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Business Tax Issues in 2007

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Summary

In recent years, business tax legislation has tended to focus on broad, structural issues and economic performance in general. For example, the 2003 tax cuts for capital gains and dividends were, in part, an incremental movement towards eliminating the double-taxation of corporate income that is a structural feature of the current U.S. business tax system. Also, these and other business tax cuts -- for example, temporary "bonus" depreciation -- were designed to provide a fiscal stimulus to spur an economy that remained sluggish after the 2001 recession. And in 2004, Congress enacted a set of business tax cuts that were generally aimed at boosting U.S. competitiveness through their impact on international trade and investment.

Initially, consideration of business tax policy in 2007 focused on more narrow, sector-specific issues. And while overall economic performance is always of concern to tax policymakers -- particularly in the area of business taxation -- in 2007 interest in business tax issues also appears to be driven by concerns about tax equity and by a search for tax revenue that would help reduce the federal budget deficit or offset tax cuts elsewhere. For example, energy taxation has been explored as a way to raise revenue as well as a means to stimulate investment in energy conservation and technology. Also, there appears to be considerable interest in restricting corporate tax shelters. And there are some indications that Congress may consider legislation that would make the research and development tax credit a permanent rather than temporary part of the tax code.

Beginning early in 2007, Congress and the Administration evinced an interest in tax cuts for small business -- cuts that some viewed as a way to counter the impact of minimum wage increases on small business. In February, both the House and Senate approved bills containing small business tax benefits (an amended version of H.R. 2 in the Senate, and H.R. 976 in the House), then in mid-March folded the tax items into their respective versions of H.R. 1591, a supplemental appropriations bill. Congress passed a conference committee version of H.R. 1591, but on May 1, President Bush vetoed the bill because of its Iraq-related provisions. On May 24, however, both the House and Senate approved a modified appropriations bill that included the previous bill's tax provisions. The President signed the measure, and it became P.L. 110-28.

In fall 2007, Congress returned to consideration of broader business tax issues. On October 25, Chairman Charles Rangel of the House Ways and Means Committee introduced an omnibus tax bill (H.R. 3970) that proposed broad changes in business taxation along with proposed individual income tax changes that focused on the individual alternative minimum tax (AMT). In broad outline, the bill's business tax changes coupled a substantial reduction in the top statutory corporate tax rate -- to 30.5% from current law's 35% -- with a set of revenue-raising items,

including repeal of the domestic-activities deduction. The bill would also extend a set of temporary business tax benefits.

This report will be updated as legislative events occur.

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Business Tax Issues in 2007

The business tax legislation enacted in recent years has tended to have as its basis concern for broad economic performance. For example, the 2003 tax cuts for dividends and capital gains were an incremental step towards a basic structural reform of the tax system termed "tax integration," designed to restrict the double-taxation of corporate-source income. Also, the "bonus depreciation" and other business tax cuts enacted in 2003 and afterwards were partly intended to provide a broad fiscal stimulus to spur an economy that remained sluggish after the 2001 recession. And in 2004, Congress enacted an omnibus business tax bill (the American Jobs Creation Act; P.L. 108-357) that had U.S. business operations in the international economy as its principal focus.

In contrast, business tax considerations in 2007 initially focused on more narrow, sector-specific issues rather than broad, structural concerns. For example, in the year's first months, both the House and Senate began consideration of small-business taxation, and in May enacted a small business tax bill as part of an appropriations measure (P.L. 110-28). Also, both the House and Senate have considered energy related tax legislation, although an energy tax measure has not yet been enacted.

In the fall of 2007, business tax deliberations turned back to broader issues. On October 25, Chairman Charles Rangel of the House Ways and Means Committee introduced an omnibus tax bill (H.R. 3970) that included a set of business tax proposals with a relatively broad focus. In

broad outline, the bill proposes a substantial reduction in the top statutory corporate tax rate coupled with a set of revenue-raising proposals.

This report describes the most prominent business tax legislation that has been considered or adopted in 2007. It also discusses selected business tax issues that have emerged in 2007: energy taxation, the research and experimentation tax credit and other temporary tax benefits, corporate tax shelters, and international taxation. In order to place these issues in context, however, the report begins with a view of the current system's basic structure, and with a broad look at recent business tax legislation.

