Department's first, targeted action last September.

As we have consistently said, business tax reform together with anti-inversion legislation is the only way to fully address these transactions. Our business tax reform will help make inversions less attractive by making the United States a more competitive location from which to do business. Specific anti-inversion measures are also needed even after the business tax system has been reformed, as there will always be other countries with lower tax rates and less stringent rules for taxing foreign earnings.

In addition to these new detailed proposals in the reserve fund for business tax reform, this year's Budget includes new details on the President's plan to simplify our complex tax code for individuals, to make it fairer by eliminating some of the biggest loopholes, and to use the savings from closing loopholes to invest in helping middle class families get ahead and growing the economy. One of the largest loopholes in the individual income tax code is a provision known as stepped-up basis. Stepped-up basis refers to the fact that capital gains on assets held until death are never subject to income taxes. Hundreds of billions of dollars escape capital gains taxation each year because of this loophole that lets the wealthy pass appreciated assets onto their heirs tax-free. Stepped-up basis perpetuates wealth disparities and inequality of opportunity, particularly given that retirement accounts such as 401(k)s and IRAs — which often represent a middle class taxpayer's only major capital asset beyond a home — do not receive this special

treatment. The budget closes the stepped-up basis loophole by treating bequests and gifts other than to charitable organizations as realization events, like other cases where assets change hands. By closing this loophole, we unlock resources that could be reinvested more productively elsewhere, making our proposal a pro-growth way to raise revenue. The budget also increases the total top capital gains and dividend rate to 28 percent, the rate under President Reagan.

Since the 2008 financial crisis, the President and Congress have taken major steps to make the financial system safer and the broader economy more resilient, including enacting legislation that ensures taxpayers will not be on the hook to bail out financial firms perceived to be “too big to fail.” Recognizing that excessive leverage undertaken by major financial firms was a significant cause of the financial crisis, the Budget builds on the reforms we have already put in place by proposing a financial fee that would further discourage excessive borrowing by large financial institutions.

Building a 21st Century Infrastructure

Transportation is critical to the nation’s economy, allowing Americans to travel safely and conveniently, and enabling our businesses — in particular small businesses — to move goods to market at competitive prices. As part of transitioning to a reformed international tax system, the President’s business tax reform plan would impose a one-time transition toll charge of 14 percent on the up to \$2 trillion of untaxed foreign earnings that U.S. companies have accumulated overseas — raising enough revenue to fill the projected shortfall in the Highway Trust Fund and make new investments as part of the President’s six-year surface transportation reauthorization. Unlike a voluntary repatriation holiday — which would lose revenue — the President’s proposed

toll charge is a one-time, mandatory tax on previously untaxed foreign earnings, regardless of whether the earnings are repatriated.

To spur economic growth and allow states and localities to initiate sound multi-year investments, the FY 2016 President's Budget request includes a 6-year expanded surface transportation reauthorization proposal to improve safety, support critical infrastructure projects, and create jobs while improving America's roads, bridges, transit systems, and railways. This builds on the Administration's 4-year proposal, the Generating Renewal, Opportunity, and Work with Accelerated Mobility, Efficiency, and Rebuilding of Infrastructure and Communities throughout America — or the GROW AMERICA Act — which was submitted to Congress last year.

Our Build America Investment Initiative has taken a series of new steps by federal agencies to support the efforts of state and local governments to access federal financing programs, structure public-private collaboration, and attract private investment to build and improve roads, bridges, ports, broadband, and water systems in metropolitan and rural areas in ways that boost economic growth and resilience, while protecting the interests of taxpayers and workers. As part of that initiative we are proposing the creation of an innovative new kind of municipal bond, Qualified Public Infrastructure Bonds (QPIB), an idea we have worked on with Senator Wyden. Today, public-private partnerships that combine public ownership with private sector management and operations expertise are limited in their use of municipal bonds. QPIBs will extend the benefits of municipal bonds to public-private partnerships, like partnerships that involve long-term leasing and management contracts, lowering the cost of borrowing and attracting new capital.

Providing Opportunity Through Education

The single greatest resource that our economy has is our people, and it is critical that Americans have the skills and knowledge to compete in the global economy. Research has shown that the value of a postsecondary education is higher now than ever before. Therefore, the President has proposed programs that will make community college and career and technical school free for every responsible student as well as improve programs that provide education tax incentives for those who attend college.

The higher education benefits we provide through our tax system, including the American Opportunity Tax Credit created in 2009, are making college more affordable for millions of students and their families. But families have difficulty choosing among overlapping benefits and navigating complicated rules, and schools may not provide the information families need to claim tax benefits for which they are eligible. Building on bipartisan reform proposals, the President's education tax reform plan would simplify, consolidate, and expand education tax credits. The plan would cut taxes for 8.5 million families and students, simplify taxes for the more than 25 million families and students that claim education tax benefits, and provide students working toward a college degree with up to \$2,500 of assistance each year for five years. These education tax reforms would complement our other proposals to make college more affordable, including continuing historic increases in the Pell scholarship program and simplifying financial aid forms. Together with free community college and career and technical schools, these proposals would benefit students, families, and the broader economy by helping more students earn a postsecondary credential, making them, and by extension our country, more competitive in the global marketplace.

Reforming the Tax System to Better Support and Reward Work

This year's Budget proposes a number of new policies to reduce taxes on working families.

Together, these policies will benefit over 44 million families, providing an average tax cut of nearly \$600.

In today's economy, having both parents in the workforce is a necessity for many families, yet dual-earner couples can face high penalties for working. When both spouses work, the family incurs additional costs in the form of commuting costs, professional expenses, child care, and, increasingly, elder care. When layered on top of other costs, including federal and local taxes, these work-related costs can contribute to a sense that work is not worth it, especially for parents of young children and couples caring for aging parents. While women, including married women, are increasingly the breadwinners of the family, they are still much more likely than their male counterparts to withdraw from the labor force in these circumstances, taking a toll on their future job options and earnings, and hurting overall economic growth. Building on congressional proposals from members of both parties, the Budget proposes to address these challenges with a new second-earner credit that recognizes the additional costs faced by families in which both spouses work. A total of 24 million couples would benefit from this proposal, which would provide a new, simple second-earner tax credit of up to \$500.

The Earned Income Tax Credit is among the nation's most effective tools for reducing poverty and encouraging people to enter the workforce. However, low-wage workers without children and non-custodial parents miss out on the anti-poverty and employment effects of the EITC

because the credit available to them is small and phases out at very low incomes. Our plan to help working families get ahead incorporates the proposed childless worker EITC expansion — an idea that has bipartisan support in this Congress — reducing poverty and hardship for 13.2 million low-income workers struggling to make ends meet while boosting employment. This proposal would double the EITC for workers without qualifying children, increase the income level at which the credit phases out, and make it available to workers age 21 through 66.

The Budget also makes permanent improvements to the EITC and Child Tax Credit that augment wages for 16 million families with 29 million children each year. These improvements provide additional benefits to low-income working parents, families with three or more children, and married families, but they are currently scheduled to expire at the end of 2017. As we made clear during the extenders debate at the end of 2014, we cannot apply a double standard where we address extenders for business but not working families. Finally, the President continues to call on Congress to raise the federal minimum wage and to index it to inflation. No American who works full time should have to live in poverty, and the proposed new minimum wage would both help working families make ends meet and add spending to the economy.

Providing Child Care for Working Families

Over 60 percent of families with children have either two working parents or a single parent who works. That is why access to high-quality, affordable child care is critical for working families and for the broader economy; it helps parents continue working or join the workforce and supports healthy child development and late successes in school. But with the cost of infant and toddler care rivaling the cost of college in many states, many families struggle to afford quality

care for their children, and the average child care tax benefit of \$550 falls well short of what is needed to provide meaningful help. The Child and Dependent Care Tax Credit and child care flexible spending accounts are also unnecessarily complex, often requiring significant paperwork and advanced planning for families to receive the full benefits.

This year's Budget streamlines child care tax benefits and triples the maximum child care credit for middle-class families with young children, increasing it to \$3,000 per child. The child care tax proposals would benefit 5.1 million families, helping them cover child care costs for 6.7 million children. These tax proposals complement proposals to ensure that quality, affordable care is available to all eligible low- and moderate-income working families with young children, as opposed to the small share of children who receive this help today. In addition, this year's Budget makes critical investments that expand access to comprehensive early learning

Encouraging Retirement Savings

As many as 78 million working Americans — about half the workforce — do not have a retirement savings plan at work. Fewer than 10 percent of those without plans at work contribute to a plan of their own. The Budget proposes additional tax relief to small businesses that start offering a retirement plan, such as a 401(k), or that start automatically enrolling workers in their plan. The President's retirement proposals would give 30 million additional workers access to a workplace savings opportunity and would complement the Administration's efforts over the past year to make saving for retirement easier by creating the simple, risk-free, and no-fee *myRA* starter savings vehicle.

Innovation

One of the major strengths of our country remains our ability to innovate. The United States competes in a global economy, and to continue to provide jobs and opportunity for Americans, we need to invest in American innovation, bolster our manufacturing base, and keep our nation at the forefront of technology.

After a decade of decline, the manufacturing sector is adding jobs for the first time since the 1990s and is poised for growth in the years ahead. The Budget takes steps to build on recent bipartisan legislation and the nine manufacturing institutes funded to date to support 16 institutes by the end of 2016 and put us on pace to build 45 institutes over a decade; equip small and medium manufacturers with the capabilities and access to technologies they need to improve their innovation and productivity; and, through a new \$10 billion public-private Scale-Up Manufacturing Investment Fund for American manufacturing start-ups, ensure that what is invented in America can be made in America.

The Budget calls for investing in a wide array of research and development, from the President's signature BRAIN Initiative (Brain Research Through Advancing Innovative Neurotechnologies), the Precision Medicine Initiative, and combatting antibiotic resistance to advanced manufacturing, clean energy technology, and agriculture.

To secure America's energy future and to protect the planet for future generations, the Budget helps increase American low-carbon energy production while improving energy efficiency. The Administration has made combatting climate change a high priority by working hard to reduce

carbon pollution here in the United States and by bringing other countries along to forge an effective global effort to combat this problem. In the United States, our carbon pollution is near its lowest levels in almost two decades. We set higher standards for fuel economy, so that our cars will go twice as far on a gallon of gas, and we are setting a new standard for trucks that will propel American manufacturing and spur the development of new technologies. This strategy has already borne fruit — thanks to lower gas prices and higher fuel standards, the typical family should save \$750 at the pump this year.

Ensuring Our Nation's Safety and Security

The Budget recognizes that while America is a world leader in domestic economic growth, it must also continue to promote U.S. national security interests while mobilizing the international community to address global challenges to the nation's safety and security. That is why the Budget advances national security priorities by proposing the funding increases above current law needed to execute the President's defense strategy. The Budget includes \$612 billion of total national defense discretionary funds, a \$26 billion, or 4.5 percent, increase from the 2015 enacted level. This reverses the decline in national defense spending of the past five years and proposes to transition enduring overseas contingency operations costs to the base budget, to fully fund and account for the costs of keeping the nation secure.

Health Care Reform

With the Affordable Care Act in place, millions of Americans no longer have to worry that an unexpected illness will throw them into bankruptcy, and people with preexisting conditions are now guaranteed access to health insurance. We have reduced the share of uninsured Americans

by almost one quarter, as about 10 million people gained the financial security of health coverage in the past year alone. And since the Affordable Care Act became law, health care prices have risen at their lowest rates in decades. Had health insurance premiums kept growing at the rate they did in the last decade, the average annual premium for a family with an employer plan would be \$1,800 higher than it is today.

The health care cost slowdown is already yielding substantial fiscal dividends. Compared with the 2011 Mid-Session Review, aggregate projected federal health care spending for 2020 has decreased by \$216 billion based on current budget estimates, savings above and beyond the deficit reduction directly attributable to the Affordable Care Act. Including related interest savings, the savings totals \$262 billion.

Comprehensive, Pro-growth Immigration Reform

The President believes that we need to fix our broken immigration system by continuing to strengthen border security, by cracking down on employers who hire undocumented workers, and by providing a pathway to citizenship for hardworking men and women who are already here and contribute to our nation every day.

Immigration reform will encourage economic growth and help achieve better fiscal policy. The President has laid out principles for immigration reform but wants to work with Congress to craft specific legislation. The Congressional Budget Office estimates that the immigration bill that passed with bipartisan support in the Senate in 2013 — and which is largely consistent with the President's vision — would increase the size of the economy by over 3 percent in the next

decade and more than 5 percent over 20 years. Meanwhile, the immigration bill would reduce the deficit by about \$160 billion in the first decade and by almost \$1 trillion over 20 years. Similarly, the Social Security actuaries have found that the Senate bill would reduce the Social Security shortfall by \$300 billion over the first 10 years. The Administration supports the Senate approach and calls on the House of Representatives to act on comprehensive immigration reform this year.

Conclusion

In summary, this budget puts forward a series of proposals to keep America's economic resurgence on track, build on the progress we have made, and help more Americans share in our economic gains through rising wages, higher incomes, and a growing middle class. The roadmap laid out in this budget includes strategies for students to begin school prepared for success, graduate from high-school, and attend college without amassing unaffordable debt; for workers to find good jobs in high-tech manufacturing; for working families to care for a sick child or an aging parent; and for states and cities to rebuild their infrastructure and expand their broadband networks.

This Budget is practical, not partisan, and it provides a comprehensive and balanced approach to the realities we face. It invests in long-term growth, while also building on the progress that has already been made to ensure a sustainable path for the debt and deficit. The Budget is a credible, common-sense plan that makes hard choices. It focuses on middle class economics that will help drive growth, create jobs, and expand opportunity for all Americans, unlocking a brighter future for future generations. I believe, as does the President, that there is plenty of opportunity for

bipartisan cooperation and a number of areas where we can find common ground to move our country forward, starting with business tax reform. I look forward to working with the members of this Committee to make progress on tax reform this year. Together, we can achieve meaningful reform that will help America's families, boost our economy, and enable U.S. businesses expand and be more competitive.



Chairman RYAN. Thank you, Secretary.

There are basically four areas I wanted to get into. I just added one to it from your testimony.

The sequester. As the author of the last agreement, bipartisan agreement to provide sequester relief, you know, I think the formula we reached in that bipartisan budget agreement in the last session was the right precedent, and so what was that precedent? It was that we understand that the mandatory side of the ledger book, the autopilot spending, is what is really not under control, is the source of our debt crisis coming in the future, and needs to be reformed.

So what Patty Murray and I sat down to do was to find an excessive amount of savings on the mandatory side of the ledger book to pay for some sequester relief, and to fix the caps for the various concerns that I think on both sides of the aisle people have, but the precedence was you had more spending reductions through mandatory entitlement reforms resulting in net deficit reduction which also got us some sequester relief.

So we all know it is a show stopper to say let's, you know, raise taxes to pay for some sequester relief. The precedent was set, which is we need to do mandatory reforms so that we can do two things: (1) Relief from the sequester through smarter spending cuts in other areas of government, and (2) contribute on the net to some deficit reductions. So I would just argue strongly, we have a good formula in place, we have a good precedent, it has bipartisan origins, let's try and stick with that formula.

Secretary LEW. Mr. Chairman, if I might.

Chairman RYAN. Yes.

Secretary LEW. I think that the agreement that you and Senator Murray reached was important and it is one of the reasons that we have been operating in a more normal way these last 2 years and one of the reasons the budget could be on time this year.

Chairman RYAN. Yes.

Secretary LEW. So I think working together is important. We obviously present our view of the best way to do it in our budget, and we need to work on a bipartisan basis to try to reach agreement.

Chairman RYAN. Yes, and my whole point is let's stick with the formula that we have because it worked before, and I think it is the best way to go forward.

Second, I want to ask you about pass-throughs. I am glad you say business reform instead of corporate, which is a good step in the right direction. Mind you, that, and I know you know this, but 80 percent of American businesses aren't corporations. They are pass-throughs. They file their taxes as individuals, sole proprietorships, LLCs, you know, Subchapter S.

The issue that I think is of greater concern these days is that, unlike the big public companies with a lot of cash on their balance sheets, the ability to borrow at historically low interest rates, the post Dodd-Frank closely-held businesses have found it really hard to obtain credit these days as banks have restricted lending. So we have a cash flow issue. They need cash flow from their current operations just to meet payroll, just to keep people working, but our current broken Code makes it harder for them to do that. Your budget takes some baby steps in the right direction. I note Section

179. I think there is some common ground there on expanding that. We will be doing that, marking this up tomorrow, but other proposals like expanded cash accounting are only right now helping small C corporations and don't do much for the vast majority of small businesses organized as pass-throughs.

So will you work with us to explore more areas in trying to help these closely-held family businesses that we think of as pass-throughs, to help figure out their expensing issues? Because in this post Dodd-Frank world, they have even tighter credit.

Secretary LEW. Mr. Chairman, I believe that our proposals reflect our commitment to making tax reform work for small businesses. We have called it business tax reform on purpose because we think of it as both corporate and small business tax reform. We have put into our plan a number of things to simplify taxes for small businesses to make it possible to take deductions more easily and more quickly, and to lower the tax burden for many small businesses.

A lot of different kinds of companies organize as pass-throughs. Some of them are mom and pop businesses. Some of them are very large companies that look more like corporations. We look forward to working on a bipartisan basis to see what we can do to help real small businesses get the kind of relief that they need.

Chairman RYAN. Big or small, it is where most of the jobs come from, and so let's—all I am saying is I don't think there is enough in this proposal to do justice to what needs to be done. So let's keep working on that.

Transition. I wanted to just get you down on the record on this idea of tax reform financing highways. Your point, just to be clear, is not to support a one-time repatriation holiday such as we did in, I think, 2004, 2005, but only as a means to permanent transition to a new, I think you call it a hybrid system, only under that kind of a scenario do you see tax reform as part of the solution to the highway trust fund issues. Is that correct?

Secretary LEW. Well, Mr. Chairman, we have pointed out many times that we think that the one-time repatriation holiday created a kind of perverse incentive. It created an incentive for companies to keep their income overseas until the next repatriation holiday.

We think that the right answer is to have real tax reform to change the structure so that companies bring their income home. Frankly, so they invest their income wherever it is most economically efficient. The idea of tax reform is to have the efficiency and economics of a business determine where you invest, not the Tax Code, which is skewing decisions in a way that is inefficient.

We believe that what we have proposed in terms of the international hybrid system will create that. We think that the toll charge that we have put in is the right way to have a transition, and we do believe that the one-time revenue from the toll charge can fund the highway—the infrastructure program in a very effective way.

When you talk to business leaders in this country, the two things—the three things that I hear most often are, one, we need to reform our Tax Code; two, we need to build our infrastructure so our economy can grow; and, three, we need to do immigration reform. We can take care of two of three at the same time here.

Chairman RYAN. Yes. So I would take issue with probably the rate and the style of hybrid that you are doing, but putting that point aside, it is a move in a constructive way. We have these—obviously have it—see it differently, but it is for a permanent conversion to a permanent new system.

Secretary LEW. Right. Right.

Chairman RYAN. Okay. The last question I want to ask you is about EITC. I think the data is pretty clear that the EITC is effective. It is effective at moving people from poverty into the workforce. It is effective at lowering barriers that are in front of a person who wants to get into the workforce, but it is also a program that is known to have a high degree of fraud. It is known to have a high improper payment rate. A lot of people say: “Well, just give the IRS more agents and they can fix that.” I think that is an insufficient answer.

Will you work with us to try to figure out how we can clean up the management and the structure of the EITC so that we can get at this exceptionally high improper payment rate, and are there ideas you have about how it could be restructured and reformed so that it truly goes to those who are really truly supposed to get it and not to others?

Secretary LEW. Mr. Chairman, I totally agree with you on the importance of the EITC as a bridge to work and to get families back to work in a way that makes good sense. It has been a bipartisan commitment from its inception, and I look forward to working with you to strengthen the EITC. I also agree that compliance needs to be improved. We do have resource constraints. I don’t think they can be dismissed. The underfunding of the IRS does make it very challenging in many areas to put the resources that are needed into compliance. So I hope we can work together to make sure the IRS gets the resources that it needs.

You know, every year the IRS recovers or prevents about \$2 billion of improper EITC claims, and between \$3 and \$4 billion in total revenue through EITC-related compliance activities. We need to do better. We look forward to doing better, but it is related to the resources available. We hope there are the resources to do it properly.

Chairman RYAN. Okay. So my point for asking, though, is I think we—many of us agree that there are other populations that this reform could be applied to, say childless adults. Let’s see if we can make the reforms pay for these improvements. So if we can contain it within itself, I think that would be an enormous step in the right direction, and that too could perhaps lead to a bipartisan common ground success.

Secretary LEW. Well, we very much look forward to working together on the childless adult provisions. It is something that I think would fill an enormously important gap in the current system. I don’t know whether the cost would be covered by it, but I would be happy to look at it and work with you.

Chairman RYAN. All right. Thank you.

Mr. Levin is recognized.

Mr. LEVIN. Thank you. Mr. Chairman, you and I have had a few discussions about these issues, and all of us want to do more of that. So if I might, I want to ask a broader question of the Sec-

retary briefly, but let me just mention about pass-throughs. I think it is one of the major challenges to tax reform, as you indicated, and I think it has to be looked at comprehensively. We are going to mark up 179 and other bills tomorrow, and I think it is a mistake to take that outside of tax reform, unpaid for, permanent.

Mr. Secretary, you have expressed your view on this before. Do you want to just comment briefly on that approach?

Secretary LEW. Congressman, we have consistently opposed taking these items one by one and making them permanent in an unpaid-for way, even provisions that we approve of and that are part of our plan. I think that Section 179 should be addressed. It should be expanded in the context of business tax reform, and I think that if we can have real progress on business tax reform, that would be a way to get it done in a way that takes the issue off the table for the future and removes the uncertainty that goes with short-term extensions, which is where we end up if we don't have business tax reform.

Mr. LEVIN. Thank you. Mr. Chairman, also in terms of international taxation, the Secretary has mentioned how I think totally unsuccessful the repatriation was before, and what the Administration has come up with is kind of a hybrid system, and I think we need to get away from the labels and look at how it might work, and let me just say briefly, as we continue dialogue, I think we need to look at EITC in terms of its implementation. I think IRS help is not the only factor, but I think, as the Secretary said, cutting revenue appropriations for the IRS is not the way to go. You can't get tax enforcement when you cut down the IRS appropriation.

Mr. Secretary, if you would, I have almost 3 minutes, would you use them? You talked in your statement about middle class economics. Just tell us, if you would briefly sum it up, what is the vision of this Administration when it presents its budget? What is it all about?