The Current System

The United States has what tax analysts sometimes term a "classical" system for taxing corporate income. That is, it imposes a tax on corporate profits -- the corporate income tax -- that is separate and generally in addition to the individual income taxes that corporate stockholders pay on their corporate-source capital gains and dividends. The corporate income tax applies a 35% rate to most corporate taxable income, although reduced rates ranging from 15% to 34% apply to corporations earning smaller amounts of income. The base of the tax is corporate profits as defined by the tax code -- generally gross revenue minus interest, wages, the cost of purchased inputs, and an allowance for depreciation.

Over the past several decades -- that is, since 1980 -- federal corporate tax revenue has generally varied between 1% and just over 2% of gross domestic product (GDP). Congressional Budget Office (CBO) data show that corporate tax receipts registered an "uptick" in fiscal years (FY) 2005 and 2006, rising to 2.3% and 2.7% of GDP, respectively -- an increase CBO attributed primarily to strong economic growth. However, CBO also projects corporate tax revenue to recede in future years to a level closer to its long-term average.¹ In FY2006, corporate taxes comprised 14.7% of total federal revenues, third place behind individual income taxes (43.4%) and social security taxes (34.8%).²

Not all businesses are subject to the corporate income tax. Income earned by partnerships is "passed through" and taxed to the individual partners under the individual income tax without imposition of a separate level of tax at the partnership level. Also, businesses that have no more than 100 stockholders and that meet certain other requirements ("S" corporations), as well as certain other "pass through entities" are not subject to the corporate income tax, but are taxed in the same manner as partnerships.

Legislation in 2007

Proposed Tax Reduction and Reform Act (H.R. 3970)

On October 25, 2007, Chairman Charles Rangel of the House Committee on Ways and Means introduced H.R. 3970, the Tax Reduction and Reform Act, an omnibus tax bill containing provisions affecting both individuals and businesses. On the individual side, the bill's principal focuses are reduction of the alternative minimum tax (AMT) and extension of a set of expiring tax benefits. For businesses, the bill couples a substantial cut in the statutory corporate tax rate and a permanent increase in the "expensing" benefit for small business investment with a set of revenue-raising provisions. Taken alone, the bill's business provisions would reduce tax revenue by an estimated \$8.7 billion over 5 years and \$1.0 billion over 10 years.³ (On October 30, Chairman Rangel subsequently introduced H.R. 3996, a bill addressing only the AMT and expiring tax provisions.)

The bill's proposed reduction in the statutory corporate tax rate is the largest of its proposed cuts, both in terms of revenue loss and number of businesses affected. Under current law, corporate taxable income is generally subject to a set of graduated rates: 15%, 25%, 34%, and 35%, with the lower rates applying to lower increments of income. The bill proposes to replace the top two rates with a single 30.5% rate. Since the bulk of taxable income in the corporate sector is earned by firms subject to the highest rates, most taxable corporate income would benefit from the rate reduction. Taken alone, the rate cut would reduce revenue by an estimated \$151.7 billion over five years -- over half the estimated revenue loss from the proposed corporate tax cuts combined.

A second tax cut in the proposal would make permanent a temporary increase in the "expensing" benefit for equipment investment by relatively small businesses. In addition, the bill proposes to extend for one year a set of other narrowly targeted temporary business tax benefits, most of which are scheduled to expire at the end of 2007, absent legislative action. (Note that Chairman Rangel subsequently introduced extensions of these as part of another bill, H.R. 3996.)

The proposal's revenue-raising items are more numerous than the tax cuts, but smaller in size (though some would reduce revenue by sizeable amounts). Together (and considered apart from the tax cuts), the revenue-raising items would increase business taxes by \$164.0 billion over five years. The single largest item is repeal of the 9% deduction for domestic production, which -- for income attributable to domestic production -- would generally offset 3.15 percentage points of the proposal's 4.5 percentage-point tax-rate reduction. A second sizeable revenue raiser would apply to multinational firms: it would require firms that defer U.S. taxes on foreign-source income to likewise defer deduction of costs attributable to the income. A third sizeable revenue raiser would repeal the Last-In, First-Out (LIFO) method of accounting, and taxing the resulting recognition of income over an eight-year period.

Small Business and Work Opportunity Tax Act of 2007 (P.L. 110-28)

Congress has had a long-standing interest in tax policy towards small business -- an interest that has continued in 2007, where action on small business taxation has occurred in conjunction with federal minimum wage legislation. The President and others took the position that an increase in the federal minimum wage -- an issue acted on early in 2007 -- should be coupled with consideration of tax cuts for small business. The tax cuts were viewed by their proponents as a means of offsetting the extra cost burden a higher minimum wage may place on small businesses.

Tax provisions were not included in the House-passed bill increasing the minimum wage (H.R. 2). However, on February 1, the Senate approved an amended version of H.R. 2 that included a package of tax benefits for small business and a set of revenue-raising measures designed to offset part of the revenue loss expected from the tax benefits. The House subsequently approved a tax bill (H.R. 976; approved on February 16) containing a set of small business tax benefits more modest in size than the Senate's. In mid-March, both the House and Senate folded the tax provisions into their respective versions of H.R. 1591, a supplemental appropriations bill. However, on May 1 President Bush vetoed the bill because of its Iraq-related provisions. On May 24, both the House and Senate approved a modified appropriations bill (H.R. 2206) that included the previous bill's tax provisions, the President signed the measure, and it became P.L. 110-28.

The Act's Provisions. As enacted, the Small Business and Work Opportunity Tax Act provided for tax cuts amounting to an estimated \$7.1 billion over 5 years and \$4.8 billion over 10 years. The cuts were partly offset by revenue-raising items amounting to \$7.0 billion over 5 years and \$4.4 billion over 10 years, for a net revenue gain of \$71 million over 5 years and \$55 million over 10 years --a net effect near to revenue neutrality.⁴ Taken alone, the revenue-losing and revenue-gaining measures in the conference agreement fell between the House and Senate bills, in terms of their size. The Senate version of the bill provided both for larger tax cuts and revenue offsets than did the House bill.

The act's final tax cuts were generally, though not exclusively, targeted at small business. A prominent provision was an extension of the "*expensing*" tax benefit for business investment in machines and equipment -- a tax benefit provided by Section 179 of the tax code. The provision is linked to small business because it applies only to firms undertaking less than a certain level of investment. The provision is a tax benefit in that it permits firms to deduct ("expense") in the first year of service a capped amount of investment outlays rather than requiring the outlays to be deducted gradually in the form of depreciation, as is required with most tangible assets. Permanent provisions of the Internal Revenue Code cap the expensing allowance at \$25,000 per year and begin a phase-out of the allowance when a firm's investment exceeds \$200,000.⁵ However, temporary rules initially enacted in 2003 (and extended on several occasions) increased the annual cap and threshold to \$100,000 and \$400,000, respectively. The increased amounts are indexed for inflation occurring after 2003; the amounts for 2007 are \$112,000 and \$450,000. The most recent extension was provided by TIPRA in 2006 and extended the increased allowance and threshold through 2009. P.L. 110-28 extended the increased expensing allowance and also increased the allowance to \$125,000 and the phase-out threshold to \$500,000.

Another temporary tax benefit the act addressed was the *work opportunity tax credit (WOTC)*. In general, WOTC permits employers to claim a tax credit equal to a specified percentage paid in first-year wages to members of certain targeted groups, including families receiving Temporary Assistance for Needy Families (TANF) support, qualified veterans, high-risk youth, and others. Under prior law, WOTC was scheduled to expire at the end of 2007; P.L. 110-28 extended the credit through August 2011 and made several modifications in qualification criteria for the targeted groups.

The act modified the *tax credit employers can claim against social security (FICA) taxes paid for employees who receive tips*. The modification was designed to keep the new, higher minimum wage from having the effect of reducing the credit. Under both the act and prior law, the credit is equal to the employer's FICA tax on tips in excess of those meeting the minimum wage requirement. Arithmetic thus dictates that if the minimum wage is increased and no other changes are made (and tips do not increase), the tax credit will be reduced: an increase in the minimum wage reduces the amount by which tips exceed the minimum wage.

P.L. 110-28 increased the minimum wage to \$7.25 from prior law's \$5.15 and would thus have reduced the tax credit, absent other changes. However, the act provided that the credit will continue to be calculated based on prior law's minimum wage. The act also provided that both the FICA credit and WOTC can offset a taxpayer's alternative minimum tax.

The act contained two principal revenue-raising provisions. One increased the scope of the "*kiddie tax*" -- a provision that taxes children under the age of 18 at their parents' tax rate on unearned income exceeding a certain threshold. The act increased the applicable age by one year (i.e., under age 19), or under 24, if full-time students. The second revenue-raising provision lengthens the *period after which interest and penalties are suspended* for unpaid taxes, in cases where the taxpayer has not received a notice from the IRS.