Secretary LEW. Mr. Congressman, I appreciate the question. We have put a lot of thought into how to design a budget that would address the challenge of making sure that our economy works for middle class families, for families that are trying to break into the middle class. We have identified what we think the real obstacles and burdens are. It includes education opportunity, it includes child care burdens, it includes the challenge of saving for retirement. We have put in place a series of provisions that we think will make a real difference to make it possible for middle class families to get ahead.

We have an economy that on the whole is growing at a much better rate than most of the rest of the developed world, but we are seeing within the United States that it is not an economy where there is broad opportunity as there should be. I think that the provisions in this budget provide a first step to solving that.

You know, some of the characterizations of this budget have, I think, been a bit off. It is not about being against one group and for another group. It is about making the system work for everyone, and the truth is we have distortions in our tax system that allow those with the most wealth and the most income to avoid paying taxes on the same basis that all of us pay taxes on.

Let me use an example of stepped-up basis and compare it to the way we pay taxes on IRAs and 401(k)s. For anyone who needs to use the assets that they have built up for their retirement, you pay income tax on that when you take it out in your retirement. If you never need to get access to your savings, to your accumulated earnings, you can pass it on to tax free. That is not right. Our system ought to treat all earnings in a similar way, and that is what our proposal does. It is not against anyone, it is for everyone.

Mr. LEVIN. Thank you.

Thank you, Mr. Chairman.

Chairman RYAN. Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. As you know, you are also serving as the Managing Trustee for Social Security, and I would like to, if we can get a quote up on the screen, direct you to it. However, this is what Obama had to say when he was first elected. "What we have done is kicked this can down the road. We are now at the end of the road and not in a position to kick it any further. We have to signal seriousness in this by making sure some of the hard decisions are made under my watch, not someone else's." That is President Obama in January 2009. You know, we have to signal seriousness, and my question to you is: Do you agree with what the President said then? Yes or no.

Secretary LEW. You know, Congressman, I think that if you look at the condition of the Social Security Trust Fund, it is in stronger shape now. A strong economy helps drive that, and I think the President has many times said that we need to deal with the long-term problems in a bipartisan way, but we do have a little bit more time to do that. What we have proposed is a budget that will build a foundation that will actually help Social Security. Even our immigration policy, for example, would have the effect of lengthening the life of the Social Security Trust Fund. So we think that we have improved the conditions of Social Security—

Mr. JOHNSON. Well, I am going to have to disagree with you because the shortfall has doubled from \$5.3 trillion to \$10.6 trillion while you guys have been in office, and that means Social Security can't pay the promises it has made.

My next question, just for the record, do you agree that Social Security finances have continued to deteriorate since Obama took office? Just yes or no.

Secretary LEW. Well, Congressman, you know, I think if you look at what has happened in these years, as we all knew, the baby boom was going to hit retirement age, and the baby boom retirement is underway. So I think if you look at the trends in Social Security financing, one has to take account of the fact that it was an entirely predictable turn that the reserves would start getting used to pay benefits.

Mr. JOHNSON. Well, if you know that, then why didn't you make a real plan to fix it?

Would you agree that the disability program is in trouble? Yes or no.

Secretary LEW. Well, Congressman, disability is a bit of a separate issue from the old age fund. I would just say that as someone who was involved in the 1983 Social Security reform, we did a lot

to fix Social Security's foreseeable shortfall. The problem is that money was spent along the way because we ran deficits for other purposes. So I don't think it is a question of what happened in the window of time of this Administration. It is actually what happened before.

The disability fund is approaching its exhaustion date. We have proposed a number of reforms in disability. I think there is a broad view that there is going to need to be some reallocation of trust fund—the taxes between the trust fund to deal with this issue in the intermediate term.

Mr. JOHNSON. Well, let's talk about reallocation. You used that word. Reallocation is actually about taking money that would have gone to a retirement and giving it to the disability program. Is that true or false?

Secretary LEW. Well, reallocation would move revenues from one part of the one trust—one trust fund to another.

Mr. JOHNSON. Sounds like we are continuing to kick the can down the road. We have to work today to strengthen and preserve Social Security.

Mr. Secretary, will the President actually follow through on the words he said back in 2009 and actually do something on his watch?

Secretary LEW. Well, Congressman, I think that if you look at the history of the last several years, the President has been prepared on a number of occasions to have the conversations that have to happen on a bipartisan basis to deal with Social Security in the long term. They did not reach the kind of end that led to an agreement. I think right now we are looking at an economy that would benefit greatly from us working on the things where we can reach bipartisan agreement, and we do have a bit more time to deal with the long-term issues. I am not going to say they don't need to be addressed, but they need to be addressed in an environment where there is a bipartisan atmosphere that is, you know, conducive to it. Let's make some progress on the things—

Mr. JOHNSON. So you are saying that the President will actually do something on his watch to fix this system?

Secretary LEW. Well, I think if we do immigration reform, that would be a big step, and we look forward to working together on that.

Mr. JOHNSON. You know, Americans depend on Social Security, and they are paying hundreds if not thousands of dollars a year into Social Security and want and need and deserve better.

Mr. Chairman, thank you for holding this hearing, and I look forward to working with you on this important issue.

Chairman RYAN. Thank you. Thank you.

Mr. Rangel is recognized.

Mr. RANGEL. Thank you.

I understand Mr. Johnson said the President can do something by himself on his watch, and I am going to advocate that he be more aggressive in that area.

Having said that, though, welcome. It is so difficult for me to look at you, Mr. Secretary, and not think of you as the kid that used to work for Tip O'Neill, but you certainly make those of us that serve the government proud of your service.

I don't see how—I am so pleased to hear that the Chairman and you and most all of us agree that there is a possibility in the area of trade and the area of tax policy that there is a possibility that we can find some area that we can agree on.

Now, both of these issues, as important as they are to the country, we need to get votes for these things, and it is difficult for some of us to go into the community and say we are for tax reform or we are for trade when people are really talking about what does it mean to me? How is this going to affect my future? What disposable income will I have? Will I have any pension benefits? Will I have something to send my kids to school? Can I get a house? Can I pay the rent? It would seem to me that we always allocate jobs with trade, and certainly we can negotiate the trade—the tax bill so that we can be fair as it relates to what used to be called the middle class, but I don't see the jobs in this bill, and it is probably difficult to pinpoint exactly who the winners and losers would be in a trade bill.

It probably will improve the ability of all of the countries involved to improve their economy, but to find out where are these jobs going to be. Because if we can do this, Mr. Secretary, we get rid of all of this Republican and Democrat and free trade of business. People want to know if it is good for the country, how it is going to be good for me?

It seems to me that if we do have a good trade bill, that we will need infrastructure in order to support that trade bill. I don't see how anybody, regardless of their party, can go to our mayors and our governors and not say that infrastructure is a part of trade.

The other thing is also education. Whatever benefits we get, we have to have a workforce prepared to meet the new economic challenges, if not for the current workforce, for those that will be coming into being.

Now, I wish the Administration would be able, and Republicans as well, to try to give some of us a package so we are not talking in theory, but we are talking about jobs, and if the Republican majority can see its way clear in the Congress to attach education, job training, infrastructure to a trade package, I can assure you that trade would mean a heck of a lot more to our constituents than just something that foreigners are dealing with with our President. If we can get that concept that the President accepts it and it is a part of the trade agreement, then, of course, I don't see any objection of giving the President the authority to negotiate a trade agreement, meaning that those things are going to be in it. But I find it very difficult for us to say we are giving the President the authority to negotiate, and when the negotiations are complete, all we have is up or down and no input.

So I don't know how much time you have to respond, but whatever it is, I do believe that trade and tax reform could bring us together for the country, for our party, and certainly to improve the image of our Congress.

Secretary LEW. Look, Congressman Rangel, the basic reason that we support Trade Promotion Authority and good treaties is because we think it grows the U.S. economy and it grows the middle class jobs in this country. You look at the growth in the future, the growth is in emerging economies. It is in the Pacific. It is in areas

where other countries are going to be exporting into those markets. We need to be exporting into those markets too.

TPP was designed to be an agreement that would drive standards up. The United States is already more open than most other countries. We already have higher labor standards and environmental standards and other important safeguards. By having an agreement where we make our high standards a mutually agreed set of high standards, and by having a world in which we have access to the growing markets, I think it will grow the U.S. employment base and create opportunities for middle class families to have a better future. None of this is a given. It requires negotiating hard. Trade Promotion Authority is actually something that puts guidelines on the Administration to help drive things in the right direction, and in the areas that I have just described, it presumably will address those issues.

It is our job, then, to come back with an agreement that delivers, and we are not going to bring back an agreement that we can't defend as growing the economy and middle class jobs. I think that is the real reason to pursue them.

Chairman RYAN. Thank you.

Mr. Brady.

Mr. BRADY. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. As you know, next month the Supreme Court is scheduled to hear arguments on whether or not the IRS overstepped its authority when the agency issued regulations extending Affordable Care Act Premium Assistance Tax Credit subsidies for coverage purchased through the Federal exchanges. The court is expected to announce its decision sometime before the end of June.

Can you tell me if the Treasury Department or the IRS is doing anything to prepare for the possibility that the court might rule against the IRS?

Secretary LEW. Congressman, let me start by saying that the Affordable Care Act is working and the tax credits are working. Millions of Americans now have access to affordable healthcare coverage.

Mr. BRADY. But the court will not be ruling on that aspect, the ACA, beyond specifically the IRS ruling.

Secretary LEW. We believe that we have—our lawyers have made the arguments, the Justice Department has made arguments that we think are compelling to the court, and we look forward to a positive ruling, but the thing that we just have to recognize is—

Mr. BRADY. But, Mr. Secretary, I don't want to interrupt, but I want make sure we understand. I am not asking for a prediction on the court ruling, but in the possibility that the court will rule for the plaintiffs, what planning is the Treasury Department or the IRS doing to deal with that type of ruling?

Secretary LEW. Congressman, there is no question but that an adverse ruling would strip millions of Americans of healthcare coverage due to the loss of the tax credits.

Mr. BRADY. So you would be, based on that, starting the work now to prepare for that ruling. Correct?

Secretary LEW. Congressman, what I am saying is the premium tax credits are an essential part of the Affordable Care Act.

Mr. BRADY. Sure.

Secretary LEW. That if they were removed, there would be serious disruption in health insurance markets in many States.

Mr. BRADY. And to ensure that there is not serious disruption, is IRS or Treasury planning now to deal with the ruling in the other direction?

Secretary LEW. What we are doing is we are continuing to implement the law, the law as it was written, which was to make sure that all American people had access to this.

Mr. BRADY. Let me ask, as Treasury Secretary today, are you, in effect, guaranteeing the Supreme Court will rule for the IRS in this case?

Secretary LEW. What I am doing, and what we across the Administration are doing, is implementing the law as it was written to provide health insurance for the American people.

Mr. BRADY. Are you—I get the impression you are very confident they will—in effect, are you guaranteeing that they are going to rule for the IRS and therefore you have to do no planning—

Secretary LEW. I leave to the Justice Department to make our legal cases in court. They have made, I think, a compelling case.

Mr. BRADY. But you certainly would not guarantee that today?

Secretary LEW. I am sorry. I would not guarantee what?

Mr. BRADY. You certainly would not guarantee the Supreme Court ruling for the IRS.

Secretary LEW. Well, I would never presume to speak for the Supreme Court.

Mr. BRADY. No, no, and I agree because there is a possibility they may rule for the plaintiffs. I guess my question to you is that should that occur, Republicans are already working to develop a thoughtful plan and a thorough plan to offer these millions of Americans choices to have affordable high quality health care. We are doing that work ahead of time. Is Treasury or the IRS doing the same type of work?

Secretary LEW. Congressman, this issue, as you know, is currently before the court. I can't comment on the pending litigation.

Mr. BRADY. Well, I am not asking about the litigation—

Secretary LEW. We are confident of our interpretation.

Mr. BRADY [continuing]. Mr. Lew, I am asking about planning in the possibility they might rule otherwise because, as you admitted, you can't guarantee the outcome. So are you planning for that?

Secretary LEW. We are confident that our interpretation that Americans in every State are eligible for premium tax credits will stand, and I have indicated that—

Mr. BRADY. Sure. But a moment ago you admitted that you can't guarantee the outcome. So let me ask this: As Republicans work toward a thoughtful, thorough plan to address that ruling, will the White House work with us in that eventuality, or will you refuse to work with Republicans in dealing with that ruling and the millions of Americans that could be impacted?

Secretary LEW. Congressman, the oral argument hasn't taken place. A ruling is months away. I have indicated that if there were

a ruling that took away the premium tax credit from a significant number of people, it would be very disruptive.

Mr. BRADY. Right. And in that case, will you work with Republicans in crafting a solution for those Americans so they can have high-quality affordable health care? This is simple. Will you work with us or refuse to work with us?

Secretary LEW. I think that it is a mistake to think that there is a simple solution.

Mr. BRADY. Oh, I am not suggesting there are simple solutions.

Secretary LEW. The Affordable Care Act was designed to be based on premium—

Mr. BRADY. Will you work with us or refuse to work with us?

Secretary LEW. Well, I am indicating our view that it is—it would be a serious disruption. You know, we obviously will look at what proposals are made, but I am not going to prejudge what the court does.

Chairman RYAN. Thank you.

Dr. McDermott.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Mr. Lew, I applaud the President's efforts to support the middle class. All through this bill, whether you are talking about sick leave or Social Security or Medicare or student debt, the President has made proposals.

What my colleague from Texas is posing is that if your next-door neighbor takes a bulldozer and knocks down your house, do you have a plan to rebuild your house, and it is about as unreasonable a posit of an idea as I have ever heard. The Republicans, in 5½ years have not proposed any alternative to the ACA. In fact, this afternoon at 1:30, they are going to bring a bill out on the floor to repeal it for the 55th time.

Now, it seems unreasonable to put—to waste your time planning for something. If they have something they want to bring forward, they can lay it on the table in the Ways and Means Committee or in the Energy and Commerce Committee or somewhere else. They have never put anything on the table.

Now, I want to talk a little bit about the proposal to the President to close the loophole that Gingrich put in the Subchapter S collection of Social Security taxes. Could you explain to me—my understanding is that if you have an S Chapter—or Chapter S corporation, you don't have to pay your employment taxes. So you don't pay for Medicare. You don't pay for Social Security. Now, when you get old, you turn 65, are you eligible then to go in and get Social Security and get Medicare on a program to which you haven't paid one single dime?

Secretary LEW. Well, Congressman, first, if I can respond to the point you made about the bulldozer. I have tried to indicate that the degree of disruption would be enormous. I also think it is important for us to recognize that what we should be working together on is how to make it more affordable and more possible for Americans to get health care, and we have always been open to working on that. I think the American people are tired of the debate about repealing the Affordable Care Act and they want to hear more about how to make it work.

Mr. MCDERMOTT. I agree.

Secretary LEW. And on the question about eligibility for Medicare, there obviously is a significant issue. You know, the proposal that we have in our budget would tax all earnings of professional service Subchapter S corporations as labor earnings. The taxpayers would get Social Security and Medicare based on what they paid in. So we think that would address the underlying issue.

Mr. MCDERMOTT. So those people are not now eligible for receiving benefits if they don't pay in?

Secretary LEW. I believe they are. They pay in, but they don't pay in as much as they would. I mean, the question here is not whether they are eligible for benefits but whether they are paying in on a fair basis.

Mr. MCDERMOTT. I think it raises \$74 billion for the trust fund.

Secretary LEW. I believe the issue is more a question of whether they are making the payments that are associated with the incomes that they have.

Mr. MCDERMOTT. Yes. I would like to raise a question about student debt. Can you give me any reason why students can't renegotiate their loans? If they took a loan out at 9 percent from a bank, why does it have to stay at 9 percent for the rest of their life? On my house, I have renegotiated my loans three, four times, bringing it down to a lesser rate. Why can't students do that?

Secretary LEW. Congressman, we have looked at this issue and worked with the Congress to come up with proposals that would give students more flexibility in terms of how to manage their student debt.

Obviously, the student loan programs are designed to give very favorable access to credit, but the rates are not always at a level that feel competitive with what would be available if there were—

Mr. MCDERMOTT. But the prime interest rate—

Secretary LEW [continuing]. A different kind of creditworthy borrower there in the market.

I think the challenge here is to work through these issues to make sure that students know all of the options that they have to repay their debt in a more affordable way, to consolidate their loans, to go through the process of having their payments—

Mr. MCDERMOTT. Did you understand the financial system when you were 20 years old?

Secretary LEW. Well, the financial system was simpler when I was 20 years old. But probably the answer is not as much as I should have.

Mr. MCDERMOTT. Thank you.

Chairman RYAN. Thank you.

Mr. Nunes is not here. Mr. Tiberi. On to Mr. Reichert. Is he—oh, there he is.

Mr. REICHERT. Thank you, Mr. Chairman.

Secretary, welcome.

I think most of us are hopeful that the Administration is willing to work with us on tax reform, and I am hearing you say that you are. That is good news. From Mr. Brady's questioning, though, I took away from your lack of an answer to his question as to whether or not you will work with us depending upon the Supreme Court's

decision—that lack of a “yes” or “no” answer indicates to me that there is an unwillingness there, and I am hoping that that doesn’t transfer over into tax reform and other issues.

I want to focus on the small-business passthrough question. And you made some comments that I find interesting compared to the language in the budget, so I just want to get to the bottom of it.

Hard-working Americans deserve a Tax Code that works for them, not them working for the Tax Code. You would agree with that, I am sure. They need to have that consistency and that certainty in the Tax Code so they know and can plan for their businesses, which gives them the security in having that knowledge and hope for the future and their family and the success of their business.

So when you say that you are willing to work with us in the 179 expensing area, can you explain to me why in your budget you did so little in that area for passthrough entities? Why didn’t you do something a little bit more bold to begin with, if really that is the way you and the President felt about passthroughs and small businesses?

Secretary LEW. Well, Congressman, I think that we have done a number of things in the budget that will help small businesses and passthroughs, not just with 179—

Mr. REICHERT. But my question, sir, is, why didn’t you do more? I think you agreed—

Secretary LEW. Well, we—

Mr. REICHERT. Just a moment. You agreed with the Chairman when you said, yes, we could do more and we will work with you. My question is, why didn’t you do the “more” part first?

Secretary LEW. You know, Congressman, we put forward what we think is a good package. If there is a desire to do more, we are open to ideas that would do more. So I think that the challenge here is going to be to come up with ideas that actually work and that don’t have unintended consequences—

Mr. REICHERT. So the question that I asked you are not going to answer?

Secretary LEW. Well, I—

Mr. REICHERT. I asked you why you didn’t—

Secretary LEW. I will be perfectly candid. And I have said this privately to the Chairman. This is a complicated area. This is an area where I think it will actually benefit all of us—

Mr. REICHERT. Okay. So—

Secretary LEW [continuing]. To work together in a bipartisan way.

Mr. REICHERT [continuing]. Can I get you to reaffirm that you will work with us to—

Secretary LEW. Yeah. I have said that we will—

Mr. REICHERT. Okay.

Secretary LEW [continuing]. Work together on it.

Mr. REICHERT. Great.

So tomorrow, as Mr. Rangel and I think Mr. Levin referred to, seven bills will be marked up in the area of S corporations and making some of those tax extenders permanent. I don’t want to talk about the permanency issue; I just want to talk about the policy.

So you said you agreed with the policy. Can you give me an example of how these small-business measures and legislation could be expanded? Because that was your statement a little bit earlier; you said they should be expanded. Can you give me an example of how you might expand S corporation——

Secretary LEW. Well, we have taken up to \$1 million the amount that could be expensed in a single year. For most small businesses, that is an enormous benefit. It would put all of the——

Mr. REICHERT. But could you give me an example of how——

Secretary LEW. I just gave you an example.

Mr. REICHERT. Further.

Secretary LEW. Yes.

Mr. REICHERT. You have already said that. Give me a little bit more.

Secretary LEW. I am here to present our budget. You are asking me to present things that we will work on in the future. Obviously——

Mr. REICHERT. I thought you might have some ideas.

Okay. My last question would be: You know, recently, this year, we adopted a rules package that requires CBO and JCT to perform a macroeconomic analysis of major legislation. Does Treasury have a dynamic model?

Secretary LEW. You know, both Treasury and JCT take account of economic factors that——

Mr. REICHERT. Does Treasury have a dynamic model? Do you have one?

Secretary LEW. I mean, our——yes.

Mr. REICHERT. Yes. Okay. Thank you. Good. That was easy.

I yield back.

Chairman RYAN. Keeping it easy, that is nice.

Mr. Lewis is recognized.

Mr. LEWIS. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here today, and thank you for all of your great and good work over the years.

Mr. Secretary, I want you to make it plain and crystal-clear. If the Republicans today repeal the Affordable Care Act and later the Senate repealed the Act, the President is saying he is going to veto it, but maybe he has changed his mind and will not veto it, maybe he just says, I am not going to veto it——

Secretary LEW. He has not changed his mind.

Mr. LEWIS. Okay. What would happen——what would happen to the hundreds, thousands, and millions of people who have the Affordable Care Act now?

Secretary LEW. Well, Congressman Lewis, because of the Affordable Care Act, we have millions of people, almost 10 million people, who have health insurance coverage that they didn't have. And the challenge of providing the kind of security that a family only knows when it has health insurance has taken us decades to accomplish. We would take a step back to the time when those families do not have that kind of access to health insurance and the kind of security that flows from it.

So I think it would be a very bad situation. It is why the President would veto a measure that would repeal the Affordable Care Act.

Mr. LEWIS. Well, thank you very much, Mr. Secretary.

Can you explain, what does the President's budget do to help more Americans prepare and save for their retirement?

Secretary LEW. I am sorry. I couldn't hear your question, Congressman.

Mr. LEWIS. What is in the budget—can you explain what is in the budget that would help more Americans save and prepare for their retirement?

Secretary LEW. So, Mr. Lewis, one of the things we have done in our budget is created incentives for employers to cover their workers in 401(k) plans, made it easier for them by giving them tax benefits for the administrative cost of setting up a plan, for matching contributions that employees make.

You know, we have built that on top of the proposal that we started last year, when we started the myRA program, where individuals will be able to start with a very safe, easy, starter retirement account.

We, for years now, had proposals to go from a system where employees opt into retirement to one where they have to opt out. We know from behavioral economics that that would work to get many, many more people covered.

So I think we have a quite robust set of proposals. And I think it is something that, if we could work together on a bipartisan basis, would make an enormous difference as we look ahead to a generation that is going to need retirement savings for a sound future.

Mr. LEWIS. Well, are we saving more or saving less?

Secretary LEW. Well, you know, I think as a country we are obviously—our savings rate is improving as our economy has improved, but we need to see middle-class workers saving more for their retirement. I think if you look at the distribution of retirement savings, the average amounts that most middle-class workers have is not really enough for them to rely on. You have to kind of strip out of the averages what the very large retirement accounts do to the averages.

And we are concerned about what working families are doing to take care of their own future. And we have tried to put in place the kind of tax incentives to move that process forward.

Mr. LEWIS. Well, thank you, Mr. Secretary.

I yield back, Mr. Chairman.

Chairman RYAN. Thank you.

Mr. Boustany.

Mr. BOUSTANY. Thank you, Mr. Chairman.

Welcome, Secretary Lew.

You know, there has been a lot of talk about helping middle-class, working families, small businesses, affordable health care, and so forth. But I have a real concern about an action that Treasury took in September of 2013 when you issued a regulation penalizing the use of health reimbursement arrangements by employers as a means of financially assisting their employees to purchase health insurance plans on the individual market.

I mean, why would Treasury institute this kind of a draconian penalty on small businesses that are struggling, as we have heard earlier?

Secretary LEW. So, Congressman, we have obviously moved through the Affordable Care Act into a system where there is an established way for plans to be put forward and for workers to have access to coverage. And we are working hard to implement it, to make sure that it is easy for small businesses to take advantage of and for workers to participate in. I——

Mr. BOUSTANY. But there are complications with this, and the penalty amounts to 10 times the fines that would be imposed on larger businesses. In other words, a large business under the employer mandate will be subject to a \$3,000 annual fine per employee, but yet, if you totaled up the penalty of \$100 per day per employee for these small businesses, we are talking about \$36,500 per employee for a small business. That seems to belie the sentiment that you are trying to help small businesses and working families.

Secretary LEW. Well, Congressman, our objective and the objective of the Affordable Care Act is to make sure that affordable health care is available to all, and I believe that the provisions that you are referring to are not consistent with that. I would be happy to follow up with you.

Mr. BOUSTANY. Why, thank you. This deserves serious attention, because I am hearing from small businesses that are seeing very high premium increases, up to 40 percent over last year's premium increases, in my district, and yet we have this. So we really need to work on this.

If I can get back to the budget for a moment, the budget revives the Federal unemployment surtax. And in case Members don't recall, this was a temporary tax created in the 1970s, and it has outlived its purpose in the 1980s, and that was to recover the cost of UI extended benefits paid in the 1970s.

This program, this tax, stuck around for a long time. We finally ended it in 2011. And yet the Administration now wants to revive this temporary tax in the—it is in the budget. Why? What is it going to be used for?

Secretary LEW. Congressman, for a number of years now, we have been putting forward proposals to try to make sure that the unemployment system is on sounder financial footing. We have put forward our ideas of how to accomplish that. We think it is an important objective. And we would look forward to working together in a bipartisan way to know that the unemployment system is on sound financial footing going forward.

Mr. BOUSTANY. Well, we will work with you on that, and I hope we can get to some resolution.

And, finally, with the remaining time I have, you won't be able to answer the question I have for you, but it relates to Treasury's role in developing the model BIT with regard to our—and specifically with regard to our negotiations with China. This has to be a top priority.

I would be very interested in getting a full understanding of what Treasury is doing with regard to that development and our negotiations with China and, likewise, with India. Because the President just announced with Prime Minister Modi that we will resume negotiations on a high-standard bilateral investment treaty.

And we seem to be miles apart from India, even on basic definitions of "investment."

So there is not much time left. Do you want to talk about it? But I would like a detailed answer in writing.

Secretary LEW. I am happy to get back to you in more detail, but in the minute that I have let me just take a quick shot at it.

I have been deeply involved in the discussions with China through our strategic and economic dialogues. It is a very important conversation because, if it concludes successfully, China will raise itself to standards that will help in a lot of ways in normalizing and improving trade balances and——

Mr. BOUSTANY. Well, it empowers their reformers.

Secretary LEW. It empowers their reformers to make the changes internally, and it stops them from doing things in international markets that cause——

Mr. BOUSTANY. Right.

Secretary LEW [continuing]. Unfair advantage.

Mr. BOUSTANY. I understand the rationale, but what I would like is a detailed summary of where we are with this.

Secretary LEW. Right. And they are just taking the very first step, very shortly, putting out their first cut at what is the list of industries that would not be open to foreign investment.

Mr. BOUSTANY. The negative list, yes.

Secretary LEW. The negative list. That will be an important indication of the seriousness. And we look forward to seeing it and taking a step forward from there.

Mr. BOUSTANY. Well, I am following this very, very closely, and I would like to stay in contact as to the progress.

Secretary LEW. I would be happy to.

Mr. BOUSTANY. Thank you.

I yield back.

Chairman RYAN. Thank you.

Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Secretary, a word of congratulations on your EITC proposal. Mr. Ryan and I have spent some conversations already about this.

And a reminder that much of the fraud that is determined in EITC has much to do with the lack of professional standards for tax preparers. We have had extensive conversations in the past with Mr. Camp's staff, and there seems to be at least some consensus on that, as well. And if we are to apply the logic of not paying for things based upon what we are to do tomorrow with 179, perhaps we should just expand EITC and not have it paid for.

Thanks again, as you acknowledged the auto-IRA that Mr. Tiberi and I have worked on. I thought we were close in the last session. We almost got there. And I hope, when we consider that half the people that get up and go to work in America every single day are not in a retirement plan, that we could consider more opportunities to expand retirement savings.

A word of congratulations on the New Markets Tax Credit program and expanding that. That is an inducement to sound investment in urban areas across the country. And Alan Krueger was a terrific advocate of that, along with Build America Bonds, which worked quite well during those years. There was not an airport

that was expanded, for Members of this Committee who have one, that did not use Build America Bonds for that very purpose.

Now, after pointing out that there are many avenues of agreement here and plaudits that the Administration deserves, given your history in Massachusetts and having worked for Tip and cheering for the New England Patriots, I think that we could also acknowledge that the proposal that the Administration has offered, Jack, on graduate medical education is a huge deal for us in Massachusetts.

You do, I think, deserve some credit in the Administration for the lowest inflation rate as it relates to health care in the past 50 years. And ACA has to receive some acknowledgement for that. You obviously are attempting to preserve and improve Medicare for future retirees as well as those who are receiving it now.

But I would carefully suggest on graduate medical education, that that is a huge plus for America. It helps to set us aside. The Pacific Northwest has Boeing and Microsoft. Those of us in Massachusetts, we have graduate medical education. And I hope the Administration will treat it with the same regard that they do other initiatives that have been proposed.

I think \$16 billion, in terms of a cutback, is a bit over the top, and I hope that you will have due consideration for the proposal that you are offering and review it and really set it aside. It is a big economic plus for those of us in New England.

And I will give you the next 2 minutes to talk about the proposals as I have outlined them.

Secretary LEW. Well, Congressman, let me start with the points you made about the New Markets Tax Credit and the Build America Bonds.

We obviously agree very much that they have made a huge difference. We have a new form of Build America Bonds that we are proposing to take them forward to the next level. And we, obviously, would propose continuing the New Markets Tax Credit, which I will point out was also a bipartisan creation—

Mr. NEAL. Exactly.

Secretary LEW [continuing]. At the end of the Clinton Administration with Speaker Hastert. So we can do things together on a bipartisan basis to create real opportunity in this country.

Obviously, the issues regarding Medicare savings are always difficult. Our budget has repeated the proposals from past budgets, where we have \$400 billion of savings in Medicare. They are all hard, and, as always, we look forward to working with Congress to, you know, develop a path forward.

You know, we put it in as part of a comprehensive approach to deal with our fiscal challenges. And I think that, you know, we would view the kind of entirety of the package as the way to see what we are putting forward.

This is an issue that I know is of particular concern in Boston and Massachusetts and in New York, and we would look forward to continuing the conversation.

Mr. NEAL. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman RYAN. Thank you.

Mr. Roskam.

Mr. ROSKAM. Thank you, Mr. Chairman.

Mr. Secretary, thanks for your time today.

You are here commenting on the President's budget, and the agency that will collect the money to enact our next budget is the Internal Revenue Service. They are tasked with collecting over \$3 trillion, as you know.

You made an argument that one of the things they need is more resources, and let's set that aside for a moment. The other thing they need is a reputation. They need a reputation as calling balls and strikes. They need a reputation as being a fair agency. So resources and reputation are at the foundation for any tax collection that is going to have integrity.

I thought it was interesting that in your remarks and in your written testimony you didn't talk about the reputation of the Internal Revenue Service and the damage that has happened in the past couple of years.

Back in the summer of 2013, when you were asked on national television, you dismissed it—that is my word, but you were fairly dismissive, in that you characterized it as a “phony scandal.”

Now, this Committee made a referral to the Attorney General last year, and I assume you have read the referral letter and the supporting documents, haven't you?

Secretary LEW. I have seen it.

Mr. ROSKAM. And, in light of that, you wouldn't characterize this as a phony scandal, would you?

Secretary LEW. Congressman, I am happy to discuss the reputation of the IRS and these issues.

I think the IRS is doing an extraordinarily effective job under very difficult circumstances, where they have been underfunded and not given the resources to do one of the most important jobs that any government does: running its revenue service.

I have acknowledged from the beginning that the actions that took place with regard to the issues that are of concern there were very bad. And they involved a small number of people at the IRS. We took immediate action to discipline the people involved, to make sure that the supervisors who were responsible are no longer there.

And I think if you look at the way the IRS is managed under very difficult circumstances, we are, with less resources, processing tax returns efficiently. We are using the online tools as much as possible to fill in for where we don't have people to answer the phones. And we are processing refunds in a timely way. I—

Mr. ROSKAM. But, Secretary, to dismiss this down to, you know, just, “There were some bad actors”—here is my question: What have you done to prevent a Lois Lerner 2.0 situation?

Think about it. Lois Lerner was the person who put together a panel of three senior career employees that had to be the threshold before an audit could happen. Lois Lerner was then the person that went around that very safeguard that she structured. She said in an email, where she really was quite aggressive with one of her employees—and this is after two times this three-person panel had said, “Look, we are not going to pursue it.”

She writes then, “I reviewed the information and thought the allegations in the documents were really damning, so I wondered

why we hadn't done something with the org. As I've told you before, I don't think your guys get it."

Mr. Secretary, what is it that you have done—other than calling this a phony scandal on national television, what have you done to make sure that Lois Lerner 2.0 is not possible?

Because to simply say, well, it is just a small group of rogue employees, or, frankly, in your other interview, when you said, well, no political employees were behind this, that is just hiding behind an adjective. You know that there are only two political appointments at the Internal Revenue Service. One is the Director, and one is the GC.

Secretary LEW. Congressman, I think if you look at the Inspector General report that came out, we followed all the recommendations of the Inspector General report. We have made clear that the behavior at issue there was unacceptable, it cannot happen again. We have a new Commissioner, new senior officials, who are very much aware of the fact that it is their responsibility to make sure things like that don't happen.

So I actually take issue with the notion that we have dismissed it. We haven't dismissed it. It is one thing to take actions in response to what happens with a small number of people in a large agency. It is another thing to condemn the whole agency, which is what I believe many are doing, and that is wrong.

Mr. ROSKAM. Well, I don't think there is a condemnation of the entire agency, Mr. Secretary, but I think that when the Administration essentially comes before this Committee for years and says there is no problem and then senior Members of the Administration are dismissive, don't you understand how that is——

Secretary LEW. Yes. I don't——

Mr. ROSKAM [continuing]. Corrosive and insidious?

Secretary LEW [continuing]. Believe we are being dismissive. I disagree with that.

Mr. ROSKAM. Oh, when it is characterized as a phony scandal, that is dismissive.

Secretary LEW. I think it is——

Mr. ROSKAM. That is: Off with you, be lively, we have this under control, we don't want to hear it anymore. There is nothing more dismissive than calling it phony.

I yield back.

Chairman RYAN. Thank you.

Mr. Becerra is recognized.

Mr. BECERRA. Thank you, Mr. Chairman.

Mr. Secretary, it is great to have you with us. Thank you very much.

And can I start by just saying, again, thank you. You have heard it already. The Earned Income Tax Credit, I think that many of us see that, right now, while the middle class and what I call the aspiring class, those that want to get to the middle class, as they continue to get squeezed, they see everything working well in the economy for corporate profits and at Wall Street, but they haven't yet seen their paychecks grow the way they would like.

Thank you for speaking to those families in the middle who have been working hard. They have been more productive than American workers in the past. They just want to see their paychecks

grow. And so the Earned Income Tax Credit for those working families is going to be helpful.

Your proposal, the President's proposal, for an expanded child credit for working families who have kids, who aspire to see them go to college, that is going to help.

And can I just applaud you and the President and the team for focusing on child care. I am fortunate. My three daughters—two of them are already in college, one on the way—we are there. But I know there are a whole lot of families back home who are wondering how they are going to get there. They have to make sure their kids are first taken care of. So the dependent care credit for those who have kids and want good daycare, good ability to take care of their kids while they are working, that is critical. And so thank you for the work that you are doing there in that regard.

How many families does the President estimate will be helped by these credits that are going to middle-class and aspiring families in America? I'm talking about the Child Tax Credit and the Earned Income Tax Credit. Are we talking thousands? Are we talking—

Secretary LEW. No, millions. I don't have the exact number, Congressman, but it is many, many millions.

Mr. BECERRA. Yes. And I think what we are saying to those millions of Americans who are striving to stay in the middle class and ultimately go beyond the middle class is, this is going to help you launch because you will get good child care if the two of you are going to work, you will have an opportunity to get some support if you are working but not making a whole lot of money but you are still working. You are doing it the way we want people to do it.

I want to touch just briefly on something that was raised earlier with regard to Social Security because it concerns me. Today, there are about 160 million Americans who are paying into Social Security. They have what we call the FICA deduction, right, the Federal Income Contribution Allocation, that is deducted. It is part of another acronym, OASDI, the Old-Age, Survivors, and Disability Insurance.

That is what Social Security is. It is all lumped together. If you work and you reach retirement age, you get Social Security. If you work, become disabled on the job, if you paid into Social Security, you get Social Security even though you are disabled, or your family does. You die, but you have paid into Social Security? Your survivors get Social Security. It is insurance for the family.

I don't think any American works and pays into Social Security and says, ah, I only want my money to go into retirement, or, hey, I know I am in a risky job, I only want my money for Social Security to go into disability. In fact, 11 times this Congress—not this Congress today, but Congress over the years, with the Administrations, whatever Administration it has been, we have worked to make sure that we always have the money allocated for the disability side of Social Security, the survivor side of insurance for Social Security, or the retirement side of Social Security.

But all of a sudden, we see this crisis being manufactured by those who say that, of the \$3 trillion that Social Security has in its Trust Fund, none of it can be made available for Americans who worked hard but became disabled or for their families. Eleven

times over the years, Congress, with the Administration, has worked to make sure the money that is out there in the Trust Fund, it goes out to those Americans who worked and paid into the OSDI fund.

And so I hope we don't tell the 59 million Americans who today are receiving Social Security, 11 million of them disability insurance under Social Security, that they are in jeopardy of losing their money because someone wants to manufacture a crisis and say, of the \$3 trillion the Trust Fund has, that we can't make that available to Americans because some technical glitch here in Washington is preventing us from moving forward to do what we have done in the past 11 times on a bipartisan basis, to make sure Americans get their Social Security, whether it is retirement Social Security, whether it is disability Social Security, or whether it is because you died and now your survivors need their Social Security. I hope we don't play that game.

And, finally, with the last moment I have, I just want to mention, Mr. Secretary, I hope this Administration, as we move forward in trade, don't leave out currency manipulation as something we attack. The last thing we need to do is send a signal that we are going to allow governments to cheat by manipulating their currency. If we are trying to get the companies in those countries to not cheat, the last thing—

Chairman RYAN. The time of the gentleman has expired.

Mr. BECERRA [continuing]. You can do is allow countries to cheat by manipulating their currency.

Chairman RYAN. The time of the gentleman has expired.

Mr. BECERRA. With that, I yield back. Thank you, Mr. Chairman.

Chairman RYAN. Maybe with somebody else's questioning you can get into those issues, but in the interest of everyone's time, Mr. Buchanan is recognized.

Mr. BUCHANAN. Thank you, Mr. Chairman.

And I want to thank the Secretary for being here today.

As I mentioned to you a little earlier, Mr. Secretary, the number-one issue in our district and I would say a lot of Florida is the idea of dysfunctionality. When we serve a lot of our constituents, that is the biggest thing they are passionate about and concerned about. So, that is one of the things I am hopeful in the next 6 months, this year, we can work together on in a bipartisan way for the importance of the American people.

I am concerned with the budget where we are looking at raising taxes another \$2 trillion, more debt of another \$8.5 trillion, and a budget basically that never balances. We are an aspirational society. You know, if you work hard and play by the rules, anything is possible in America. I don't want to punish one group over another group. I will also mention that President Kennedy stated, "A rising tide lifts all boats."

And one of the questions I would have for you: When you talk to various experts, they talk about, if we could focus on growing the economy, instead of 2 percent, 2½, growing it 4 or 5 percent—China is at 8 to 10 percent. But if we can get back to what we did in the 1990s, we could fix a lot of the challenges that we have in America, a lot of the problems we are talking about go away.

Why can't we, or shouldn't we be asking ourselves, on any of these proposals, any of these policies we are putting forward, does this grow the economy? How would you respond?

Secretary LEW. Congressman, I think that is the right question.

First, on your point about working together in a bipartisan way, I couldn't agree more that it would be a good thing for the country and the American people would feel a lot better about Washington and the future of the U.S. economy if they could see us working well together. It has a lot to do with confidence.

I saw it in the 1980s when we had a divided government. I saw it in the 1990s when we had a divided government. And you talk about the growth in the 1990s. We were making important policy decisions in a bipartisan way for much of that period of time.

So I think that to focus on each of the individual items is important, but, ultimately, our goal has to be growth. Because if it becomes a question of, how do we cut our way to prosperity, there is no answer to cut our way to prosperity. There is no answer for any society. How do you cut the way to prosperity?

Mr. BUCHANAN. Let me ask to be clear. You are committed and the Administration is committed to working with us this year to get tax and trade ideally done?

Secretary LEW. Correct.

Mr. BUCHANAN. Okay.

The second thing I wanted to mention, because it was in your comments, about people need to pay—some people need to pay more of their fair share. The taxes now for medium or small businesses, many of them, when you add State and Federal together, it is almost 50 percent. I have seen it was 49.6 percent, lower in Florida, but in California it is higher. Then you have additional taxes on there.

Where is your sense of fair share? We are looking to take the cooperate rate, ideally, from 35 to 28 or 25 percent. But yet many of these businesses—that is the world that I have lived in—these are the folks that are growing the jobs. They might have 100 jobs, but you can't take 50 percent of what they earn because they would have nothing left because the balance of their money stays in to grow their inventory, to add employees, and to make additional investments.

So what is your sense of what is fair?

Secretary LEW. Well, you know, Congressman, one of the reasons we take up to \$1 million, the amount that a small business can deduct in depreciation, right, when they make an investment, is exactly to encourage that kind of behavior, having it be advantageous to invest in your business, to invest in your workers.

I think that—

Mr. BUCHANAN. But if you have a business—let me just say, let's take it at the \$1 million to \$2 million range, with around 150 employees—we have a lot of those all over Florida—are you saying that government should take half of the next million? Is that what you are saying?

Secretary LEW. Well, look, it is hard to respond to a hypothetical. I don't know what the effective tax rate in the—

Mr. BUCHANAN. Well, that is the tax rate. It is 49.6 across the country, I think.

Secretary LEW. The effective tax rate for most businesses is lower than their marginal rate, and you have to look at the entire numbers——

Mr. BUCHANAN. If you look at the number of businesses, you are right. But there are a lot of businesses that create a lot of jobs in the country that might have 300 employees, 200 employees. I don't look at them as even a medium-sized business; they are still categorized as a small business. But to take half of their money is not right.

Secretary LEW. To the extent that companies make the choice how to organize, either as a passthrough or as a C corp, you know, if it is economically advantageous to organize as a corporation, that is an option that is available. Companies that are choosing to be on the individual side obviously see benefit in being organized as an individual company. And we have to kind of look at——

Mr. BUCHANAN. My point is I think——

Secretary LEW [continuing]. What all the factors are.

Mr. BUCHANAN [continuing]. We need to work on a bipartisan basis together——

Secretary LEW. We do.

Mr. BUCHANAN [continuing]. To address that.

Secretary LEW. Yes. I fundamentally agree with the point that we want the burden on small businesses to be easier and lower. And, you know, we think we have put some ideas forward that advance that, and we are open to working together on this issue.

Chairman RYAN. Thank you.

Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

And thank you, Mr. Secretary.

Am I correct that, while the Administration strongly supports a one-time mandatory tax of 14 percent on profits that corporations claim to have earned offshore only as a part of comprehensive corporate and business tax reform, the Administration continues to strongly oppose any stand-alone measure similar to the voluntary repatriation that was approved back in 2004?

Secretary LEW. We don't believe that the 2004 voluntary repatriation worked. It ended up costing a lot of money, it didn't increase investment, and it put in place an incentive to store income overseas, waiting for the next tax holiday.

We think we have proposed the right way to deal with this and think that we are now in a conversation where we can maybe do this the right way.

Mr. DOGGETT. So a one-time repatriation of the type some have talked about really doesn't provide a good source for transportation or anything else. It is a revenue-loser, not a revenue-gainer, unless you do it, as you recommend, as a part of comprehensive business tax reform.

Secretary LEW. Yes. I think if you have estimates that show that a provision loses revenue, it is hard to call it a revenue-raiser.

Mr. DOGGETT. Exactly.

And your written testimony refers to some of the manipulation that some of these multinationals have engaged in. Indeed, as you know, there are a number of studies that have been made of that. One in tax year 2008 suggested that, while five tax havens had

half a percent of the world's population, almost half of American corporate earnings claimed to have been earned offshore were claimed for those five countries.

Another in 2013 suggested that somewhere between \$55 billion and \$133 billion of profits earned in the United States had been shifted abroad and that over half of these claimed offshore profits were located in six tax havens.

Isn't it true that a substantial amount of these alleged offshore earnings were actually earnings of operations that occurred here within the United States?