Selected Business Tax Issues

Research and Experimentation Tax Credit and Other Temporary Benefits

The tax code contains a set of relatively narrowly applicable tax benefits (the "extenders") that are temporary in nature -- they each were enacted for only fixed periods of time, and are each scheduled to expire on various dates. The benefits tend to be tax incentives: provisions designed to encourage certain types of investment or activity thought to be economically or socially desirable. As targeted tax incentives, the benefits tend to raise a similar policy question:

according to traditional economic theory, smoothly functioning markets and undistorted prices generally allocate the economy's scarce resources in the most efficient way possible. Absent market malfunctions -- failures that economists believe are more the exception than the rule -- economic theory indicates that tax benefits or penalties that interfere with the market reduce economic efficiency and reduce economic welfare. The question with each extender, then, is whether there is a market failure or socially desirable goal that makes the incentive's intervention in the market desirable.

One extender is the research and experimentation (R&E) tax credit, which was first enacted in 1981, and which has been renewed on numerous occasions. The credit provides businesses a tax benefit that is linked to the firms' increase in research outlays in the current year over a statutorily defined base period. The credit is based on economic theory's notion that free markets do not operate smoothly in the case of research and development -- that absent government support, firms would not spend as much on research as is economically efficient. (It could also be argued, however, that the amount of support provided by the R&E credit and several other extant research subsidies more than compensate for the theoretical shortfall in research.)

The R&E credit's most recent extension was provided by the Tax Relief and Health Care Act of 2006 (TRHCA; P.L. 109-432) in December 2006, and it is currently scheduled to expire at the end of 2007; the extension included an additional, alternative method that firms can use to calculate the credit, which may result in additional tax savings for firms in certain circumstances. There has been interest in the current Congress, however, in making the tax credit permanent.

The extenders in general have been a continuing issue for Congress -- in part because their temporary nature necessitates period action if they are not to expire, and in part because of the strong support for many of the benefits. Thus, while TRHCA extended many of the provisions in addition to the R&E credit, they also began to receive consideration in 2007.⁶ As noted above, an element of the Tax Reduction and Reform Act (H.R. 3970) that was introduced in October is a one-year extension of a number of expiring tax provisions, including the R&E tax credit. On October 30, Chairman Charles Rangel of the House Ways and Means introduced a bill (H.R. 3996; the Temporary Tax Relief Act) devoted only to extending expiring provisions and providing a "patch" that would reduce the individual alternative minimum tax for one year.

Energy Taxation

Democratic leaders have stated that energy taxation is an issue they intend to address in 2007. Their focus appears to be two-fold: a revenue-raising scaling-back of tax cuts for the petroleum firms that were enacted in recent years and enactment of a new set of incentives aimed at energy conservation and promotion of alternative energy sources. Those goals were addressed, in part, in an energy bill (H.R. 6) the House passed in January 2007. The bill contained both tax and non-tax provisions. Its tax measures restricted several tax benefits as they apply to oil and gas production, and provided that the resulting tax revenues were to be used to fund a reserve for energy efficiency and renewable energy.

In June, the Senate began consideration of its own, amended, version of H.R. 6, which included a wide-ranging non-tax ("policy") component. While the Senate Finance Committee approved a tax package of revenue-raising items and provisions to promote conservation and alternative energy sources, the tax plan was not added to the policy component of H.R. 6 because of opposition to its revenue-raising provisions -- especially a tax on oil and gas from the Gulf of Mexico and restrictions on leasing transactions involving foreign property.⁷

In the House, on June 20 the Ways and Means Committee approved a bill that -- unlike H.R. 6 -- was restricted to energy tax provisions (H.R. 2776). Like the Finance Committee measure, it

contains a mix of revenue raisers and tax benefits. The bill was approved by the House on August 4.

In broad outline, the Finance Committee and House bills are similar, with their conservation and alternative fuels measures partly offset by revenue-raising items. They differ, however, in the exact make-up of the respective components and in the magnitude of their revenue effects. Specifically, the Finance Committee bill contains revenue-losing items estimated to reduce revenue by a total of \$32 billion over 10 years, and revenue-raisers expected to increase revenues by the same amount, thus achieving approximate revenue neutrality on a net basis. The House bill is likewise estimated to achieve revenue neutrality, but the expected magnitude of its respective revenue raisers and revenue-losing provisions is smaller, totaling \$15 billion over 10 years in each case.