Secretary LEW. Well, Congressman, it is hard for me to comment on individual circumstances like that, but let me take it up one level and say that, globally, the issue of legal tax avoidance has led to the erosion of the tax base. And it is an enormous concern, not just to the United States but worldwide.

I mean, it is wrong for countries to have a race to the bottom, with, you know, zero or close-to-zero tax rates to be a magnet for these kinds of activities. It is also wrong for us to have a tax system that has the highest statutory rate in the world that drives businesses to look for these havens.

We need to reform our broken system to make it work, to end inversions, to end the push. Other countries need to change their system and raise their standards. It is hard for us to get other countries to do what they need to do if we don't do what we need to do.

And I think the business-tax-reform discussion we have is something that will empower us on the world stage to try to get other countries to do the right thing, as well.

Mr. DOGGETT. I hope that it will if all elements are actually adopted and strong anti-abuse provisions are included, as you suggest.

Now, your selection of this 14-percent rate, I know that is considered onerous by some of those multinationals that don't believe they need to pay the Treasury any more than they pay their CEO or their lobbyist to ensure that the laws remain like they are and don't feel they have any real responsibility to pay for the cost of our national security from which they benefit so much.

But it seems to me that telling corporations they pay less than a nickel and a dime on a dollar of profits that have really been earned in the United States is rather generous. It is better than the nickel that was done in 2004, a little higher than the 9 cents that Dave Camp recommended last year, but it ought not to be the opening bid. It ought to be the floor in looking at this whole issue.

And, of course, all these corporations, if they really pay taxes abroad, under your proposal they are entitled to a credit for that.

Secretary LEW. Right.

Mr. DOGGETT. The stateless income to which you refer—

Secretary LEW. Correct.

Mr. DOGGETT [continuing]. That has been hidden from taxes everywhere, that is an example of corporate tax avoidance that we need to put a stop to and not reward.

Secretary LEW. Congressman, I totally agree that we need to make sure we end up with a toll charge that is set at a reasonable level. We have proposed 14 percent. I know it is a little higher than

some other proposals, but I think the credit for taxes overseas brings the effective rate down considerably.

You know, we have proposed a pro rata credit because it is at such a reduced rate, so it would be roughly 40 percent of the taxes paid. If you use the example of a firm that has a billion dollars in accumulated earnings and has paid \$100 million in foreign tax, you know, they would get \$40 million credit and they would end up paying \$100 million, or 10 percent. So even the 14 percent exaggerates the impact on most firms.

Mr. DOGETT. Thank you.

Chairman RYAN. Mr. Smith.

Mr. SMITH OF NEBRASKA. Thank you, Mr. Chairman.

Thank you, Secretary Lew, for being here with us today.

Let me begin with a very quick question. Do you believe that the estate tax is double taxation?

Secretary LEW. No.

Mr. SMITH OF NEBRASKA. No. Okay.

Back in April of 2013, you and I had a constructive and, I think, a thoughtful exchange on business tax reform versus comprehensive tax reform. And, at the time, you said, "We want to work together on tax reform on the individual side, as well, to make it simpler. The thing that I think we have universal agreement on is that it is just too complicated."

In light of what you said 2 years ago, I certainly want to raise for you some concerns I hear regularly from constituents about the stepped-up basis and the estate tax.

It is obviously no secret that we have fundamental disagreement on the level of the estate tax. I believe it is a double taxation, and you disagree with that. That is fine. A lot of us would prefer zero estate tax, and we know the Administration would actually, I think, probably prefer a higher estate tax.

But one thing I am consistently finding and certainly being told by farmers and ranchers and small-business owners is that, while dealing with the estate tax is certainly challenging, it isn't anywhere near the administrative nightmare removing the allowance for stepped-up basis would cause.

And so, as an example, when a family passing on the agricultural land which has been held for decades has to calculate capital gains, the family could face multiple challenges, which only begin with finding the value of land bought so long ago, determining purchase values for multiple tracts purchased in different times, and determining whether any land was sold off prior to inheritance.

And so such a proposal is certainly the opposite of tax reform. In fact, it only makes compliance more difficult.

Have you or anyone at the IRS looked into what the added compliance time and costs of this provision would be?

Secretary LEW. Congressman, I am happy to get back to you on what the estimates on the compliance would be. But I think that the design of the provision that we have put in our budget was really very much to make it easier for taxpayers, not harder for taxpayers, to comply with. There are exemptions that are quite generous. There are 15 years to make the tax payments that are due so that it would not result in a forced sale. And we think that for the vast majority of assets which, you know, are subject to

stepped-up basis, things like stocks and bonds, those questions are a little bit simpler to answer.

On real estate, obviously, we currently have a system where ultimately you have to know what your basis is in real estate. I don't know why it would be more complicated in stepped-up basis than it is in other contexts, but I am happy to follow up with you.

Mr. SMITH OF NEBRASKA. Okay. Well, I appreciate that. And the feedback I get from constituents is that it would certainly add to the complexity.

I would also like to touch on another provision in the President's budget, the financial fee on certain banking institutions. Has the Treasury or any other department in the Administration studied the effect that this proposed fee would have on the availability and cost of credit for families and businesses in the marketplace?

Secretary LEW. Congressman, we have looked at what it would mean in terms of its percentage impact. It is obviously a fairly small fee, just in terms of the size of it on their total basis.

And it is designed to have an effect that would be complementary with many of the reforms that we have made that make our system safer and sounder. Right now, we have a system that is heavily weighted toward leveraged exposure. This would make it a bit more costly to have leverage, but it would not make it prohibitively costly. And we think that will lead to a safer financial system.

We also think that when you look in the context overall of tax reform, there are other benefits that would go to financial firms, and, net, it is a fair and a good policy.

Mr. SMITH OF NEBRASKA. Shifting gears just a little bit, I have a question on extenders. The temporary extenders that have taken place extended roughly 2 years at a time unpaid for in the past. Is that accurate?

Secretary LEW. It has sometimes paid for, sometimes not. Often not.

Mr. SMITH OF NEBRASKA. Often not. That's correct. I agree with that.

And could it be, I think, a good idea, as well, to extend those on a permanent basis? Would that not be more intellectually honest to take a few of those and make them permanent rather than just continually extend unpaid for on a so-called temporary basis?

Secretary LEW. That is exactly what we propose.

I mean, as somebody who has worked in tax policy in various ways for 35, 40 years, it is hard to defend provisions that come and go and that have deadlines that pass, and it makes it hard for businesses to know what to expect and how to plan. You end up enacting things retroactively that can't possibly affect the behavior that was made in a rational way.

We do that, we pick and choose, and we pay for it in the context of tax reform.

Mr. SMITH OF NEBRASKA. Okay.

Secretary LEW. And that is what I think should be the basis of our bipartisan conversation.

Mr. SMITH OF NEBRASKA. Thank you, Mr. Chairman.

Chairman RYAN. Thank you.

Mr. Thompson.

Mr. THOMPSON. Thank you, Mr. Chairman.

Mr. Secretary, thank you very much for being here.

And I, too, want to add my appreciation to you and the President for submitting a budget that attempts to really focus on the middle class. While I agree with my friend from Florida that businesses across this great country are very, very important, they do a great service, they provide great products, the truth of the matter is it is those consumers, largely in the middle class, who are the job creators in this country. If there is no middle class, then there is nobody to buy all the great things that our businesses sell and manufacture. All the business stuff just goes out the door. So it is important that we do focus on the middle class.

And there is no better place to do that than through investment in infrastructure. So we may disagree with how we get there. You have taken a very important first step in recognizing the need to invest in the critical infrastructure that keeps everything going across the country.

I have a couple of questions I would like to ask, a little more specific stuff. One is on something that has come to my attention called a cash-rich split-off. And you are smiling, so I am assuming you know what it is that I am talking about. I think it came to light when Yahoo was going to buy Alibaba. It is where they take a low-basis asset and stock and exchange that for a line of business in cash to avoid any gain in appreciation.

And that sounds a lot like that legal tax avoidance that you were talking about, or, using another term, a great, big, huge loophole. Is this something that you are looking at? Does it need legislation to close that loophole, or is it something that can be done administratively?

Secretary LEW. Well, Congressman, I obviously can't comment on what a specific company may or may not do with regard to its tax planning or transactions. But, under current law, a company can split off component parts on a tax-free basis as long as there is an active business in each part. But if there is such a spin-off, the firm would be liable for capital gains if the firm sold the shares involved.

So I would have to know more about the transaction. I don't know off the top of my head whether there is any administrative issue here, but I am happy to follow up.

Mr. THOMPSON. Well, it is something I plan on looking into, and I would appreciate it if we could get your shop to help us better understand it and figure out how we in fact close that loophole.

Also, I agree with my friend from Massachusetts that the New Markets Tax Credit is extremely important. And I would like to know if you have given any thought about including the BRAC status as a criterion in the 2015 applications?

I think it is important to recognize that BRAC has been responsible for a lot of areas experiencing severe economic downturn. And there have been some examples of closed military bases that have really added to positive economic growth through creative means. And I would think that the New Markets Tax Credit would be a great place to go. So I would like to get you guys to look at that, as well.

Secretary LEW. Congressman, I am not aware of any discussion regarding BRAC eligibility, but I am happy to take it back and look at it.

Mr. THOMPSON. Thank you so much.

And then, also, LIFO—and we have had this discussion before—last in, first out. The proposal in the budget is a little disheartening, not only because it is a LIFO, which is very, very disruptive in general, but, specifically, in this proposal, you have a retroactive provision in there, if I understand it correctly. So, if enacted, it would go back decades and take back money that was generated through a tax policy that was on the books and legal.

This would devastate not only small family businesses but the employees that they employ today. This has shut businesses down, some of those in my district that you are very well aware of.

And is there a reason for the retroactivity? I can understand a LIFO forward, but going back just seems terribly unfair and destructive.

Secretary LEW. Congressman, there has been a discussion about the proper accounting standards for a long time. And, obviously, the attempt is to, as part of tax reform, come up with a better, more fair, efficient approach. I am happy to look at the impact of the retroactivity on the firms that you are concerned about, but the goal was to fix what is broken in our Tax Code. It is obviously not to cause undue burden.

Mr. THOMPSON. Okay. Well, I look forward to working with you on it.

Thank you.

Chairman RYAN. Thank you.

Ms. Jenkins.

Ms. JENKINS. Thank you, Mr. Chairman.

Mr. Secretary, thank you for coming over today to testify on the President's budget.

I would like to draw your attention to the proposal on page 53 of the budget, where the President proposed——

Secretary LEW. I don't have the budget in front of me, so if you could tell me what is on page 53?

Ms. JENKINS. I would be happy to. It is where the President proposes a tax on future 529 college savings account distributions.

When the President proposed this tax 2 weeks ago, I was shocked to see him target these very popular plans. I was equally relieved when he withdrew his proposal last Tuesday, but, apparently, he changed course too late to remove it from the budget proposal.

Then, the next day, the Administration spokesman made a confusing statement that inferred that the President was only withdrawing the 529 tax provision due to political pressure and that he still stands behind the tax as good policy.

So, Mr. Secretary, can you please clarify for our Committee, first, does the President still support the concept of a tax on 529 plans, and does he believe that this tax would be good policy? And, second, can Congress expect to see the President try to revive this 529 tax again?

Secretary LEW. So, Congresswoman, just to be clear, the White House indicated quite clearly that the President is not going to be pushing for this provision. It was obviously already in the budget.

And I think the comment on policy is not saying that—it is something they were pushing, that was causing a lot of distraction. There is an important discussion to be had here on many tax issues, some of them regarding education, that would provide real opportunity for middle-class families. Clearly, it wouldn't have gone in the budget if there wasn't a solid policy reason for it. And I think the comment was to say that it is something that really does, you know, largely benefit more affluent people. And it is something that, in the context of a plan to make middle-class college education affordable, there is a basis for.

He is not pushing it. We are not pushing it. It was never a key part of our plan. It is not a huge dollar impact on the whole budget. And I don't think there should be any confusion on the issue.

Ms. JENKINS. Okay. So he still thinks it is good policy, but for political reasons he is going to withdraw——

Secretary LEW. No——

Ms. JENKINS [continuing]. The proposal.

Secretary LEW. There is a lot of things that one can justify on policy grounds that don't go forward.

Ms. JENKINS. Okay. Thank you for somewhat of a clarification on that confusion.

Now I would like to just briefly discuss H.R. 529, which I introduced on a bipartisan basis with Congressman Ron Kind from Wisconsin last week.

And I have been a champion of 529 plans for a very long time, since I was a State treasurer back in Kansas. And this is the third Congress that we have introduced this legislation. It strengthens 529 plans in order to make them more attractive to middle-class folks across the country who simply want to save for their kids' college education.

And this bill, in particular, makes some commonsense enhancements to 529 plans that will allow students to purchase a computer with their 529 plans. It allows funds to be redeposited without penalty if a student withdraws from school for any reason. And it removes some outdated administrative paperwork requirements.

So, Mr. Secretary, what is your take on this legislation? Do you agree with us that these 529 plan improvements will help middle-class folks save for their college expenses? And will the Administration support the bill?

Secretary LEW. Congresswoman, I am happy to look at the proposal and get back to you. Obviously, with 529s on the books, we would look forward to making sure that they work as effectively as possible. I am not familiar with the details of the legislative proposal but would be happy to look at it and get back to you.

Ms. JENKINS. Okay. Well, I look forward to working with you. Thank you.

I yield back.

Chairman RYAN. Thank you. Mr. Larson.

Mr. LARSON. Well, thank you, Mr. Chairman, and thank you, Mr. Lew, for your service to the country, and thank you, Mr. Chair-

man, for this very productive hearing. On a spontaneous note in observing my colleagues that meet today on this Committee, and we all know that Congress operates at about a 9-to-11 percent approval rating, we have one of the icon figures in American industry, the most ambitious gentleman. I propose in the spirit of what Mr. Camp did last year and, Mr. Chairman, your initiatives in keeping with keeping this Committee open and on pace that we continually have Johnson and Lewis forums where not only are they there for the Committee, but we invite other Members of Congress who would be interested as a way to restore what we all know individually is the great strength of this Committee and the opportunity for us to work across the aisle with one another.

We had several issues that were explored today, and in rapid order, I think first with respect to infrastructure, Mr. Chairman, we had several letters that were sent last year with respect to making sure that we had hearings on infrastructure and discussed the tax aspects of this as well. Separately, Mr. Blumenauer also sent a letter, and I know that that is at the core of putting people back to work in this economy. I hope we can continue down that line. Maybe that could be the start of a Johnson/Lewis discussion and forum on infrastructure.

Also, on Social Security, as was brought up by Mr. Johnson, there is a proposal out there that provides a tax cut and tax relief for seniors that is paid for. I hope all Members will consider this proposal as a way in which we can solve this problem into the next century.

Third, on the Affordable Care Act, you know, with respect to whatever is going to come on the floor tomorrow, I think it is long overdue that we recognize a proposal put forward by the Heritage Foundation and adopted successfully by Governor Romney as something that we all can work together on for the benefit of the American people.

And, of course, with respect to currency and trade, I know that the Administration will adhere some of the concerns that were raised there.

Lastly, Mr. Lew, I believe you were asked a question earlier about dynamic scoring and didn't have an opportunity to fully answer the question. I wanted to provide you with a few moments if you could to expand upon your thoughts on dynamic scoring.

Secretary LEW. Thank you very much, Mr. Larson. You know, the question of how we score legislation is obviously inherently a technical and complicated one. We have established practices that are meant to be as accurate as possible, and the risk of going from something that is known to be the most accurate to something that has all kinds of uncertainty in it is something we worry greatly about because I think there is a shared concern that we not blow a hole in our budget because our estimates are wrong.

So there is some element—I was asked if there is any dynamic scoring in the Office of Tax Policy and Joint Tax Committee scoring today. There is some, but if one goes further and uses assumptions that drive the numbers in a way that may not turn out to be correct, we will all regret it after the bills actually get added up, and I didn't want there to be—I don't want there to be any misunderstanding of what our position is on—we agree with current scoring

rules. We have always been open to alternative measures and to understanding what the kind of up side and down side risks are, but to use those to make decisions that have real consequences is very different.

Mr. LARSON. Well, thank you, Mr. Chairman. I know that Mr. Neal also makes the point on several different occasions where we apply dynamic scoring, and if we are going to look at dynamic scoring, we have to make sure that we are willing to apply that, and it may be that it is a very sound practice. I am not an economist, but what do we apply it to? And I think it can be applied equally across the board to have the same effective results. And, lastly, to the Chairman as well, the last couple of weeks have been painful with Green Bay and everything else, but I wanted you to know that I didn't take it personally, you know, and I wanted to—we got this picture that we wanted to provide to you, and I will give it to you, Mr. Chairman. It is a—

Chairman RYAN. I can't see it from here. Describe it.

Mr. LARSON. It is a picture of Tom Brady, and I think once we—

Chairman RYAN. With objection, it shall not be included in the record, so at least the Seahawks now know how Packer fans feel.

Mr. LARSON. But we will pass this up.

Mr. LEVIN. I think his time has expired.

Chairman RYAN. Yes, his time has expired.

Mr. Schock is recognized.

Mr. SCHOCK. Thank you, Mr. Secretary. Thank you for being here.

As you know, the Federal debt limit will expire on March 15th. Do you know roughly what our debt limit will be on or about March 15th when our debt limit is set to expire?

Secretary LEW. Well, I don't have an exact estimate right now. Obviously, we are several—two months' of data away. I think that the challenge of funding our government is one that we fundamentally make when we make decisions on what our tax and spending policy is.

Mr. SCHOCK. Do you know roughly—

Secretary LEW. Not when the debt limit is—

Mr. SCHOCK. Sure. When March 15th rolls around, have you and your staff begun looking at how long you will be able to use extraordinary measures beyond that point?

Secretary LEW. Yes, we have obviously started looking, but I won't be able to answer that question with clarity until we get through tax season and we know what our cash balances are in tax season.

Mr. SCHOCK. Well, that is going to be a problem, because March 15th is the deadline. Tax season is April 15th.

Secretary LEW. Yes, I—there is—you know, all—

Mr. SCHOCK. Are you saying you are not going to know until April or March?

Secretary LEW. All the public estimates, you know, CBO's estimates, show that we have some period of time. You asked me how long it goes? I don't think we have any kind of a crisis on March 15th. I can't tell you exactly how long it goes, and that is what I thought you were asking.

Mr. SCHOCK. Okay. Yes.

Secretary LEW. It is the outer limit, not the initial period where the question comes in.

Mr. SCHOCK. Okay. Can you get back to us with a rough estimate?

Secretary LEW. Yes. We will, as we always do, stay closely in touch with the Committee as our understanding develops of what the projections look like. We think it is important for Congress to have clarity on this and we will remain—

Mr. SCHOCK. Likewise. Thank you.

Following up on a letter that I sent to you last January, it was co-signed by 17 Members of the Ways and Means Committee, dealing with FATCA. I am still having trouble understanding why Treasury wants FATCA to regulate non-financial, non-cash value insurance. Can you update Members of the Committee, at least the 17 of us here that signed that letter, on the status of your agency's deliberations regarding the relationship between non-financial products and FATCA?

Secretary LEW. You know, Congressman, our goal in FATCA, and really now an international goal, because FATCA has been adopted pretty much as an international norm, is to make sure that there is the kind of transparency that permits tax authorities to see where there is behavior that is evading tax systems and to get accurate reporting on offshore accounts.

You know, we believe that the proposals we have made, the law and the proposal we have made advance that. I would be happy to follow up with you on the specific issues with regard to the entities you have described.

Mr. SCHOCK. Okay. I look forward to doing that.

Finally, year in and year out the Administration comes forward with a budget, and part of the framework is always the desire to make our corporate tax reform more competitive. You have laid out a benchmark of I think 28 percent, ideally 25 percent for manufacturing. But I will tell you when I am back in my district, the frustration is not just among employers with the Tax Code and the complications—complexity of the Tax Code, it is really with individuals, and if there is one message I heard from my constituents after the Camp draft came out last year, it was that they, as individual taxpayers, were excited at the prospect that 9 out of 10 of them would be able to do their own tax return on a single piece of paper, take a standard deduction, and be done.

Why is the Administration not equally energized, motivated, and deliberative about ensuring that not just our Tax Code is simplified and made easier for corporations and manufacturers, but also for individuals? Is the Administration willing to work with us on creating a competitive individual tax reform?

Secretary LEW. We very much agree with the goal of simplifying the Tax Code. A number of our proposals were designed to take provisions like the education provisions and simplify them. There is always a tension between things being simple and them not being reflective of the complexity of the different situations that the provisions apply in. You don't want to have cliffs in the Tax Code. The way you avoid cliffs is through provisions that tend to be more complicated. So there are good reasons for some of the pro-

visions not being totally simple, but the goal of simplifying as much as we can is one that we share.

Mr. SCHOCK. Okay. I look forward to that.

I would just offer up as we both share the goal of helping those who have been left out of an economic recovery, the Administration continues to talk the minimum wage, and I would just point to the President's home State, where I am a Congressman, we have now raised the minimum wage four times in the last 10 years. Each year we have raised the minimum wage the percent of people living in poverty has gone up. The percent of people unemployed has gone up, and Illinois now leads the Midwest in percent of people in poverty and percent of unemployment, and I think we need to look at a different strategy here at the Federal level, and I would harken back to the days of JFK when he cut taxes and the percent of people living in poverty went down and the percent of people making a living wage went up, and I hope that we can embrace a JFK strategy with this Congress and this President.

Thank you.

Chairman RYAN. Thank you.

Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman.

Mr. Lew, thank you for being here. I appreciate your reference to Congress not hollowing out the IRS so that we can actually administer programs and save taxpayer money and give them better service. I think that is something we need to focus a little attention on.

I also appreciate the fact that you are here as somebody who knows what a balanced budget looks like. If memory serves, you were at OMB when we had three consecutive years of budget surpluses. So you have some unique authority as an Administration spokesperson in being able to help guide these conversations and give some perspective.

I think you were also on the staff of Speaker O'Neill back at a time when there were some interesting policy initiatives where you played a key role where we were able to come together, look for some long-term perspective, and make a difference, even bridging the gap between President Reagan and Speaker O'Neill famously working together.

I have appreciated your offering up some, I think, complex and timely series of proposals, many of which I find appealing and look forward to a deeper dive, and I appreciate that the Administration continues to call for infrastructure investment.

Based on my limited contact with the President and watching, I sincerely believe he is investing intellectually, politically in rebuilding and renewing America.

Some of the policies that have come forward to try to support that have been difficult to achieve. I was struck—actually I read an op ed by my colleague from Ohio, Mr. Renacci, that really talked about approaching this in a comprehensive fashion. Something that needs to be sustainable. It needs to be adequate to cover the job. It needs to revisit the user pay principle. That has been something that is—that provides us with sustainability.

Now, President Reagan in 1982 called out a challenge to Americans in his Thanksgiving Day address calling on Congress to come

back and actually more than double the gas tax, because we hadn't raised the gas tax in 23 years. The President pointed out that this was a user fee that would be able to deal with deteriorating American infrastructure and move us forward in the future. It is a speech I think almost any of us could give today. Members of Congress, the President, I wish we—only it is 22 years since we have raised the gas tax instead of 23.

I was curious if, based on your experience with Speaker O'Neill and Ronald Reagan, who were able to come forward to deal with the serious problem with American infrastructure on a bipartisan basis and raise the user fee, if, by any chance your proposal is not embraced unanimously by Congress and it moves forward and is enacted into law, if you have some thoughts about what we might be able to do moving forward to support the coalition that ranges from business to labor, truckers to AAA, environmentalists, local government, contractors, who all agree, as expressed in *The Washington Post* editorial again today, amidst the crying need and falling gas prices, if there isn't something that could be done to deal with a user fee adjustment?

Secretary LEW. Congressman Blumenauer, I know that you and I have discussed infrastructure for many years, and you have a passion for rebuilding this country that we share. I think if you look back at the 1980s, we found a pathway for bipartisan agreements on important issues; 1983 Social Security reform, 1986 tax reform. And it was also during the Clinton Administration in 1997 we had the balanced budget agreement, bipartisan balanced budget agreement.

I think that what we have put forward in our plan to use the one-time savings from tax reform to fund infrastructure has all of the ingredients about being something that could become a basis for a bipartisan agreement. We deliberately came up with an approach that we thought would provide that opportunity.

Obviously, if Congress has other ideas, we will look at ideas that come forward, and we will work with Congress to find a way. What we have to do is meet our needs to invest in infrastructure in this country, because it is doing a disservice to future generations to leave behind a crumbling infrastructure. The way to build a better future is to think ahead and build it today.

Mr. BLUMENAUER. Great. I hope you will consider that as a fallback in case your proposal—

Chairman RYAN. Thank you. The time of the gentleman has expired.

We are not going to do two to one. So for the people on the Republican side of the aisle, we will do Paulsen, Marchant, then we will go over to Mr. Pascrell.

So Mr. Paulsen is recognized.

Sorry. He is gone. No, he is not.

Mr. Marchant is recognized.

Mr. MARCHANT. Thank you, Mr. Chairman.

Secretary, I would like to discuss a couple of issues with you that I hear about every time I go back home and have a town hall meeting.

In reading the Congressional Budget Office projection of *The Budget and Economic Outlook: 2014 to 2024*, it appears that we

will end up this 2014 with about a \$492 billion deficit, and then about a \$469 billion deficit, a little less than that, in 2015, but in 2022 through 2024, we will be back to \$1 trillion a year deficits, and this is very upsetting to the people that I represent. It is very upsetting to all of us on this panel.

Does this budget that the President has prepared and presented to us change the trajectory of that debt? Does it change the trajectory of the size of government? Does it do anything to return us to a balanced budget, or does it end up in 10 years being back at a trillion dollars a year?

Secretary LEW. Congressman, if you look at the deficit as a percentage of our economy, it is a percentage of GDP, we maintain it through the period 2025 in the mid 2s. At 2½ percent is where it ends up.

Obviously, our economy is growing and 2½ percent of a larger number is a larger number, but the measure of whether we are making progress and maintaining the progress, I believe, is looking at the deficit as a percentage of GDP.

Mr. MARCHANT. So the goal of the Administration and the Treasury is to not balance the budget or diminish the debt that we already have, but to maintain a percentage of GDP?

Secretary LEW. No. Look, I think our goal is to grow the economy and to find the right balance between fiscal policies that keep us on a sustainable path and give us the ability to invest in the future and make sure that we have a growing economy. The real answer is to have a growing economy.

I believe we have presented a plan, a framework, for doing that. I think that if you look at when we hit what is called primary balance when the only deficit is related to servicing past debt, it happens, you know, in this period, and then there is still need to focus on the future. I am not saying that this is the end of the discussion on fiscal policy.

I think if you look over the last few years, we have done a tremendous amount to reduce the deficit as a percentage of GDP. It is a fraction—it is a quarter of what it was.

Mr. MARCHANT. Define primary balance for the people that are out there listening to this.

Secretary LEW. The question is what is driving whatever deficit you have, and if the only deficit is interest on past debt, that is different than if you are building up new expenses by buying new things or paying for new things, and we hit that point in this window where the only deficits we have are attributable to servicing prior debts.

I am—that is not the same as balance. I would not suggest that it is balance, but it is something that is used as a test of fiscal sustainability because the situation is under control if you are in primary balance.

Mr. MARCHANT. The other thing I want to discuss with you, as you know, I am from Texas, and we in Texas and in the entire West believe that the oil and gas industry was one of the most critical things in industries that took us out of this last recession, provided good jobs, and now we open this budget up and find out that the oil and gas industry, which admittedly has had some setbacks

in the last 2 months, is going to have a \$9½ billion—a \$95 billion additional tax bill in this budget.

Can you give me an explanation for why the Administration would feel like that would be a great reward for this industry for its performance in this economy, and how it could possibly handle that kind of additional tax burden in the current scenario?

Secretary LEW. Congressman, the energy revolution has done a tremendous amount to drive our economy forward, and energy prices go up and down and there will be, you know, natural tendencies for the industry to grow in some periods more than in others.

We don't believe that the Tax Code should be driving activity in a way that makes investment in energy as specially treated as it is right now under current law. We don't think that it is necessary for there to be profitable businesses in the energy area. Obviously, this is a moment where lower energy prices are creating special pressures which we are very sensitive to. There is going to be a regional impact, but over time we have seen that, you know, letting the market forces work is better than having a Tax Code that drives investment.

Chairman RYAN. That is very enlightening. Thank you.

Mrs. Black.

Mr. MARCHANT. You probably misspoke.

Chairman RYAN. Yes. Did you mean you don't think there ought to be profitable businesses in this area?

Secretary LEW. No. I said I don't think that we need to change current tax provisions for there to be profitable businesses.

Chairman RYAN. Okay. I think you did misspeak.

Secretary LEW. If I misspoke, let me correct that. I was speaking to the tax provisions not to—we support—

Chairman RYAN. It didn't come out the right way.

Secretary LEW. We support a strong and thriving energy industry, and we wish them to be profitable.

Chairman RYAN. Mrs. Black.

Mrs. BLACK. Thank you, Mr. Chairman, and thank you, Mr. Lew, for being here, and we always have to watch when we say something and get a little tongue twisted, because we will obviously have that come back to us.

Secretary LEW. I appreciate the opportunity to clarify.

Mrs. BLACK. I want to come back to 2 years ago when you were before this Committee and we were talking about the budget and about the balance, and I want to go back to a couple of things that were said in here, my colleague from Texas talking about balancing the budget. As a matter of fact, we see in this budget that we are going to increase our spending by \$2.4 trillion over the next 10 years. We are going to add \$8.5 trillion in debt to our current debt, and I know that you cannot tell us what that might look like here as we look at the debt limit, but I will be very interested to see what that is going to turn out to be, and then we are going to increase Federal spending by \$240 billion in just this next year.

You talk about in both your written comments and your verbal comments that you gave us, you talk about this being a balanced fiscal approach. In my life with my parents teaching me that a balanced fiscal approach is not to have a lot of debt, and when I look

at what we are leaving for the future of our children, not having a lot of debt is also very important.

So I am very concerned about us not getting to balance, and that was a big part of the conversation we had 2 years ago is that the President's budget did not ever come to a balance, and you mentioned about growing the economy, but if we see the debt that we owe and there is an increase in interest rates, we are not going to be able to sustain, no matter how much growth we have, in paying back our debt. So I am very concerned about that.

I want to go to one other thing that you said in your opening comments about the economy increasing job creation, and I want to do like Paul Harvey says, the rest of the story, because the rest of the story is more than just looking at unemployment.

I want to read to you a clip that is out of *MarketWatch* which was published on January 9th, and it says, "The U.S. added 252,000 jobs, which is absolutely great that we are adding jobs in December, and the unemployment rate fell to 5.6 from 5.8, but the hourly wages declined and more Americans dropped out of the workforce." So when we talk about unemployment rate, that really is not the true number that we should be looking at. As a matter of fact, they end their article by saying, "Yet the labor workforce participation rate dropped by .2 percent in December to 62.7 percent, matching the post recession rate and the lowest level that we have seen since 1978."

So when we talk about having a good economy, and as you report, I think we do have to be very careful about how we use numbers, because these policies that are being set forward don't show us that we are having an increase in the middle-class value of their life by having decreased wages, a third of the people who could potentially be working not in the workforce, and this is very disturbing.

There are policies that are set by this Administration that do affect this, and I think we have to be careful as you chronicle what is happening and what sounds to be such a cheery thing to really say what the truth is.

Now I am going to get to my final question here, and I know I am not leaving you a lot of time, but there is so much to talk about, and that is what I hear in the frustration of the people back in my district. In particular, in their savings for their children's future in education and also their retirement. And, as you know, we had an opportunity to work across the aisle. Congressman Davis and myself worked on the tax breaks—the loophole—or, excuse me, the complicated Tax Code having to do with education taxes, 15 different education tax breaks in the Code, 90 pages in the IRS manual for the instructions. We put out a plan that was passed here in the House. It did not move forward in the Senate, and in the very little time that I am leaving you to respond, will you assure us that the President will work with us in this particular area, because education is becoming much more expensive, and we would love to have a conversation to have him consider the proposals that we put forward that we think are very commonsense and very good proposals that allow the middle class to actually use the Tax Code to help them in educating their children. I am leaving you with 30 seconds. I apologize.

Secretary LEW. I am not sure how to address all those issues in 30 seconds, but I will talk fast.

We have tried to be very prudent in our assumptions about interest rates in our budget. We are assuming that between 2020 and 2025, interest rates will be, you know, roughly 4½ percent. They are now much lower than that. So we have built into our forecast the assumption that interest rates will go up over this period of time.

The challenge of paying down our debt is one that is going to take a long time. As long as we are maintaining the current deficit projections and we can invest in a growing future economy, we think we have the best chance of having that kind of strong future. And then the Chairman is telling me I am out of time so I can't get into the other issues.

Mrs. BLACK. Could Mr. Chairman just have him acknowledge that he will work with us on this education tax?

Secretary LEW. Yes.

Mrs. BLACK. I would appreciate it.

Secretary LEW. We obviously have a robust set of proposals in here in education.

Mrs. BLACK. Thank you.

Secretary LEW. We hope you will work with us and we will work with you.

Chairman RYAN. I am doing this for your 1 o'clock.

Mr. Pascrell.

Mr. PASCRELL. Thank you, Mr. Chairman, and thank you, Secretary, for your service.

As you know, the budget does talk about a lot of investments. It is a proposal. The investments I am talking about like the Child Care Tax Credit, we have introduced legislation along those lines, as well as the new Second Earner Tax Credit, improvements in our education tax incentives.

So you propose paying for these middle-class investments by closing tax loopholes and—which primarily benefit the more wealthy Americans who have been doing pretty well for themselves.

Now, just during this current recovery, not just during this current recovery, but over the past 30 years, while the average Americans wages have been stagnant, think of where it would have been if we didn't have a stimulus package or the ACA as an example.

Now, my friends on the other side, and I don't use that as being a wise guy, despite their recent newfound commitment to the problem of income inequality, have predictably cried class warfare. They are up to it again.

Our Chairman, Mr. Ryan, who we are counting on to bring us together in this Committee, said this Sunday on *Meet the Press* regarding the Administration's budget, "What I think the President is trying to do here is to again exploit envy economics. This top down redistribution doesn't work. We have been doing it for 6 years. Look, it may make for good politics. It doesn't make for good economic growth."

Now, Secretary Lew, you served in the Clinton Administration back in the early '90s. Do you remember that big fight over the tax increase? We have had some big fights over that policy. Ultimately taxes on the wealthy were increased. Meanwhile, at the beginning

of the Bush Administration, we tried trickle down through huge tax cuts for the folks at the very top of the income spectrum.

Can you compare the economic growth in the performance of our country in those time periods following the implementation of the respective tax policies? And what I am specifically talking about is the GDP between 1993 and 2002 in which the average was 3.68 percent—

Secretary LEW. That was the longest period of uninterrupted growth in American history.

Mr. PASCRELL. Thank you. And between 2003 and 2007 in which the average was 2.79 percent. Would you just give us a quick synopsis?

Secretary LEW. Yes. Congressman, I think we have seen through experiments testing these policy theories and we saw in the 1990s that the tax policies that were put in place with the, you know, charges that it would destroy the economy had the opposite effect. We saw the economy boom.

In early 2000 we saw—2001, 2004 we saw huge tax cuts that were promised to have the benefit of driving economic growth. We ended up on the edge of an economic—in an economic disaster with those tax policies in place.

Mr. PASCRELL. And the party of austerity didn't pay for any of this. Did it?

Secretary LEW. It didn't pay for it.

Mr. PASCRELL. Okay. Let me ask you a second question.

Secretary LEW. I was going to say we had one more experiment, and it was January 2013. We agreed to go back to the tax rates that were in effect in 1990, and our economy is growing now.

Mr. PASCRELL. Do you believe the Administration's policies over the past 6 years have exacerbated income inequality in this country, or would income inequality be worse if it were not for the policies like the Affordable Care Act and the Recovery Act and the stimulus package, et cetera?

Secretary LEW. I think that the problems of income inequality have been developing for decades. If you look at the actions taken since 2009, if our economy was still in recession, it would be way worse for working people. We have a recovery that has created 10 million jobs. That is good for working people. We have seen the Tax Code revised so that some of the inequity in terms of the top rates has been fixed. We have seen benefits extended to working families through things like the Earned Income Tax Credit and the Child Care Credit. So I think we have taken important steps, but with that said, we still have a very deep underlying set of challenges to deal with, which is why the President's budget this year embraces these issues and comes forward with a program that won't solve all the problems. It will put things in the right direction, and I think it is a very important time for us to make decisions to—

Chairman RYAN. Thank you. Thank you.

Mr. Reed.

Mr. REED. Thank you, Mr. Chairman, and thank you, Mr. Secretary, for being here.

And to open up I want to recognize the work that we have done together in regards to revitalizing the American Manufacturing Innovation Act that was signed into law at the end of the year. We

worked in a bipartisan manner to get that done, and I did that working with the other side and with you in the White House, because there are millions of hard-working families that are going to benefit from that legislation.

So I offer my line of questioning along that vein, and I think my colleague from California, Mr. Becerra, articulated something that I have a lot of trouble with. When he talks about the Social Security Disability Trust Fund, something you and I talked about a year ago, and he says that we are trying to contrive a manufactured crisis to split Americans apart in regards to this crisis that truly is a crisis, the bankruptcy of the Disability Trust Fund, I find that offensive.

I also find his comments to be representative of the old guard, the old school mentality, that there is \$3 trillion of Social Security money that is supposedly the Federal Government's to raid, to bail out a failing Disability Trust Fund. I think that is wrong, because you are taking from Social Security retirees the money that they put into the Social Security Trust Fund that is to go to them, and I think you and I both agree, reading your budget, as you said in your budget, "The Administration will oppose any measures that weaken the Social Security system."

How does taking Social Security retiree money from one trust fund that is already distressed and bailing out the Disability Trust Fund somehow strengthen the overall Social Security retiree trust fund? Does that not weaken it? Yes or no.

Secretary LEW. Well, Congressman, over the years there have been many transfers. I remember in the 1980s when old age—

Mr. REED. Mr. Secretary, over the years, that is old school. There is a new generation of leaders down here in Washington, D.C. that say we cannot do old school, because you have already raided the trust funds. You have already taken from the trust funds, and you have put them in the position where they are on the path to bankruptcy. We need to do better than that, and I think you are committed to it. I will give you the benefit of the doubt. When I read your budget and you are talking reforms in regards to getting the disability community back to work, when you talk about continuing disability reviews to make sure that those that are truly catastrophically disabled get the benefits that the Disability Trust Fund is designed to go to, I think there is sincerity here that you want to get to a solution. Is there not?

Secretary LEW. No, it is very sincere, but, Congressman, if I could just answer your question, there are no policies that could take effect fast enough to deal with the disability insurance shortfall other than an interfund transfer, and it is the way we made sure that Social Security's old age fund didn't go bankrupt when we were working on Social Security—

Mr. REED. I so appreciate that. So you are putting on the table, if I am hearing you correctly, that there are other pots of money other than Social Security retirees' money that is in the Social Security Trust Fund that are available through an interfund transfer that could be utilized to take care of the Disability Trust Fund—

Secretary LEW. Well, you have the Old-Age, Survivors, and Disability Insurance Trust Funds. Those are kind of your options.

Mr. REED. So the White House is not aware of any other funds that are out there that could be tapped into in order to bail out the Disability Trust Fund?

Secretary LEW. Well, if you are just going to reallocate the tax rate, that is where the allocation—

Mr. REED. I understand that is the payroll tax rate reallocation, and that is the status quo. That is the old school. Are there not new ideas that could be put on the table—

Secretary LEW. Look, I think there are new ideas in our budget in terms of making sure that the review process is done properly, making sure that we have program integrity. I do believe that we have to look at the short-term needs of the Disability Trust Fund and have a short-term solution and not expect things that will have perhaps long-term benefit that could solve the problem that is much closer.

Mr. REED. Well, I appreciate it. Is one of those solutions that you talk about getting the disabled community in a position maybe to potentially get back in the workforce? It is in your budget. I think we share that commitment. Is that fair to say?

Secretary LEW. Yes, but we also have to accept that there is a large number of people who are disabled who are not able to work, and we have to have a system that is there for those people that—

Mr. REED. And I think we would agree for the catastrophically permanently disabled, the Trust Fund, that is what the intention is, and I would agree with that sentiment on it.

So when we talk about potentially getting the disabled community in a position to harmonize the goals of getting people back into Main Street, back to work, I am interested also in your budget proposal that says, "Using evidence and evaluations to drive innovation and outcomes." So on that workforce development component of getting people from the Disability Trust Fund that are capable of working back to work, Mr. Secretary, what would you propose as the evidence and evaluation criteria we could utilize to achieve what is a mutual goal of working together to achieve that outcome?

Secretary LEW. I think that we need to have the system set up to encourage people to go back to work. We also have to have a system that is there for people who are not able to go back to work, and I would look forward to following up with you. In 2 seconds I can't do much more than that.

Mr. REED. All right. I look forward to that. I would be interested in your criteria in judging that type of reform.

Chairman RYAN. Thank you.

Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

Mr. Secretary, let me thank you for being here.

Chairman RYAN. Danny, turn your mic on.

Mr. DAVIS. All right. I applaud the President's budget for its focus on supporting working families through the expansion of the Earned Income Tax Credit, improvements to the EITC, and substantial assistance to cover costs of caring for children.

When I cochaired the Education and Family Tax Working Group with Representative Black, both conservative and progressive policy experts agreed that the EITC has strong evidence of encour-

aging work and alleviating poverty. The central recommendation from stakeholders for improving the EITC was to address the limited utility of the credit for childless workers and noncustodial parents which I promoted strongly through my fatherhood deal. These programs helped Chicagoans, Illinoisans, and Americans.

I also commend the budget for strengthening depressed communities by permanently reauthorizing the New Markets Tax Credit, and exemplar of public/private partnership, as well as by investing in promise zones and critical infrastructure efforts.

A vital element of the budget is the restoration of a small amount of the sequester cuts which experts predict will strengthen our economy through hundreds and thousands of jobs.

I also want to take a moment to support the increased funding for the Internal Revenue Service. Republicans have insisted on cutting its funding by about a billion dollars in the last few years. However, these funds are needed to provide services to taxpayers such as critical tax help to low-income families and to ensure that tax cheaters pay their fair share.

As many of us are, I am seriously concerned about protecting and strengthening the middle class, but I am also concerned about another category of individuals called the poor, the working poor. These are individuals whose economic boats are perennially stuck at the bottom, and for generations in their family they remain.

Can you tell us what this budget will do to help lift those individuals out of poverty and into the coveted middle class that we all value so greatly.

Secretary LEW. Congressman, we entirely share the goal of making sure that the ideal of the middle class remains available to all and becomes available to all, and it is not one policy. It is a combination of things, obviously starting with the minimum wage. Raising the minimum wage is very important, but making sure that families have access to things like the child credit, to the Earned Income Tax Credit is equally important, and making sure that there is access to education so that young people grow up with the tools to have the kind of opportunity that can get them the kind of middle-class jobs in the future.

So I don't think there is one simple solution. We put together a variety of proposals that together we think will make a big difference. We have proposed a way to pay for it in a way that is consistent with a responsible fiscal policy, and we think that the time is now for debate on these issues.

Mr. DAVIS. I seriously agree with much of what I find in this budget, and, again, I commend you and your colleagues and the President for working on it, and, Mr. Chairman, I yield back.

Chairman RYAN. All right. Thank you.

Mr. Kelly.

Mr. KELLY. Thank you, Mr. Chairman. Mr. Secretary, thanks for being here.

What I want to address, and I know we have been talking about different aspects of the budget, but let's talk about a budget in general. You have done a lot of budgets. Did you have—

Secretary LEW. More than I care to count.

Mr. KELLY. And I understand that. In the private sector we always have to put budgets together every year, but it is increase—

it really—there is a lot of weight on us to make sure they balance, and that somehow we have revenue to cover what our intended expenses are.

When you are—have discussions with the President, and I am not suggesting that the President has a lot of fingerprints on this budget, have you ever discussed with him the growing deficit?

Secretary LEW. Well, first of all, the President is deeply involved in the development of this budget and in all budgets, and I think that is appropriate. It is his policy. You know, he has I think over the years shown a determination to fix a very broken fiscal path. We have an enormous amount of progress that we have made, and we are making more progress in the 10-year window of this budget. I think that the—

Mr. KELLY. But in your position, the deficit, we—you talked today about how we have been able to cut the deficit.

Secretary LEW. Yes.

Mr. KELLY. This year the President is projecting a \$4 trillion spend. Right? And in revenues they are going to come in somewhere around \$3 trillion. Now, back home where I come from, you start to use figures like that, the zeros go off the chart. So I tell them, listen. It is like somebody who makes \$30,000 a year spending \$40,000 a year, going home and saying: “Honey, no problem. Go out and spend 40 grand this year because I am going to make 30 grand.” And she says: “Well, gee, you told me last year to go ahead and spend more than you were bringing in and it would be all right.”