Prominent among the tax benefits in both bills is extension and modification of the tax credit for production of energy from renewable sources provided by Section 45 of the tax code, although the Finance Committee's version would result in a larger revenue loss. The remaining revenue-losing items in the two bills differ considerably.

A large revenue-raising item common to both bills is denial of the tax code's Section 199 domestic production deduction to certain oil- and gas-related income.⁸ The deduction was first enacted with the American Jobs Creation Act of 2004 (P.L. 108-357) and applies to the domestic U.S. manufacturing, extractive, and agriculture industries in general, not just to the petroleum industry. The deduction is phased in, with a rate equal to 6% of domestic production income in 2007-2009, and a permanent rate of 9% in 2010 and thereafter. The House bill would deny the deduction to all domestic production of oil and gas; the Finance Committee would deny the deduction to integrated oil companies.

On October 25, the Senate Finance Committee approved a bill (S. 2242) containing several of the energy tax provisions that were in the plan it approved in June.

Tax Shelters

An additional area in which Congress may look for tax revenues is corporate "tax shelters" -- phenomena that also concern policymakers because of their corrosive effect on tax equity and popular perceptions about the tax system's fairness. In popular usage, the term "tax shelter" denotes the use of tax deductions or credits produced by one activity to reduce taxes on another: the first activity "shelters" the second from tax. In economic terms, a tax shelter can be defined as a transaction (for example, an investment or sale) that reduces taxes without resulting in a reduced return or increased risk for the participant.⁹ But the term is so vague and general in most usages that it could also be defined simply as a tax saving activity that is viewed as undesirable by the observer using the term. Under most definitions, tax shelters can be either illegal and constitute "tax evasion" or legal, comprising "tax avoidance."

Congress has evinced considerable interest in tax shelters in recent years, and has enacted some restrictions into law. The American Jobs Creation Act of 2004 (AJCA; P.L. 108-357) contained a number of provisions designed to restrict tax shelters. In part, the act's provisions were directed at specific tax shelters -- for example, leasing activities and the acquisition of losses for tax purposes ("built in" losses). In addition, the act included provisions -- for example, revised penalties and reporting requirements -- designed to restrict sheltering activity in general.¹⁰ In 2006, the Senate version of TIPRA contained a number of tax shelter restrictions, but the provisions were not included in the conference committee bill.

The Senate's TIPRA provisions included what the bill termed a "clarification" of the economic substance doctrine that has been followed in a number of court decisions applying to tax shelters.

Generally, the economic substance doctrine disallows tax deductions, credits, or similar benefits in the case of transactions not having economic substance. The Senate version of TIPRA would have integrated aspects of the doctrine into the tax code itself. A similar measure was contained in the Senate version of the AJCA, but was not adopted.

Several bills in the 110th Congress have included codification of the economic substance doctrine as a revenue-raising "offset" for tax cuts elsewhere in the tax code. These include S. 2242, approved by the Senate Finance Committee on October 25, and H.R. 3970, proposed by Chairman Charles Rangel of the House Ways and Means Committee, also on October 25.

International Taxation

There are some indications that Congress may look to the tax treatment of U.S. firms' foreign income in searching for additional tax revenue. In part, the focus on international taxation stems from a concern about tax benefits that are perceived to promote foreign "outsourcing" -- the movement of U.S. jobs overseas.

Economic theory is skeptical about whether tax policy towards U.S. multinationals can have a long-term impact on domestic employment, although short-term and localized impacts are certainly possible. Taxes can, however, alter the extent to which firms engage in overseas operations rather than domestic investment. Under current law, a tax benefit known as "deferral" poses an incentive for U.S. firms to invest overseas in countries with relatively low tax rates. Deferral provides its benefit by permitting U.S. firms to postpone their U.S. tax on foreign income as long as that income is reinvested abroad in foreign subsidiaries. The benefit is generally available for active business operations abroad, but the tax code's Subpart F provisions restrict deferral in the case of income from passive investment. If made, proposals to restrict deferral may consist of expansion of the range of income subject to Subpart F.