The annual deficit is adding to our long-term debt at a rate that is totally unsustainable. As a person that has done budgets all your life, you can’t look at this and think of this as a really—as a real budget. This is a Christmas wish list that nobody could possibly fill.

Secretary LEW. Well, Congressman, I actually don’t agree. I mean, I—

Mr. KELLY. Well, Mr. Lew, listen. I am not going to get into a debate whether you agree or not. There is no way in—there is no way in heck anybody can sit back and say that deficit spending year after year after year makes sense. There is just no way. No. There is no way you can defend that. Nobody that ever looked—took an economy course or economics course would say: “Yeah, just keep spending money you don’t have and somehow it is going to be all right.”

Do you know that by 2025 just the interest on our debt is going to be \$785 billion. That is billion with a B. There is no way anybody would look at this model and say: “Makes sense to me.”

Now, we talk about how well we are doing as a country. We are the healthiest person in the sick ward. There is nobody in the world that can look at the way we have been spending money, I am talking collectively, globally, and say: You know what? We are on the right path, and I don’t care if you are Greece or you are in the United States. The only difference is the number of zeros in deficit spending that add to long-term debt that make us unsustainable. There is just no argument for that, sir.

My question is, when you talk to the President with your background, and certainly with his acumen, and I don’t know how

much business acumen is there because nobody would present this budget with a straight face, and say: This is the path forward. That just can't be done.

Have you had that discussion?

Secretary LEW. So, Congressman, I think if you look at the improvement in our fiscal position over the last 6 years, it is tremendous.

Mr. KELLY. When compared to the rest of the places around the world. I understand that.

Secretary LEW. No. Compared to ourselves.

Mr. KELLY. No, it is not. It is not. Listen. You and I both know that if it wasn't for the energy—

Chairman RYAN. Order. Order. I would encourage the gentleman to let the Treasury Secretary answer the question.

Mr. KELLY. Listen. I would like to have order, Mr. Chairman, but let me tell you this. We continue to have this ring-around-the-rosie conversation that somehow things will get better if we just keep spending more money and have no way to actually raise the revenue to pay it. We can't even get to the point we can pay down the principal. All we are doing is making interest payments. There is just no logic to doing that. It is totally illogical, sir.

Secretary LEW. I am happy to try to offer an answer if you—

Mr. KELLY. I would appreciate it because I have been sitting here for 5 years and—

Chairman RYAN. And you have a minute and 16 seconds to do it.

Secretary LEW. Having presented three balanced budgets with surpluses actually in my time as OMB Director, no one is going to—I am not going to take second seat to anyone in terms of caring about responsible fiscal policy. I think if you look at where our budget was, where our economy was when this President took office, it was in terrible shape, and it is now in healthy shape. I think that we have to look now at what do we do to build a foundation for future economic growth, and I agree there is a need to continue—

Mr. KELLY. Okay. I just want to point something out.

Secretary LEW. But we now have a—

Mr. KELLY. Excuse me. Listen. I want to point something out. Since the President took office, household incomes—now, please, we should stop using the term “middle class” because it kind of reflects that we have a higher class and a lower class. Middle-income families have taken—they are making \$2,380 less than when the recovery started. That is a drop of 4.4 percent. When you get into the Hispanics, the Blacks, the female-headed families, and families with three or more children, they fare far worse under the Obama plan than anybody else. Black households' median income has plunged 11 percent since the recovery. Hispanic households are off 4.5 percent. For single moms, median household incomes have dropped 7.5 percent. For those households with three or more children, it fell even more to 9.2 percent. We keep using this talking to point to how we are going to help the middle class. Let's talk the real thing. It is middle-income people. They have to have more money. We cannot continue to drive this debt higher and think that somehow there is a rosy picture at the end.

I thank you for your time. I appreciate your service, but honest to God, we have to get this thing fixed.

Chairman RYAN. Thank you.

Mr. Renacci.

Mr. RENACCI. Thank you, Mr. Chairman, and thank you, Secretary Lew, for being here.

You know, I was thinking, when my colleagues were talking about you working with Tip O'Neill and that timeframe, I was actually thinking about the facts of my life. I had just graduated from college. I was from a blue collar, union family, and I decided that as someone in the middle class I was going to work toward upward mobility, and I started my own company at a very young age.

The one thing I can tell you back then that was very important is that I realized if you worked hard and did the right thing you could achieve the American dream, but I also realized back then the government wouldn't get in your way, and I look back at the days when Tip O'Neill and the President were working together to get some things accomplished, and I hope at some point in time we can do that going forward, because I do want to look at that 24-year-old some day and say: You can do the same thing. You can work toward upward mobility, because we talk so much about it, but factually we get in the way too often, and that is one of the problems I have with some of the budgets.

Now, I will say there are some things in the budget that I am glad to see there, and I am hoping that we can work together, but we talk so much about middle class—middle-class economics, and the President uses that term to describe his approach to tax policy changes. You know, the idea, of course, is that his proposal was designed to benefit hard-working middle-class Americans, which I always look back and say that was me at one point in time. The idea behind this approach I really believe is a good one.

As the Committee has addressed just a few weeks ago, many middle-class Americans are still struggling. While the economy has shown some signs of recovery, too many continue to find that their paychecks are shrinking while costs are rising. Considering the focus the President claims to put on reducing taxes for the middle class, I was surprised by a study on the distributional effects of the President's proposal published by the Tax Policy Center.

Mr. Chairman, I ask that the study titled *Distributional Effects of the President's New Tax Proposals* published by the Tax Policy Center be included for the record.

Mr. Lew, according to the Tax Policy Center analysis——

Chairman RYAN. Without objection.

[The submission of The Honorable Jim Renacci follows:]



DISTRIBUTIONAL EFFECTS OF THE PRESIDENT'S NEW TAX PROPOSALS

Leonard Burman and Ngan Phung
January 30, 2015

ABSTRACT

The White House announced a package of tax proposals as part of what President Obama called "Middle Class Economics" in the State of the Union Address. This paper summarizes and discusses TPC's distributional estimates, focusing on the distribution of all income tax cuts, the major tax cut provisions, and the largest tax increase provisions including the new fee on financial institutions. The tax cuts primarily benefit low-income single workers and working age households with children. The income tax increases primarily affect those with very high incomes and those with a substantial amount of capital assets.

We thank Chye-Ching Huang, Bill Gale, Howard Gleckman, Elaine Maag, Jeff Rohaly, Joe Rosenberg, Kim Rueben, and Roberton Williams for helpful comments. Jeff Rohaly oversaw the modeling.

Views expressed are those of the authors and should not be attributed to the Tax Policy Center, the Urban Institute, its board or funders.

INTRODUCTION

The White House announced a package of tax proposals¹ as part of what President Obama called “Middle Class Economics” in the State of the Union Address. For the most part, the proposals would continue the President’s pattern of raising taxes on high-income households and cutting them for those with lower incomes.

The Treasury Department estimates that the proposals would raise \$210 billion over ten years by increasing the top tax rate on long-term capital gains from 24.2 percent to 28 percent and taxing unrealized capital gains at death. A new financial fee would raise another \$110 billion. Part of that revenue would finance a package of middle-class tax cuts (\$175 billion) and retargeted education tax benefits would cost about \$50 billion.² In addition, some of the revenue would finance new spending initiatives for early childhood education and community college, which are not considered here.

Based on the White House Fact Sheet,³ the President’s tax proposals would:

- allow married couples to claim a 5-percent nonrefundable credit for the first \$10,000 of earnings of the lower-earning spouse (a maximum credit of \$500);
- double the Earned Income Tax Credit (EITC) for workers without custodial children and raise the income level at which the credit phases out, increasing the maximum credit to about \$1,000;
- increase the Child and Dependent Care Tax Credit (CDCTC) for middle-income families, especially those with young children: maximum expenses used to calculate the credit would rise from \$3,000 per child to \$6,000 per child for children under age 5, the credit rate for young children would rise to 50 percent, and middle-income families would be eligible for the maximum credit rate of 35 percent rather than the 20-percent rate that applies to such families under current law;

¹ White House, “Fact Sheet: A Simpler, Fairer Tax Code That Responsibly Invests in Middle Class Families,” January 17, 2015. Available at <http://www.whitehouse.gov/the-press-office/2015/01/17/fact-sheet-simpler-fairer-tax-code-responsibly-invests-middle-class-fami>.

² Since release of the fact sheet, the President decided to withdraw one of the offsetting education tax increases—taxing future withdrawals from Section 529 College Savings Plans. This estimate predates the withdrawal of the proposal. The change in 529 plans was estimated to raise about \$1 billion, so the costs of the education provisions will rise slightly as a result.

³ Details of the plan will be available when the Administration releases its Budget on February 2. Assuming that the Treasury follows past practice, its “Green Book,” which contains detailed explanation and revenue estimates for the Fiscal Year 2016 revenue proposals, will be posted here—http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx—sometime on the afternoon of February 2.

- repeal dependent care flexible spending accounts under which employers may allow employees to exclude from taxable income up to \$5,000 (regardless of number of children) to pay for childcare expenses that allow a parent to work;
- make permanent and expand the American Opportunity Tax Credit (AOTC)—up to \$2,500 per year for up to five years of study and available for less than half-time attendance—and repeal the Lifetime Learning Tax Credit (LLTC), the deductibility of student loan interest (for new student loans)⁴, and the tax exclusion for qualifying withdrawals from Section 529 education savings plans (the last proposal has since been withdrawn in response to bipartisan protest);
- enact an “auto-IRA” proposal that would require employers with more than 10 employees who do not offer a retirement plan to allow employees to designate a portion of pay to deposit into an IRA;
- limit the size of accumulated balances in IRA and employer-sponsored retirement plans;
- permanently extend the lower income threshold for refundability of the Child Tax Credit and the expanded EITC provisions that are set to expire after 2017;
- raise the top income tax rate on long-term capital gains and qualified dividends from 20 percent to 24.2 percent (for a top effective rate of 28 percent including the 3.8-percent Affordable Care Act (ACA) net investment income tax on high-income taxpayers);
- include as income on a decedent’s final individual income tax unrealized capital gains, net of a \$100,000 exclusion for singles and \$200,000 for couples; and
- impose a tax on large financial institutions.

If all of the major individual income tax provisions (excluding the financial fee) were fully phased in, the package would raise taxes by an average of \$164 per household in 2016.⁵ (See Table 1.) Winners would outnumber losers by more than seven to one with the tax increases concentrated among the one percent of tax units with the highest incomes. The vast majority of households in the bottom four quintiles who would face an income tax change would pay lower taxes (or receive larger refunds) as a result of the policy proposals. At the top, however, the increase in tax rates on long-term capital gains and dividends as well as the taxation of capital gains at death would loom large. Average taxes among the top one percent would rise by about \$27,000 or 1.8 percent of after-tax income; the richest 0.1 percent would see an average tax increase of \$156,000, cutting their after-tax income by an average of 2.4 percent. Average tax changes would be small for every other income group except the bottom 20 percent—no more than 0.1 percent of income. The average tax change for the middle three quintiles is less than

⁴ Some of this savings will be offset by exempting from tax any student loan forgiveness under income-based repayment. We don’t include the tax exemption of forgiven loan amounts in our estimates.

⁵ Note that TPC’s simulations do not include the effect of eliminating dependent care flexible spending accounts. They also exclude the 529 provision, but the Administration has withdrawn that proposal. The estimates assume that the policies are fully phased in—i.e., the estimates assume that taxation of capital gains at death and elimination of the student loan interest deduction had always been the law. The actual burden on households over the budget period would be lower (for example, because much student loan interest will continue to be deductible; only interest on new debt would be affected by the proposal). Finally, following standard convention, the distributional tables ignore behavioral responses to the tax changes. The Tables also do not reflect the effect of extending the refundable tax credits after 2017 as they would not change tax liability or credits in 2016.

\$100. The lowest income households would see their average after-tax income rise by 1.2 percent, primarily because of the proposed increases in the refundable EITC and AOTC.



TABLE 1. MAJOR INDIVIDUAL INCOME TAX PROVISIONS IN PRESIDENT OBAMA'S 2015 STATE OF THE UNION: DISTRIBUTION OF TAX

Expanded Cash Income Percentile	Tax Units with Tax Increase or Cut				Percent Change in After-Tax Income	Average Federal Tax Change (\$)
	With Tax Cut		With Tax Increase			
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase		
Lowest Quintile	30.4	-617	0.8	1,295	1.2	-177
Second Quintile	18.4	-452	3.7	1,549	0.1	-26
Middle Quintile	24.7	-557	6.1	2,076	0.0	-12
Fourth Quintile	43.6	-668	4.1	4,901	0.1	-91
Top Quintile	43.0	-533	6.9	26,308	-0.6	1,590
All	30.4	-580	3.9	8,730	-0.2	164
Addendum						
80-90	58.9	-584	3.7	4,222	0.1	-186
90-95	46.4	-353	0.8	40,005	-0.1	164
95-99	9.2	-731	4.3	33,248	-0.4	1,362
Top 1 Percent	3.2	-1,707	77.8	34,488	-1.8	26,777
Top 0.1 Percent	1.0	-1,818	93.3	167,234	-2.4	156,014

Source: Tax Policy Center, Table T15-0004, <http://taxpolicycenter.org/t15-0004>

¹ Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2016: Baseline: Current law

² Very preliminary, based on White House Factsheet, 1/17/15.

NEW, REFORMED, AND EXPANDED TAX EXPENDITURES

Looking at the tax cut provisions alone shows a much more uniform distribution of tax benefits. (See Table 2.) There is a significant tax cut for the bottom quintile, as seen in Table 1, and a sharp drop-off for the second quintile since they are less likely to benefit from the expansion in the refundable EITC but they still have incomes too low to receive much benefit from nonrefundable tax credits.⁶ The average tax benefits rise all the way up to the 9th decile. Sixty percent of households in this income group benefit from at least one of the tax cut provisions. Overall, households in this income group receive average tax cuts worth \$354 (before considering offsetting revenue increases). These families are most likely to benefit from the expansion of the AOTC and the introduction of the two-earner credit. The credits phase out at higher income levels. However, a few high-income households have workers whose employers do not currently offer retirement plans and would thus benefit from the auto-IRA provision. Even among those

⁶ Some of these families would benefit after 2017 from the permanent extension of the temporary increase in refundable tax credits, but that does not show up in this table since it refers to tax year 2016.

with very high incomes—the top 0.1 percent—about 4 percent qualify for at least one tax benefit, yielding an average tax cut of \$81 (before considering the effect of offsetting tax increases).⁷



TABLE 2. MAJOR TAX REDUCTIONS IN PRESIDENT OBAMA'S 2015 STATE OF THE UNION: DISTRIBUTION OF TAX CHANGES^{1,2}

Expanded Cash Income Percentile	Tax Units with Tax Increase or Cut				Percent Change in After-Tax Income	Average Federal Tax Change (\$)
	With Tax Cut		With Tax Increase			
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase		
Lowest Quintile	30.4	-618	0.5	472	1.2	-186
Second Quintile	18.6	-452	1.5	836	0.2	-71
Middle Quintile	25.0	-561	1.7	819	0.2	-126
Fourth Quintile	43.9	-680	1.7	799	0.3	-285
Top Quintile	43.8	-545	0.4	594	0.1	-236
All	30.7	-586	1.1	765	0.2	-171
Addendum						
80-90	60.1	-597	0.9	597	0.3	-354
90-95	46.5	-356	*	**	0.1	-165
95-99	9.3	-731	0.0	0	0.0	-68
Top 1 Percent	5.3	-1,686	0.0	0	0.0	-89
Top 0.1 Percent	4.1	-1,997	0.0	0	0.0	-81

Source: Tax Policy Center, Table T15-0010, <http://taxpolicycenter.org/t15-0010>

¹ Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2016; Baseline: Current law

² Very preliminary, based on White House Factsheet, 1/17/15.

* Less than 0.05

** Insufficient data

CAPITAL GAINS TAX INCREASES

The President proposed two significant tax increases on capital gains. He would raise the top tax rate on long-term capital gains and qualifying dividends from 20 percent to 24.2 percent. Including the effect of the 3.8 percent ACA net investment income tax, that would make a top tax rate of 28 percent. That top rate is well within the range of historical experience; and was the top rate as recently as 1997. However, the proposal also would for the first time tax capital gains at death, subject to a \$100,000 exclusion.⁸ Capital gains on gifts would also be subject to immediate

⁷ Note that Table 2 shows some families as paying higher taxes because repeal of the LLTC is analyzed together with the AOTC expansion in the set of tax cuts. Many households will benefit by switching from the LLTC to the AOTC, but a small fraction would no longer be eligible for any credit under the proposal.

⁸ In 2010, the estate tax was eliminated and a "carryover basis" regime—in which capital gains above a certain exemption were postponed but not forgiven on inherited assets—was implemented. Ultimately, estates were allowed to choose between an estate tax with a large exemption and carryover basis subject to a somewhat lower exemption in that year. Carryover basis had also been enacted in 1976, but postponed and ultimately repealed before it ever took effect. For a discussion of some of the economic issues

taxation. (Currently, recipients of gifts assume the donor's basis and gains are not taxed until the asset is sold.) Individuals could still postpone realizing a capital gain on assets transferred from a spouse at death, and any portion of the \$100,000 exclusion that is not used by the first spouse to die would transfer to the surviving spouse (which effectively makes the combined exclusion for a couple \$200,000). Long-term capital gains on a primary residence held at death would benefit from the ordinary income tax exclusion of up to \$500,000 for couples (\$250,000 for singles), again with carry-over to a surviving spouse. In addition, special rules would postpone recognition of gain on transfers of small businesses

Not surprisingly, the fully phased in tax change resulting from the capital gains and dividends provisions would be heavily concentrated at the top of the income distribution (Table 3). The top quintile would bear 78 percent of the tax increase and 58 percent would fall on the highest-income 1 percent. The effects of the tax rate increase are heavily concentrated at the top because the increase only applies at very high income levels. While the proposal would raise taxes on less than 1 percent of tax units, almost 80 percent in the top 1 percent and 93 percent of the top 0.1 percent would pay higher taxes. More surprising, however, is the fact that 0.1 to 0.2 percent of households in the middle three quintiles would be affected. And those with negative incomes—largely arising from business losses—would also bear a significant share (2.5 percent) of the tax change.

surrounding taxing capital gains at death, see Leonard Burman, "President Obama Targets the 'Angel of Death' Capital Gains Tax Loophole," *TaxVox*, January 19, 2015. Available at <http://taxvox.taxpolicycenter.org/2015/01/18/president-obama-targets-angel-death-capital-gains-tax-loophole/>.



TABLE 3. CAPITAL GAINS AND DIVIDEND PROVISIONS IN PRESIDENT OBAMA'S 2015 STATE OF THE UNION: DISTRIBUTION OF TAX CHANGES^{1,2}

Expanded Cash Income Percentile	Tax Units with Tax Increase or Cut				Percent Change in After-Tax Income	Pct of Tax Increase	Average Federal Tax Change (\$)
	With Tax Cut		With Tax Increase				
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase			
Lowest Quintile	0.0	0	*	**	-0.1	0.6	8
Second Quintile	0.0	0	0.1	47,172	-0.1	3.0	43
Middle Quintile	0.0	0	0.2	63,970	-0.2	6.5	105
Fourth Quintile	0.0	0	0.2	80,824	-0.2	9.4	184
Top Quintile	0.0	0	5.1	34,091	-0.7	78.0	1,750
All	0.0	0	0.8	38,421	-0.4	100.0	319
Addendum							
80-90	0.0	0	0.2	63,476	-0.1	3.3	148
90-95	0.0	0	0.4	88,398	-0.2	3.6	327
95-99	0.0	0	4.3	33,352	-0.5	12.7	1,427
Top 1 Percent	0.0	0	79.5	32,177	-1.7	58.4	25,581
Top 0.1 Percent	0.0	0	93.3	160,428	-2.3	35.0	149,633

Source: Tax Policy Center, Table T15-0006, <http://taxpolicycenter.org/t15-0006>

¹ Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2016; Baseline: Current law

² Very preliminary, based on White House Factsheet, 1/17/15.

*Less than 0.05

**Insufficient data

The proposal to tax unrealized gains at death would raise taxes on a small but significant share of people who, despite seemingly modest incomes, have enough capital gains to exceed the exclusion thresholds. Data from the Federal Reserve Board's Survey of Consumer Finances (SCF) indicates that the bottom 80 percent of the income distribution had one quarter of accrued capital gains in 2013. (See Table 4.) After applying the exclusions on gains for owner-occupied housing and a \$100,000 exclusion for singles and \$200,000 for married couples, the share held by the bottom four quintiles falls to about 10 percent. We estimate that a higher share of the tax will be borne by the lower-income groups because the decedents who are affected by the tax tend to be older than the population at large and our model imputations are based on data from an earlier SCF. Our estimates appear to be broadly consistent with the Congressional Budget Office's (CBO) estimate that 35 percent of the tax benefit from not taxing capital gains at death in 2013 benefits the bottom 80 percent of the income distribution. (Note that CBO's estimates did not allow for the exclusions in President Obama's proposals.)



TABLE 4. DISTRIBUTION OF ACCRUED CAPITAL GAINS, BEFORE AND AFTER EXCLUSIONS, BY INCOME PERCENTILE, 2013

Income Percentile ¹	Before Exclusions			After Housing Exclusion			After Housing Exclusion and General \$100,000/\$200,000 Exclusion			
	Number (thousands)	Amount (\$ billions)	Percent of Total	Number (thousands)	Amount (\$ billions)	Percent of Total	Number (thousands)	Percent of Units	Amount (\$ billions)	Percent of Total
Lowest Quintile	10,203	700.1	3.9	2,880	270.3	2.0	345	1.4	219.0	1.8
Second Quintile	14,043	834.4	4.6	4,272	233.8	1.7	552	2.2	103.2	0.9
Middle Quintile	15,341	955.8	5.3	6,436	400.3	2.9	838	3.6	213.1	1.8
Fourth Quintile	20,373	2,058.3	11.4	9,682	1,091.6	7.8	1,616	6.6	712.9	5.9
80-90	10,695	1,575.0	8.7	6,285	1,059.1	7.6	1,105	9.4	805.2	6.7
90-95	5,745	1,599.9	8.9	4,110	1,215.3	8.8	1,355	22.6	918.6	7.6
95-99	4,753	4,626.7	25.6	4,127	4,070.7	29.3	2,183	45.1	3,609.7	29.9
Top 1 Percent	1,218	5,719.4	31.7	1,195	5,560.3	40.0	941	77.0	5,495.9	45.5
All	82,570	18,069.6	100.0	38,987	13,891.6	100.0	8,935	7.3	12,077.5	100.0

Source: 2013 Survey of Consumer Finances

¹ Excludes primary economic units with negative income.