In recent years, however, the thrust of legislation has been more in the direction of expanding deferral and cutting taxes for overseas operations. For example, the American Jobs Creation Act of 2004 cut taxes on overseas operations in several ways, while in 2006, TIPRA restricted Subpart F in the case of banking and related businesses receiving "active financing" income and in the case of the "look through" treatment overseas operations receive from subsidiary firms.¹¹ (See also the discussion of TIPRA, below.) Further, several analysts have recently argued that attempts to tax overseas operations are either counterproductive or outmoded in the modern integrated world economy.¹² Traditional economic analysis, however, suggests that overseas investment that is taxed at a lower or higher rate than domestic income impairs economic efficiency.

Business Tax Legislation and Issues, 2001-2006

The major tax cuts enacted in 2001 and 2003 with the Economic Growth and Tax Relief Reconciliation Act (EGTRRA; P.L. 107-16) and the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA; P.L. 108-27), respectively, focused more on individual income taxes than corporate taxes, and included measures such as reductions in statutory tax rates, tax cuts for married couples, and expansion of the child tax credit. JGTRRA, however, contained a number of tax cuts aimed at businesses, as did legislation enacted in 2002, 2004, and 2006.

The most prominent business tax cuts can be summarized as follows: temporary "bonus" depreciation provisions (now expired) designed to spur investment spending; capital gains and dividend reductions, intended (in part) to increase capital formation and the flow of savings to the corporate sector; extension of a set of narrowly-applicable temporary tax benefits (the "extenders") that were addressed by several acts; and provisions enacted in 2004 designed to

boost U.S. manufacturing and competitiveness (the domestic production deduction and foreign tax credit provisions).

The policy questions the business tax legislation raised -- again, in broadest terms -- were as follows:

- What would be the impact of the investment incentives on the economy's capital stock? Does the reduced tax burden increase the supply of capital and saving, thus increasing long-run growth? Or, is the economy's supply of capital relatively fixed, meaning the investment incentives simply interfere with the efficient allocation of investment?
- Were the enacted business tax cuts effective in stimulating the economy in the short run, thus aiding recovery from the 2001 recession? Or, do planning lags and other factors make business tax cuts ineffective as a fiscal stimulus, meaning the relation between the business tax cuts and economic recovery was serendipitous?
- What was the effect of the business tax cuts on the overall fairness of the tax system? Did the reductions accrue primarily to relatively high-income stockholders and corporate creditors, or were any reductions on tax progressivity outweighed by positive employment effects?
- How did the business tax cuts affect U.S. economic competitiveness? Have provisions such as the domestic production deduction helped revitalize domestic manufacturing, or do the deduction and other competitiveness provisions interfere with the efficient and flexible participation of U.S. businesses in the world economy?

Enacted Legislation

The Job Creation and Worker Assistance Act of 2002 (JCWA; P.L. 107-147) contained temporary "bonus" depreciation provisions that permitted firms to deduct an additional 30% of the cost of property in its first year of service rather than requiring that portion to be depreciated over a period of years. The provision generally applied to machines and equipment (but not structures) and was limited to property placed in service after September 11, 2001, and before January 1, 2005. JCWA also temporarily extended the net operating loss "carryback" period (the years in the past from whose income a firm can deduct losses) to five years from two years. The provision only applied to losses in 2001 and 2002. JCWA also temporarily extended a set of expiring tax benefits (the "extenders" discussed above), many of which applied to business taxes.

While a principal thrust of the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA; P.L. 108-27) was accelerating the effective date of individual income tax cuts enacted in 2001, the act also contained a number of business provisions. JGTRRA's tax cuts for dividends and capital gains applied to individual income taxes but nonetheless reduced the tax burden on stockholders' corporate-source income. Under the U.S. classical method of business taxation, corporate source income is taxed twice: once under the corporate income tax and once under the individual income tax -- an instance of double-taxation that is thought by economists to inefficiently restrict the flow of capital to the corporate sector. JGTRRA's reductions were an incremental step in the direction of removing the double-taxation -- a reform economists term tax "integration." The reductions were temporary, and were scheduled to expire at the end of 2008.

In addition to its capital gains and dividend reduction, JGTRRA increased bonus depreciation to 50% and extended its coverage to the period between May 5, 2003, and January 1, 2005. JGTRRA also temporarily (for 2003, 2004, and 2005) increased the "expensing" allowance for small-business investment from \$25,000 to \$100,000.