The appendix further discusses issues related to the measurement of the distribution of capital gains tax liability.

EFFECTS OF INCLUDING THE FEE ON FINANCIAL INSTITUTIONS

Table 1 excluded one of the biggest tax increases in the package: the 7 basis point (0.07 percent) tax on the liabilities of U.S. financial firms with assets over \$50 billion. The Administration estimates that this would affect “roughly 100 firms.” The burden of taxes is ultimately borne by people, not firms. Table 5 shows the distribution of all the major elements of President Obama’s proposals, including the financial fee, assuming that the financial tax is ultimately borne by investors in the form of lower after-tax rates of return and workers in the form of lower wages.⁹ Under that assumption, part of the burden of the tax ultimately falls on relatively modest-income retirees who have pensions or 401(k) plans. Those households do not benefit from the tax cuts, which are focused on workers and families with children. Including the effects of the financial fee, the average tax increase rises from \$164 to \$209. The highest-income 10 percent of households would face average tax increases, while the other groups would see their taxes go down (other than the middle 20 percent, whose taxes would be virtually unchanged). Overall, however, losers would slightly outnumber winners: one-third of tax units would pay higher taxes, including (indirectly) the financial fee, while about 30 percent would get a net tax cut. (See Table 5.) Only in the bottom quintile would winners outnumber losers. However, the biggest tax increases remain concentrated at the very top. About 98 percent of households in the top one percent would face higher taxes. On average their taxes would rise by about \$39,000 (2 percent

⁹ TPC distributed the tax the same way it distributes the economic incidence of the corporate income tax: 20 percent of the burden falls on labor, 20 percent on the normal return to all capital, and 60 percent on the returns to corporate equity (shareholders). See Jim Nunns, “How TPC Distributes the Corporate Income Tax,” September 13, 2012. Available at <http://www.taxpolicycenter.org/UploadedPDF/412651-Tax-Model-Corporate-Tax-Incidence.pdf>.

of after-tax income); the richest 0.1 percent would pay about \$168,000 more (2.4 percent of income).



TABLE 5. MAJOR TAX PROVISIONS IN PRESIDENT OBAMA'S 2015 STATE OF THE UNION: DISTRIBUTION OF TAX CHANGES^{1,2}

Expanded Cash Income Percentile	Tax Units with Tax Increase or Cut				Percent Change in After-Tax Income	Average Federal Tax Change (\$)
	With Tax Cut		With Tax Increase			
	Pct of Tax Units	Avg Tax Cut	Pct of Tax Units	Avg Tax Increase		
Lowest Quintile	30.3	-616	4.8	237	1.2	-174
Second Quintile	18.3	-447	20.3	305	0.1	-17
Middle Quintile	24.4	-549	48.2	289	0.0	7
Fourth Quintile	42.8	-649	53.9	420	0.1	-51
Top Quintile	38.9	-507	59.9	3,362	-0.7	1,818
All	29.6	-569	33.0	1,140	-0.3	209
Addendum						
80-90	57.1	-543	42.0	462	0.1	-116
90-95	36.1	-330	61.4	660	-0.2	286
95-99	6.4	-843	93.3	1,782	-0.5	1,608
Top 1 Percent	2.3	-1,713	97.6	29,743	-2.0	28,983
Top 0.1 Percent	0.4	-1,786	99.6	168,661	-2.6	168,006

Source: Tax Policy Center, Table T15-0002, <http://taxpolicycenter.org/t15-0002>

¹ Distribution of Federal Tax Change by Expanded Cash Income Percentile, 2016; Baseline: Current law

² Very preliminary, based on White House Factsheet, 1/17/15.

Note that different assumptions about the incidence of the tax and the distribution of the returns to capital could significantly affect the distribution of tax changes and the share of tax units with gains or losses from the proposal. For example, financial sector executives and investors might have benefited disproportionately from excessive risk-taking. To the extent that the tax discouraged such risk-taking, the costs of the policy would be borne primarily by very high-income financial sector participants (and the rest of society would benefit because there would be less risk of another financial sector collapse and resulting recession). In this case, the effect on low- and middle-income households would look more like the results displayed in Table 1.

CONCLUSION

The President's tax plan includes new or expanded tax benefits that are targeted at low- and middle-income households, while the offsetting income tax revenue is targeted at higher-income households. Winners outnumber losers by more than seven to one. About 30 percent of tax units would pay lower income taxes while about 4 percent would pay more. The tax cuts benefit low-

income single workers and working age households with children. The income tax increases primarily affect those with very high incomes and those with a substantial amount of capital assets. Not surprisingly, a revenue increasing package with tax increases targeted at a sliver of the population imposes some substantial tax increases on those with very high incomes. The top 0.1 percent would pay \$156,000 more in income taxes under the proposal, and \$168,000 including the effect of the new tax on large financial institutions.

Despite the careful targeting of the proposal, the Administration has already faced withering—and effective—criticism for a provision that would have scaled back the tax benefits of 529 college savings plans. That proposal would have overwhelmingly affected higher-income households that do not need assistance paying for college and helped to finance a far more generous expansion of aid for higher education through the AOTC. In the face of the resulting uproar, the Administration withdrew the 529 proposal.

Given that any fiscally responsible tax reform would create both winners and losers, that experience does not bode well for the prospects for a major overhaul of our broken tax system any time soon.

APPENDIX

Our analysis of the distributional effect of taxing capital gains at death differs significantly from the Treasury Department's.¹⁰ There is an issue about whether income is being properly measured for households with modest incomes but gains over \$100,000. Our income qualifier is a measure we call expanded cash income (ECI), which is adjusted gross income (AGI) plus certain other income items that are excluded from AGI such as nontaxable fringe benefits, tax-exempt interest, and tax-free transfer payments.¹¹ Capital gains are included in ECI when realized—i.e., when people have sold the asset and received the cash proceeds. This may cause an overstatement of “economic income” when gains are realized and an understatement when they are deferred, but it comports with what most people think of as income.

Treasury Deputy Assistant Secretary, Adam Looney, argues that capital gains should be added to income to assess the distribution of tax burden from taxing gains at death.

Importantly, in examining the effect of this proposal on taxpayers at different income levels, it is necessary to take into account the capital gains income that is currently excluded from tax by the loophole. To do otherwise would count the taxes paid by individuals without counting the income, which would be misleading.

Using this metric, Looney estimates that 99 percent of the tax is borne by the less than 1 percent of households whose AGI plus gains taxed at death exceeds \$500,000.

This position seems to argue that taxing capital gains at death has the instant effect of raising the affected decedents' incomes, possibly by hundreds of thousands or even millions of dollars. Of course, the unrealized income was often accrued over many years. The right solution to this puzzle would be to include accrued unrealized capital gains in income and include accrued capital gains tax liability in total taxes every year rather than realized capital gains and the associated tax liability. This measure would increase households' incomes in years when they do not realize capital gains and reduce measured income in years when they realize an unusually large gain. Overall, it is likely that such a measure would show a somewhat smaller share of capital gains and tax liability accruing to very high income taxpayers than a measure based on realizations.¹² And the President's proposal to tax capital gains at death would still impact

¹⁰ Adam Looney, “The President's Proposals to Cut Taxes for Over 44 Million Families,” *Treasury Notes* (blog), January 29, 2015. Available at

[http://www.treasury.gov/connect/blog/Pages/The%20President%E2%80%99s%20Proposals%20to%20Cut%20Taxes%20by%20Average%20of%20Nearly%20\\$600%20for%20Over%2044%20Million%20Families.aspx](http://www.treasury.gov/connect/blog/Pages/The%20President%E2%80%99s%20Proposals%20to%20Cut%20Taxes%20by%20Average%20of%20Nearly%20$600%20for%20Over%2044%20Million%20Families.aspx).

¹¹ For a full explanation of TPC's income measure, see Joseph Rosenberg, “Measuring Income for Distributional Analysis,” Tax Policy Center, July 25, 2013. Available at <http://www.taxpolicycenter.org/UploadedPDF/412871-measuring-income.pdf>.

¹² Using panel data, I compared the distribution of 10-year average capital gains versus average income with annual snapshot views of realized capital gains and annual income (including capital gains) between 1979 and 1988. The annual distributions showed a smaller share of gains realized by taxpayers in the highest income groups in every year. 10-year average gains are much closer to

moderate-income families by increasing accrued capital gains tax liabilities, although by less than shown in Table 3, since adding accrued unrealized capital gains would tend to push taxpayers with substantial assets into higher income groups, but by less than suggested by Looney.

Note that there are other reasons why our estimates might differ from the Treasury Department's—most notably because Treasury analysts have access to administrative tax data from estate tax returns and other sources that the TPC does not possess. Treasury reports that the Survey of Consumer Finances—the data source our estimates are based on—underreports asset values for very wealthy individuals.¹³ We would likely estimate a different distribution of tax burdens if we had access to those data. The bottom line is that our estimates have a range of uncertainty (as do governmental offices' estimates) and seemingly significant differences may reflect differences in data sources and methodology.

annual accruals. See Leonard E. Burman, *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed* (Washington, DC: Brookings Institution Press, 1999) p. 100.

¹³ U.S. Treasury, "Tax Expenditure for Exclusion of Capital Gains at Death." Available at <http://www.treasury.gov/resource-center/tax-policy/Documents/Analysis-and-Research-Tax-Expenditure-Step-Up-Basis-2014.pdf>.



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Mr. RENACCI [continuing]. The middle quintile of the earners with a household income of about \$60,000 would actually face an average Federal tax increase of about \$7. In fact, the middle 60 percent of earners would see almost no effect on their Federal taxes as a result of the President's middle-class economics.

Considering the results of this independent study, can you explain the claim that these policies are really aimed at providing relief to the middle class?

Secretary LEW. Well, Congressman, you know, I look at the work of the Tax Policy Center frequently. I think that over time, they have done a lot of good work. I think in this case, their analysis is just not based on the best data available, and I think the analysis that we have done at Treasury is better.

I think that they are looking at a few provisions like the financial services fee and stepped-up basis incorrectly in terms of tracing how it is going to flow through to families that are middle-class families. I think technically it is not correct, and I think in terms of the data, we have data that shows that it is not correct.

Mr. RENACCI. So you are disagreeing with—

Secretary LEW. I disagree with the analysis here. Obviously, when you put policies in that have demonstrable benefit to middle-class families, that is what reflects what you are trying to accomplish. I don't think the financial service fee or stepped-up basis is going to end up flowing down and hurting those middle-class families the way that analysis suggests.

Mr. RENACCI. Okay. I know my time is limited. I want to switch over to something that is important.

Treasury issued anti-inversion rules in the fall. As a result, Medtronic announced that instead of using foreign cash to acquire Covidien, it would borrow and take on more debt to finance the acquisitions, meaning more leverage and more interest deductions in the United States and actually less profits. Chiquita Brands had to scrap their planned inversion and instead got acquired by Brazilian investors, closing down their North Carolina headquarters and eliminating hundreds of U.S. jobs.

These are consequences of an ill-conceived inversion—the ill-conceived inversion rules, and now this budget doubles down with even more inversion proposals that will just make the U.S. companies less competitive and more attractive acquisition targets for foreign companies and competitors.

Is this what you intended to happen and did you consider these success stories of the new rules?

Secretary LEW. You know, Congressman, I think the real answer is tax reform. We have a broken Tax Code that is driving companies to do things that we think may be legal but they are wrong. It is wrong to change your address just to avoid paying taxes while you get all the benefits of doing business in the United States.

We made clear at the time that we did not have administrative capacity to completely address the inversion issue. It would require tax reform to take away the incentive and also anti-inversion provisions. We look forward to working with Congress to accomplish tax reform to really address this.

Mr. RENACCI. I appreciate that. I know, I am running out of time, and I do agree tax reform would correct this, but are you saying that the anti-inversion rules are not working?

Secretary LEW. No. I think the anti-inversion rules we put in are working partially, which is what we knew they would do. They don't completely solve the problem.

Chairman RYAN. Thank you.

Mr. Meehan.

Mr. MEEHAN. Thank you, Mr. Chairman, and, Mr. Secretary, thank you for being here, and I also want to express my appreciation for the Administration's attention to graduate medical education. I think it is not just a question of what it may do for regional economies, but the idea of us being able to train this next generation of medical professionals.

We are talking about the cost of education here, and it is just—it is mind-boggling to think about people graduating \$3 and \$400,000 in debt, and it goes back to another issue, and I think this is something that I am seeing when I am talking to people in my district consistently, and you talk about increasing the ability for people to be able to pay for education, and we keep trying to find ways to redistribute dollars to do this, but let me ask you a question, because there is a significant investment in education by the Federal Government and by the policies of the Federal Government, nonprofit institutions for the most part, tax incentives of various sorts. So with such a critical role, what is it that you are doing to hold down the increasing cost of education?

Secretary LEW. You know, Congressman, most of that is not in my purview as Treasury Secretary, but I do have a deep interest in this and have worked across the Administration. So I can tell you that there are things that we are doing to make it clear to families and to students what the cost of education will be, what their choices are, what the track record of schools is in terms of giving the kind of education that is likely to lead to the kind of options that we all want for our children to have, and I think it is very important that we not just deal with the student loan piece of it, but we also deal with the structure of how education is marketed and made available to students. Students should see what their choices are. They should understand what the benefit of different options is, and they should also understand the cost of getting deep in debt. We have too many schools that are enrolling students and not keeping them in even to finish their degree, and those students end up in debt with no degree.

Mr. MEEHAN. Yes, but we have a great deal of schools which are stretching families who appreciate the very great difficulty which you identified in almost a market-based economy in which people are trying to get the best education they can for their children. I mean, you know yourself, you are a Harvard University graduate. It could be about \$225, \$230,000 for a family, and that is pretax income. So I go back again. Here is one of the problems. Those very same institutions, you are talking to me about the responsibility on the parents and the families to be looking at these and making decisions. I am asking about what responsibilities you are putting on the institutions themselves. I was trying to look for factors that may be influencing the cost of education, and, you

know, the cost for a private university has more than doubled since the 1970s when I went there, and I suspect somewhere around the time you may have attended college. For public universities proportionately, it has tripled.

Now, at the same time, and I was just looking at a statistic, the amount of staffing has grown exponentially. In 1975, there were 446,000 college professors and 268,000 administrators of all types. In the middle of the last decade, there were 675,000 professors and 750,000 administrators of their various types. We have seen a dramatic explosion in this educational complex in which this bureaucracy has become a food frenzy, and the American families are paying for it. The very same people who you are looking at right now about—who are making those investments oftentimes they are the ones that are dipping into their retirements to meet these exorbitant fees.

So what are we doing with the leverage that we have to begin to compel these institutions which already benefit as nonprofit institutions to say that there is—if you want to have the benefit of government-subsidized tuition and other kinds of things, then you must demonstrate the capacity—you are doing it in health care. Why aren't you doing it in education?

Secretary LEW. Well, Congressman, by starting with transparency and empowering families, individuals, to make decisions, that actually puts pressure on the university system to take that very seriously.

I agree with you, costs have been rising too rapidly. I think that it is not an easy thing to address because there is a kind of irreducible minimum of the number of people it takes to teach groups of 20 and 30 people, and even with the move toward, you know, high technology, ultimately the contact with teachers still matters. Universities have become more complicated places. They have a complicated variety of things they do. It is not my area, obviously, of current expertise. The Department of Education is looking hard at these issues, and I am sure they would be happy to follow up.

Mr. MEEHAN. Thank you.

Chairman RYAN. Thank you.

Mr. Smith.

Mr. SMITH OF MISSOURI. Thank you, Mr. Chairman.

Mr. Secretary, as I have been sitting here listening to your presentation and also a lot of questions, I am reminded of a Congressman from Missouri, of a speech he gave in 1899. It was Congressman Willard Vandiver, and he said, "I come from a State that grows corn and cotton, cockleburs and Democrats. You're frothy eloquence neither convinces me nor satisfies me. I am from the Show Me State and you have to show me."

And I am asking in this budget that you presented to us how the policies that are implemented in this budget help rural America? Whenever you look at the statistics of rural America, where less than—well, 97.9 percent of all the counties in the United States have not rebounded from the recession, and you are seeing that 60 percent of rural counties have decreased in population in the last year, what policies in your budget help rural America rebound from this economy?

Secretary LEW. Well, Congressman, obviously agricultural policy is not primarily my responsibility, but our Department of Agriculture has been working with Congress to put in place programs that we think are very beneficial to rural America. I know that the efforts that the Department of Agriculture has made to bring investment into rural America have been very successful. I have collaborated with the Department on some of their business efforts. You know, I actually think if you look at the economic performance of rural areas, they have done considerably better than your description. Again, it is not my core area, but I would be happy to follow up with you and look at the data that you are looking at and the data that I have seen, because it has been, I think, for a lot of rural communities a better period than you just described.

Mr. SMITH OF MISSOURI. I would love to compare that. But let's talk about a policy that has been discussed, one that you have proposed and that is increasing the estate tax and the death tax. This is something that is extremely detrimental to the farmers and small businessowners, at least in my congressional district.

If you look at the Bootheel of the State of Missouri, those seven counties are the—have some of the best farmland in the entire State of Missouri and in the country. Those seven counties produce more than a third of all agriculture production for our State. The average per acre of a farm there is roughly \$8,000. The average family farm is 441 acres.

Do you realize that underneath the policies that you are proposing that every one of those average family farms in the Bootheel of Missouri would be devastated by your proposal of the estate tax that would almost—almost count to about 57 percent of a tax on their inheritance, which as you—maybe you don't know this, but almost 85 percent of all the values of farms is within their equipment and their farmland. They don't have a lot of—a lot of liquid assets. So, if they have a 57 percent tax increase, they are going to have to sell their farm, which is eliminating a small business, which is destroying heritage. Would you explain that to me?

Secretary LEW. Well, Congressman, as we have looked at the estate tax over the years, we have agreed to have high thresholds so that real family farms would be large—many would be exempt.

Mr. SMITH OF MISSOURI. So the average family farm, I said, is 441 acres. Now, 441 acres times \$8,000 would go over your \$3.5 million exemption. So I am saying that an average family farm does not even qualify underneath your proposal right now.

Secretary LEW. So, Congressman, I think that the goal of both our estate tax and our stepped-up basis proposals are to make sure that we don't have large appreciation of assets that essentially go untaxed for all time.

Mr. SMITH OF MISSOURI. So they need to pay taxes double and triple and basically—

Secretary LEW. No. Not double and triple.

Mr. SMITH OF MISSOURI. This is why the statistic I said earlier about 60 percent of counties in rural America are decreasing in population, because they experience a Tax Code that promotes them to sell their family farm to move to the city. And I believe this is so unfortunate. These policies have to be stopped. This is a war on rural Americans. It is a war on the middle class.

Secretary LEW. I would be happy to follow up with you, Congressman, and look at some of the numbers you have described and numbers that we have——

Mr. SMITH OF MISSOURI. I would love that.

Secretary LEW [continuing]. Reviewed. I actually don't think the impact is as broad as you have described it. I am happy to follow up.

Mr. SMITH OF MISSOURI. Let's get together. Thank you, Secretary.

Chairman RYAN. Thank you.

Mr. Holding.

Mr. HOLDING. Thank you, Mr. Chairman.

Mr. Secretary, America is a great country because of our people. Our people are aspirational, entrepreneurial, and intuitive. And I am sure we could agree on that.

Secretary LEW. I think we can.

Mr. HOLDING. But when the American people see a budget which proposes more than \$2 trillion in spending, more than \$2 trillion in additional tax, more than \$8 trillion in additional debt, a budget that never balances and, at the end of the day, you end up with bigger government and bigger debt, I don't think the intuition of the American people says that that is a success. And I don't think they look upon it as, you know, this is the way forward to ensuring that America is the greatest Nation for our next generation.

I believe I am the last person, so I am going to follow up on a couple of other Members' queries. First, following up on Dr. Boustany's query, the question to you about the theft of intellectual property in China. I know that you have been involved and take an interest in this, and you raised it with the Chinese. Obviously strong intellectual property rights are incredibly important to our economy. It is perhaps one of our largest and most productive assets as Americans.

If you could just take a brief moment and talk about what the Administration is doing to address theft of our intellectual property by the Chinese. I was in China recently, and I can tell you that I was singularly unimpressed with their efforts to prevent theft of intellectual property.

Secretary LEW. Congressman, I have raised this issue at the highest levels of the Chinese government. I think they understand that they need to take more action in this area. They have certainly indicated that they understand it is an issue. You know, the reality is they, for a long time, denied that they had a problem. And, you know, now they have a system that is, at least, starting to deal with it. We have to be relentless in pushing our view forward on this. We have to make clear that if China wants to be the world leader that it aspires to be, it has to play by the basic rules that the rest of the world plays by. And it is not limited to intellectual property. I make the case to China on currency. I make the case to China on market access. I make the case to China on competitiveness.

I think it is in our interest for there to be a healthy China, and it is in China's interest for there to be a healthy United States, but it has to be on fair terms. It can't be——

Mr. HOLDING. Right.

Secretary LEW. This pertains to the question on the bid that came up. One of the places for us to pursue these issues is in the context of the bid discussion. Because if they can't get to meet the world standard, they can't get a bid.

Mr. HOLDING. All right. And you would also agree that, you know, the United States—our intellectual property laws are probably the gold standard—

Secretary LEW. Yes.

Mr. HOLDING [continuing]. Around the world and that is why innovation is such an important part of our economy—

Secretary LEW. Absolutely.

Mr. HOLDING [continuing]. The companies, what we innovate here.

Secretary LEW. And, in fact, if I could interrupt, Congressman, I have said to them, if you want your economy to do well in the future, you need to encourage innovation and you can't do that unless you respect intellectual property rights.

Mr. HOLDING. Right. So you would also agree that, in the current TPP negotiations, and as we consider TPA, we should be very mindful of addressing intellectual property protections when we negotiate with other countries and don't dumb-down our own standards here in the United States to meet standards of countries where innovation and advancement in things like biologics, you know, are nowhere in comparison to the standards—the innovation that we have in this country. Correct?

Secretary LEW. Congressman, I think we have to pursue a high-standard discussion in a number of areas, intellectual property is one. But worker standards is another. Environmental standards is another.