The American Jobs Creation Act of 2004 (AJCA; P.L. 108-357) grew out of legislation designed to end a dispute between the European Union (EU) and the United States over a U.S. tax benefit for exporting (the extraterritorial or ETI provisions) that had been determined to contravene the World Trade Organization agreements' prohibition on export subsidies. The EU objected to the ETI benefit, and imposed countervailing tariffs authorized by the WTO. AJCA repealed ETI, but also enacted a set of new WTO-legal business tax cuts designed, in part, to offset the impact of ETI's repeal on domestic businesses. However, the scope of AJCA substantially transcended ETI and its offsets, and the act was, in its final form, an omnibus business tax bill.

Aside from ETI's repeal, AJCA's most prominent provisions were a new domestic production deduction equal to 9% of income from domestic (but not foreign) production, and a set of tax cuts for multinational firms, including more generous foreign tax credit rules governing interest expense. AJCA also temporarily extended the \$100,000 small business expensing allowance (through 2007).

The Tax Increase Prevention and Reconciliation Act of 2006 (TIPRA; P.L. 109-222) extended JGTRRA's reduced rates for dividends and capital gains for two years, through 2010. TIPRA also extended JGTRRA's \$100,000 small-business expensing-allowance for two years, through 2009.

The Tax Relief and Health Care Act of 2006 (TRHCA; P.L. 109-432) was passed in the post-election session of the 109th Congress. Many of the extenders had expired at the end of 2005, and TRHCA extended them, generally for two years (through 2007).

¹ U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2008-2017* (Washington: GPO, 2007), p. 81. Available at the CBO website, at [\[http://www.cbo.gov/publications/bysubject.cfm?cat=0\]](http://www.cbo.gov/publications/bysubject.cfm?cat=0).

² *Ibid.*, p. 1.

³ U.S. Congress, House, Committee on Ways and Means, *Estimated Revenue Effects of Proposals Contained in The Tax Reduction and Reform Act of 2007*, (Washington, Oct. 25, 2007). Published in the BNA *TaxCore* service, Oct. 26, 2007.

⁴ Revenue estimates are by the Joint Committee on Taxation, and are taken from U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of Revenue Provisions Contained in the Conference Agreement for H.R. 1591*, JCX-25-07, Apr. 24, 2007. Available at the committee's website, at [\[http://www.house.gov/jct/pubs07.html\]](http://www.house.gov/jct/pubs07.html).

⁵ The cap is reduced on a dollar-for-dollar basis by each dollar of investment exceeding \$200,000. Thus, firms undertaking investment in excess of \$225,000 cannot claim the allowance under the permanent rules.

⁶ For a list of extenders addressed by TRHCA, see CRS Report RL33768, *Major Tax Issues in the 110th Congress*, by David L. Brumbaugh.

⁷ Heather M. Rothman, "Senate Energy Tax Package Could Be Doomed in House," *BNA Daily Tax Report*, June 26, 2007, p. G-1.

⁸ Wesley Elmore, "Democrats Outline Early Agenda for 110th Congress," *Tax Notes*, Jan. 8, 2007; Kurt Ritterpusch, "Early Components in Democrats' Oil Industry Rollback Plan Firm Up," *BNA Daily Tax Report*, Jan. 5, 2006.

⁹ These definitions are taken from Joseph J. Cordes and Harvey Galper, "Tax Shelter Activity: Lessons from Twenty Years of Evidence," *National Tax Journal*, vol. 38, September, 1985, pp. 305, 307.

¹⁰ For a list and description, see CRS Report RL32193, *Anti-Tax-Shelter and Other Revenue-Raising Tax Proposals Considered in the 108th Congress*, by Jane G. Gravelle.

¹¹ "Lookthrough" rules generally apply the same treatment of particular items of income in the hands of the recipient as in the hands of a payor. Thus, for example, a dividend paid to a parent out of active business income of a subsidiary would remain active business income in the hands of the parent rather than dividend income (i.e., passive investment income).

¹² Mihir A. Desai and James R. Hines, Jr., "Old Rules and New Realities: Corporate Tax Policy in a Global Setting," *National Tax Journal*, vol. 57, December 2004, pp. 937-960. For a critique of Desai and Hines, see Harry Grubert, "Comment on Desai and Hines, 'Old Rules and New Realities: Corporate Tax Policy in a Global Setting,'" *National Tax Journal*, vol. 58, June 2005, pp. 263-278.