And I heard a number of questions earlier about currency. And let me just say we take the issues of currency very, very seriously. We do it in the G-7, in the G-20, in our bilateral discussions. And we look forward to working with Congress to figure out how to talk about it in the context of—

Mr. HOLDING. Good. I have a few other quick hits.

Congressman Smith of Nebraska asked you if you thought that inheritance tax was a double taxation, and you said that you didn't think it was. So I assume that you agree with me that it is actually a triple taxation. Would I be correct in that assumption?

Secretary LEW. No, sir.

Mr. HOLDING. Okay. For the record, I am going to send you a followup question or two on FATCA, the—

Secretary LEW. I would be happy to look at that.

Mr. HOLDING. With the renunciation rates going through the roof, really at the highest levels we have ever seen, I believe it is abhorrent that the American government is pursuing regulations and policies that would encourage Americans to renounce their citizenship. So I want—I will submit a followup question.

Secretary LEW. Thank you.

Mr. HOLDING. Thank you.

Chairman RYAN. Well—

Secretary LEW. Mr. Chairman, you run a tight ship.

Chairman RYAN. We really try. It is 12:57.

Does anybody want to talk for a few minutes?

Mr. LEVIN. No, thank you, Mr. Chairman. We have to eat lunch.

Chairman RYAN. We have to eat lunch.

Thank you, Secretary Lew, for appearing with us today.

I want Members to be advised that they may submit written questions to be answered later in writing and that they will also be reflective and included in the record for this hearing. We kept a tight ship. We got you out on time. The hearing is adjourned.

[Whereupon, at 1:00 p.m., the Committee was adjourned.]

[Submissions for the Record follow:]



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SUBMISSION FOR THE RECORD

Committee on Ways and Means

February 17, 2015

**Hearing on the President's Budget for Fiscal Year 2016 with U.S. Department of the Treasury
Secretary Jacob J. Lew**

Chairman Ryan, Ranking Member Levin, thank you for opportunity to submit a statement for the record regarding the President's fiscal year 2016 budget proposal with Secretary of the Treasury Jacob Lew.

The Family Business Estate Tax Coalition (FBETC) is a grassroots coalition of over 60 organizations representing family-owned businesses. The goal of the FBETC has always been full repeal of the estate tax, and the coalition still believes this is the best solution to protect all family-owned businesses from the estate tax. However, the FBETC supported the compromise reached in 2010 between Congress and the President, with a \$5 million exemption and the maximum rate of 35 percent, as a bridge to full repeal. The FBETC also strongly supports permanently indexing the exemption level to inflation, providing for spousal transfer, and maintaining stepped-up basis.

The FBETC has serious concerns about a number of proposals in President Obama's fiscal year 2016 budget. Specifically, the FBETC strongly opposes the proposal to reduce the estate tax exemption to \$3.5 million, remove the inflation adjustment, and raise the top marginal rate to 45 percent. The FBETC also strongly opposes the proposed repeal of stepped-up basis. The combined effect of these proposals would be the creation of two taxes at death, and would push the combined top tax rate at death to over 60 percent—a level not seen in over three decades. To the contrary, these proposals would instead take a major step backwards in the decades-long movement to provide estate tax relief to family-owned businesses and farms.

Proposed lower estate tax exemption and higher estate tax rate

Since 2001, when the estate tax was put on a glide path to full repeal with the passage of the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA), reducing the burden of the estate tax on family-owned businesses and farms has been a Congressional priority. There are many reasons for this.

- The estate tax hurts capital formation and job growth. Prior to 2001, the estate tax reduced capital formation in the economy by an estimated \$850 billion.¹
- Estate tax compliance is time-consuming and expensive. For every \$1 of tax revenue raised from the estate tax, \$1 is wasted in compliance. For example, in 2006, it is estimated that family businesses spent \$27.8 billion just to comply with the law.²
- The estate tax forces family businesses to sell their highly illiquid business assets, thereby jeopardizing the health of the business. In addition, the business may be jeopardized when family members leave in anticipation that the business would not survive a death in the family.

The total cost of the estate tax not only comes from the cost of the tax, but also from the cost of estate tax planning. Family-owned business owners make decisions based on thinking that they may incur the estate tax regardless of whether they ever do. As a result, a large portion of them make unnecessary, even wasteful, expenditures on products and services — such as financial planning and insurance — that they may never require, depriving the business of investment capital that could more productively be used for other purposes, including business growth. Even with a \$5 million exemption level, 34 percent of small businesses have incurred expenses in the last five years in order to protect themselves and their heirs from estate tax liability, and another 15 percent expect to do so in the future.³ Additionally, less than 10 percent of small businesses understand the estate tax, which means they will have to pay for lawyers and accountants to help them understand the law.⁴

¹ Joint Economic Committee, United States Congress, *Costs and Consequences of the Federal Estate Tax*, May 2006.

² Ibid.

³ Taxes and Spending: Small Business Owner Opinions—NFIB Member Poll, NFIB Research Foundation, See also, testimony of Neil D. Katz, Managing Partner, Katz, Berstein & Katz, LLP, from Committee on Small Business Hearing: *Planning for the Death Tax: Can Small Business Survive?*, May 31, 2012: “So while there may only be 3,000 or 4,000 small business owners who die during the year who are impacted by the estate tax, it is impacting a lot of people . . . If there are thousands of lawyers learning about this, there are hundreds of thousands of people that are dealing with this every day.”

⁴ National Federation of Independent Business, *National Small Business Poll Tax Complexity and the IRS*, Volume 6, Issue 6, 2006

Furthermore, because the value of many family-owned businesses is tied to illiquid assets, such as land, buildings, or equipment, this can cause families to lose the viability of their businesses altogether. For example, since 84 percent of a farmer's assets are land based, farmers may be forced to sell their land to pay for the estate tax.⁵ Additionally, when a business owner is placed in a situation where they are forced to sell business assets to pay the tax, the result can be assets sold at "fire sale prices," which further hurts the prospects that surviving family members will be able to carry on the business. Protecting these family businesses from the estate tax is important in order to keep these businesses operating for future generations.

With the President's fiscal year 2016 budget proposal calling for a reduction in the estate tax exemption to \$3.5 million (not indexed to inflation), and an increase in the top rate to 45 percent, more family-owned businesses would face additional costs associated with tax compliance, and the next generation would face increased risk of having to sell their businesses to pay for the tax.

Creating a New Capital Gains Tax at Death and Repealing Stepped-Up Basis

In addition to the increase in the estate tax, the President's fiscal year 2016 budget also proposes to both repeal stepped-up basis, and create a new capital gains tax at death. The FBETC strongly opposes both of these proposals.

Virtually all of the same difficulties that family-owned businesses and farms face when dealing with the estate tax would be repeated and magnified under the proposed new capital gains tax. It would harm capital formation and economic growth. It would force companies to conduct even more costly estate planning. It would force businesses and farms to sell off illiquid assets to pay the tax, leading to a "mushroom effect"—creating fresh taxes on property sold to pay other taxes. And it would place an unimaginable burden on families, who would be forced to sort through countless records while trying to find an original receipt, bill of sale, or property

⁵ American Farm Bureau Federation, *Estate Tax Reform*, January 2011.

deed—or worse yet, to face the tax on the entire value of an asset because of the inability to locate documents for property purchased years in the past.

Furthermore, when combined with the proposed increase in the estate tax, the two taxes at death would push the top marginal tax rate to over 60 percent, which is substantially higher than the 55 percent rate in place prior to 2001.

Historically, the tax code has always allowed for a basis adjustment for inherited property for the purposes of calculating capital gains taxes.⁶ This means that if inherited property is sold by an heir, capital gains taxes are due on the increase in value since the property was inherited. It is important to note that the basis adjustment moves up as well as down, and if the value of an asset on the date of death is lower than the decedent's basis, the asset's basis is stepped down.

With the passage of the *Tax Reform Act of 1976*, Congress attempted to switch from stepped-up basis to carryover basis for inherited property. In the process, the law also created a \$60,000 minimum basis adjustment, which served as a de facto capital gains tax exemption. The proposal was never allowed to go into effect, however. In response to withering criticism, the proposal was postponed for three years with the passage of the *Revenue Act of 1978*. In 1979, as Congress debated whether to repeal the provision or modify it, the Joint Committee on Taxation prepared a background report on carryover basis. The report states:

“The carryover basis provisions have been criticized as being extremely complex and administratively unworkable. Administrators of estates have testified that compliance with the provisions caused a tremendous increase in the time required to administer an estate and resulted in raising the cost of administration.”⁷

Shortly afterwards, carryover basis was repealed entirely with the passage of the *Crude Oil Windfall Profit Tax Act of 1980*.

Additionally, in 2010, when the estate tax was repealed for one year, stepped-up basis was limited to \$1.3 million plus an additional \$3 million for property passed between spouses. For

⁶ Joint Committee on Taxation, *Background and Issues Relating to Carryover Basis*, JCS-6-79, March 9, 1979.

⁷ *Ibid.*

all other inherited property, carryover basis applied. Once the estate tax was reinstated in 2011, with a \$5 million exemption and 35 percent rate, stepped-up basis was reinstated.

With the carryover basis proposal outlined in the fiscal year 2016 budget, the Administration has actually proposed a far more damaging tax regime than was enacted, and ultimately repealed during the Carter Administration. As mentioned earlier, the carryover basis proposal enacted in the *Tax Reform Act of 1976* contained a \$60,000 basis adjustment, which, when adjusted for inflation amounts to \$249,634 in 2014 dollars.⁸ After the tax was delayed for the years during the 95th Congress (1977-1979), the Treasury Department proposed raising this basis adjustment to \$175,000,⁹ which would translate to \$570,644 in 2014 dollars.¹⁰

The proposal put forth by the Obama Administration would allow for a \$100,000 per-person capital gains tax exclusion (\$200,000 per couple). When adjusted for inflation, this would affect substantially more family-owned businesses than was originally enacted in the *Tax Reform Act of 1976*, and more than double the number of families affected under the proposal from the Treasury Department in the 95th Congress. Any discussion about this proposal should begin with an explanation as to why, if a plan that was so unworkable that it was never allowed to go into effect in 1976, it should be applied to even more businesses in 2015.

Conclusion

The Administration's proposals related to the estate tax and stepped-up basis are unreasonable and unworkable. They would turn back the clock on decades of progress providing relief to family-owned businesses and farms, force new and repeated trips to the attorney's office, create countless administrative problems, and act as a brake on economic growth and job creation. Congress should reject these proposals and instead build on the bipartisan progress made in recent years to repeal the estate tax once and for all.

⁸ Calculated using Consumer Price Index Inflation Calculator, Bureau of Labor Statistics, U.S. Department of Labor, available at <http://data.bls.gov/cgi-bin/cpicalc.pl>

⁹ Joint Committee on Taxation, *Background and Issues Relating to Carryover Basis*, JCS-6-79, March 9, 1979.

¹⁰ Calculated using Consumer Price Index Inflation Calculator, Bureau of Labor Statistics, U.S. Department of Labor, available at <http://data.bls.gov/cgi-bin/cpicalc.pl>



**Statement of the Puerto Rico Manufacturers Association
By Mr. Carlos Rivera Vélez, PhD, PE, President**

**For the Hearing Record
of the
Committee on Ways and Means
U.S. House of Representatives**

**Hearing on
The President's Fiscal Year 2016 Budget Proposal with U.S. Department of the
Treasury Secretary Jacob J. Lew**

February 3, 2015

Thank you Chairman Ryan, Ranking Member Levin and distinguished Members of the Committee. It is my pleasure to present this statement as President of the Puerto Rico Manufacturers Association (PRMA). The PRMA is a private, voluntary, non-profit organization established in 1928 to serve as the voice of manufacturing in the U.S.'s largest and most important Territory.

As Congress considers moving forward on the issues of reforming the tax code we wish to provide some background on the Federal Tax Code's unique treatment of U.S. companies operating in Puerto Rico as well as the importance of manufacturing to our overall economy. We also ask for your consideration and inclusion of our concerns during your deliberations over Tax Reform.

Puerto Rico has been part of the U.S. since 1898 and today is the home for 3.7 million U.S. Citizens. No jurisdiction of the U.S. is more dependent on manufacturing than Puerto Rico. In fact, manufacturing is currently the leading private sector employer and represents almost one-half of Puerto Rico's economy, far more than any State.

It's important to remember that manufacturing jobs in Puerto Rico are U.S. jobs employing U.S. citizens. Our goal for Tax Reform is simply to "do no harm".

SUMMARY OF KEY POINTS FOR YOUR CONSIDERATION:

- PRMA has taken no official position with respect to the President's Tax Reform measures as described in the Treasury Green Book for FY 2016.



- However, on a personal level, I believe that Treasury's recommended international provisions will harm Puerto Rico and will result in the loss of U.S. / Puerto Rico manufacturing jobs. Puerto Rico is part of the United States and the loss of Puerto Rico jobs directly impacts American Citizens as well as stateside suppliers.
- Historically, Federal tax law has fostered manufacturing and continues to play a pivotal role in attracting and keeping U.S. companies and U.S. jobs in Puerto Rico.
- We urge that Tax Reform should "do no harm" to Puerto Rico's economy by discouraging investment in Puerto Rico.
- Puerto Rico needs a seat at the table during deliberations on Tax Reform.
- Most subsidiaries of U.S. companies operating in Puerto Rico are organized as Controlled Foreign Corporations (CFCs) under the current tax code. However, they are treated as domestic in every other way.
- Puerto Rico is not a tax haven. We believe Puerto Rico is the only jurisdiction in the United States where CFCs employ U.S. Citizens, operating under a hybrid application of U.S. law and on U.S. soil.

TAX POLICY'S HISTORICAL ROLE IN PUERTO RICO'S ECONOMY:

Federal tax policy has traditionally recognized the unique relationship of Puerto Rico to the United States. Initially the provisions adopted as part of the Revenue Act of 1921 and later through the activities of the 1948 Operation Bootstrap (of which PRMA was a major participant) and the creation of IRC Section 936 as part of the Tax Reform Act of 1976, the U.S. Congress has traditionally adopted targeted policies, particularly tax policies, towards Puerto Rico that were "pro-growth" and spurred the conversion of Puerto Rico from an agrarian economy to one based on manufacturing.

Although initially a largely agrarian economy, the decades after World War II saw manufacturing replace agriculture as the driving force of the economy of Puerto Rico. In the 1940's employment by the manufacturing sector was approximately 56,000. That number dramatically increased in the late 1980s after the enactment of IRC Section 936 to approximately 106,000 and to a high of 155,000 by 1995. It was primarily due to the jobs offered by the manufacturing sector that living standards, wages and educational levels rose dramatically. Today more than 40% of the population has at least 13 years of education. Thanks to Congressionally driven tax policy, the economic miracle that is Puerto Rican manufacturing has grown from labor intensive basic manufacturing to a capital intensive industrialized sector to now a knowledge based advanced manufacturing model.



MANUFACTURING GROWTH AND TRANSITION:

Because of these tax policies and in spite of the recent economic recession impacting our island for the past nine years, Puerto Rico's manufacturing sector has shifted from one based on labor such as the manufacturing of food, tobacco, leather and apparel to the more capital-intensive industries of pharmaceuticals, chemicals, machinery and electronics operating nearly 2,000 plants on our island.

Puerto Rico ranks the fifth in the world for pharmaceutical manufacturing with more than 70 plants. As of 2014, Puerto Rico based plants produced 16 of the top 20 best selling drugs on the U.S. mainland.

Puerto Rico is also the world's third largest biotech manufacturer with more than two million square feet of dedicated plant space and is the seventh largest medical device producer hosting more than 50 plants on the island. Manufacturing accounts for 48.6 % of Puerto Rico's Gross Domestic Product (GDP) and directly employs 8% of the work force or about 74,000 people. We estimate an additional 80,000 Puerto Rico residents are indirectly employed by our sector.

We also estimate an additional 80,000 Stateside jobs supported by Puerto Rico's manufacturing companies (CFCs). Therefore, our manufacturing sector has the multiplier effect of contributing 234,000 jobs (direct, indirect and induced) to the US and Puerto Rico economies. For example, one of our member companies reports that it annually transports over \$140 million worth of product from Puerto Rico just through the Port of Jacksonville, Florida.

Manufacturing companies paid \$1.4 billion in income taxes in 2009 or 57.9% of all corporate income tax collected. The role of CFCs in Puerto Rico's economy is of such importance that during the current fiscal year, seven (7) of these companies doing business in Puerto Rico represent 20% of the revenues of the Government of Puerto Rico's budget or \$2 billion.

Manufacturing offers better wages for U.S. Citizens in Puerto Rico. Unfortunately, while approximately 42% of our population lives below the "poverty line" and the current unemployment rate is at 14%, workers in the manufacturing sector earn an average wage of \$39,000, which is actually 30% higher than the per capita average. We are also proud to report that in an economy in which fully 40% of the workers earn minimum wage, manufacturing wages are a major factor in improving the standard of living for all of Puerto Rico's residents.



IRC SECTION 936 FOSTERED MANUFACTURING:

In spite of these positive numbers, the overall economic picture for Puerto Rico generally and for manufacturing specifically must be balanced by the “hard” facts that manufacturing has lost a significant number of jobs particularly since the repeal of IRC Section 936 in 1996.

In its 1993 Report to the Chairman of the Senate Finance Committee, the General Accounting Office (GAO) summarized the IRC Section 936 credit as follows: Under section 936, the tax credit equals the full amount of the U.S. income tax liability on possessions source income. Firms qualify for the credit if, over a three year period preceding a taxable year, 80 percent or more of their income was derived from sources within a possession and 75 percent or more of their income was derived from the active conduct of a trade or business within a possession. This provision effectively exempts all possessions source income from U.S. taxation. Dividends repatriated from a U.S. subsidiary to a mainland parent qualify for a dividends-received deduction, thus allowing tax-free repatriation of possessions income. In addition, the provision exempts from U.S. taxation the income earned on qualified investments made by section 936 firms from their profits earned in the possessions. This income is called qualified possessions source investment income, or QPSII. Puerto Rico established rules to ensure that QPSII funds invested through the island's financial intermediaries meet the act's requirements.

The enactment of IRC Section 936 had a positive and direct impact on Puerto Rico's economy. In 1989, the GAO noted that 13 years after enactment of IRC Section 936, manufacturing firms in Puerto Rico employed 105,500 individuals directly comprising 11% of the total employment of 952,000. By 1997, that number stood at 155,000 Americans directly employed by the Puerto Rico manufacturing sector.

However today, the number of U.S. citizens employed directly by manufacturing has been reduced to approximately 74,000. It's fair to say that this drastic reduction is mostly due to the elimination of IRC Section 936 more than any other single factor. In fact, a number of corporate decision makers cited the loss of IRC Section 936 as the primary reason for either the closure or relocation of facilities to Mexico, China and the Dominican Republic.

Unfortunately, as manufacturing jobs have disappeared few other local employment opportunities remain. This has caused a sizeable “brain drain” as tens of thousands of skilled workers have left Puerto Rico in search of new employment. Over the past decade, an estimated 300,000 US citizens representing approximately 7% of the total population (mostly the young and those with



higher educational levels) left the island for better opportunities on the mainland. This troubling trend suggests greater social consequences if the shrinking manufacturing sector were to continue. Economic circumstances are driving this “brain drain” leaving many of our talented citizens with little choice but to immigrate to the mainland or remain on the island becoming dependent on social programs.

Even in the context of IRC Section 936 repeal, the U.S. Congress recognized the consequences of this repeal and its impact on Puerto Rico and provided for a ten-year transition period. Subsidiaries of U.S. companies were given the opportunity to re-organize as Controlled Foreign Corporations. Although not as generous as IRC Section 936, the CFC mechanism provides a special tax incentive offering a potent financial reason for U.S. companies to remain or expand operations in Puerto Rico.

We believe Puerto Rico is the only jurisdiction in the United States where CFCs employ U.S. Citizens, operating under U.S. law and on U.S. soil. This is truly a unique situation to consider during Congress’ deliberations on Tax Reform.

TAX REFORM 2015:

Considering Congress’ historical use of the Federal tax code as a tool to foster and support economic growth in the U.S. Territory of Puerto Rico, we urge full consideration of the impact of future Tax Reform on Puerto Rico’s economy and job base. We believe Congress shares a bipartisan goal of fostering manufacturing and encouraging investment in American jobs. Again, we note that Puerto Rico jobs are American jobs.

The GAO’s 1993 Report also reviewed the factors that U.S. corporations consider when they contemplate establishing a plant or similar facility in a foreign location. The GAO identified six primary considerations including energy costs, transportation costs, labor costs, stability, infrastructure, and tax structure.

Thankfully, Puerto Rico has a stable government and excellent infrastructure given the millions of dollars invested in recent years on infrastructure improvements. We have world-class seaports, airports and a modern ground transportation network.

Conversely, the Island has a highly skilled and educated workforce but labor costs are the highest in the Caribbean. In addition, local and federal labor laws make Puerto Rico one of the most



heavily regulated jurisdictions in the U.S. and certainly much higher than others in the Caribbean basin area.

Puerto Rico is an island and highly dependent on imports of raw materials, food and oil; increasing costs for manufacturing and business operations. While there is a planned conversion over to liquefied natural gas (LNG), currently, energy is generated using imported oil resulting in higher energy costs. A recent comparison with Florida found that energy costs in Puerto Rico are three times that of Florida: on average 27 cents per kilowatt-hour in Puerto Rico versus 9 cents in Florida. The average for the United States is 11 cents per kilowatt-hour.

The bottom line is that we have several factors that must be considered when we compete to foster investment in manufacturing operations in Puerto Rico. Our neighbors in the region as well as our global competitors are aggressively pursuing our manufacturing to re-locate their U.S. operations from Puerto Rico by offering cheaper labor costs, cheaper energy costs, less restrictive regulation and access to the U.S. market.

Therefore, the ability of Puerto Rico to remain economically competitive internationally may well depend on how the U.S. Congress treats U.S. companies operating subsidiaries in Puerto Rico under reforms to the tax code.

We share your goal of giving U.S. manufacturing a competitive edge when Tax Reform is enacted. We also ask for the opportunity to work with you on this task while ensuring no harm to manufacturing jobs in Puerto Rico. Puerto Rico is a vital element of the U.S. manufacturing sector and we wish to continue fostering opportunity for U.S. citizens on our island as well as Stateside.

In conclusion, I would like to thank the Committee for your consideration and ask that we be invited to appear before your Committee during any upcoming hearings on tax reform. I'm looking forward to working with you as Congress deliberates the future of the Federal Tax Code.



Supplemental Sheet

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