

Will Democratic Majority Impact Tax Policy?

Tax and finance executives at Fortune 100 companies and U.S.-based multinationals believe the change in control in Congress will have a significant impact on tax policy for business in specific industries, according to a comprehensive new survey.

The “Tax Policy Forecast Survey” released last month by Miller & Chevalier Chartered (www.millerchevalier.com), a Washington, D.C. law firm, surveyed executives on the impact of the Democratic-controlled Congress on tax policy, likely revenue sources and IRS scrutiny of business tax returns.

Impact on Tax Policy

Although survey respondents do not think that broad-based tax reform is imminent, 68 percent believe tax policy for business will be significantly impacted with the Democratic majority. Within that group of respondents, 83 percent believe that impact will be unfavorable to domestic business, and 90 percent think it will be unfavorable to international business, according to Miller & Chevalier.

Perceptions of whether the change in control will significantly impact tax policy varies by industry—with 55 percent of executives in the manufacturing and restaurant and retail industries agreeing with that statement, compared to 70 percent of oil and gas companies and 78 percent of financial services organizations.

“We know Congress is looking for ways to fund new tax priorities, such as providing alternative minimum tax relief,” said Greg Mastel, former Chief Economist on the Senate Finance Committee and Chair of Miller & Chevalier’s Government Affairs Department. “While there

remains uncertainty about the Congressional tax agenda, respondents to our survey told us they are keeping a close eye on a number of individual policy decisions that impact their industries.”

“While businesses believe new revenue raisers are likely on the horizon, they may not yet understand the scope of the measures being contemplated,” added Phillip Mann, former Tax Legislative Counsel at the U.S. Treasury Department and a past chair of the American Bar Association Section of Taxation. “For example, many companies think ‘we don’t engage in tax shelters so we’ll be fine,’ when in fact a number of pending tax policy proposals could significantly impact the day-to-day operations of a broad range of businesses.”

Impact on Individual Businesses

The survey found that slightly more than half—56 percent—of survey respondents think the change in control will have a significant impact on their own businesses, but again, certain industries are more concerned than others. For example, only 42 percent of manufacturers are concerned about the impact on their business, compared to 80 percent of oil and gas companies and 79 percent of those in the financial services industry.

“While respondents do not seem to be concerned about broad-based tax reform, they are worried that Congress will enact proposals targeted at specific industries,” Miller & Chevalier wrote in the executive summary of its survey.

Revenue Sources

Revenue-raising provisions in proposed legislation have survey respondents worried about

the impact of tax policy changes on both domestic and international businesses.

An overwhelming majority—84 percent—of respondents believe that the Democratic-controlled Congress will impact international businesses unfavorably, according to Miller & Chevalier. Sixty-two percent expect international operations to take a bigger tax hit, as lawmakers look for revenue raisers.

With the adoption of pay-as-you-go (PAYGO) budget rules in the 100th Congress, executives are concerned “that the House Ways and Means and the Senate Finance Committees will look towards revenue raisers that will have a significant impact on corporate taxpayers,” Miller & Chevalier wrote.

“While they accept the fact that revenue offsets will be required in a PAYGO environment, they have not yet determined which revenue raisers are likely to affect their organizations in particular and, thus, are not very far along in deciding what their response will be to the process,” the firm wrote.

Table 1 outlines the business tax revenue sources that executives believe Congress will tap to offset the costs of providing alternative minimum tax (AMT) relief for individual taxpayers, as well as which revenue sources would have the greatest negative impact on their own businesses.

The top three revenue sources expected to be tapped follow:

1. Codification of the economic substance doctrine, which, in general, stipulates that a transaction must have a meaningful economic purpose or investor risk in order to be considered legitimate (65.38 percent)
2. Increased taxes for international operations (61.54 percent)
3. Reduction in the domestic manufacturing deduction under

Internal Revenue Code Section (“Code Sec.”) 199 (36.92 percent)

There is less universal agreement on which potential revenue sources would have the greatest negative impact on their business. The top three responses follow:

1. Increased taxes for international operations (27.69 percent)
2. Reduction in the domestic manufacturing deduction under section 199 (20.77 percent)
3. Reduction of interest, rent, or royalty deductions (20 percent)

IRS Scrutiny

A majority of executives believe that Congress will push for greater IRS scrutiny of business tax returns in each of the following areas:

- International business operations (86.15 percent)
- Financial instruments and transactions (76.92 percent)
- Joint ventures and partnerships (63.08 percent)
- Executive compensation (92.31 percent)

Business Response

Miller & Chevalier also asked executives what response, if any, they were planning given the change in Congressional control. The survey revealed that 81 percent of respondents were definitely, or at least considering, planning to lobby tax issues.

The survey also found that about 46 percent of respondents don’t plan to alter their tax strat-

egy at this time, compared to about 25 percent who do have such plans, and 28 percent who are unsure.

Given the change in Congressional control, PAYGO, and revenue offset proposals already circulating, “there really is going to be an emphasis on finding revenue offsets” in the 110th Congress, according to Marc Gerson, the Miller & Chevalier member who led the forecast survey.

He urges businesses to “be proactive and strategic and engage with Congress” so that Congress understands the impact of proposed revenue offsets. “Folks really need to get in there and engage with Congress.”

While some companies have tax advisors, lobbyists, or their own representatives in Washington, D.C., other companies can become more involved in the process by tapping information through trade associations and by contacting their senators and representatives directly, he says.

Gerson recently joined Miller & Chevalier after serving as Majority Tax Counsel for the House Ways and Means Committee in the 109th Congress. He says Congress is open to hearing from taxpayers about their concerns. When he worked on Capitol Hill, Congressional leaders reviewing a proposal often asked, “Who is affected by it, and have we heard from them?” ■

Table 1. Expected Revenue Raisers

| Revenue source | % of executives expecting this source to be tapped to pay for AMT relief | % expecting this source to have the greatest effect on their business |
|--|--|---|
| Elimination or reduction of LIFO inventory benefits | 25.38% | 11.54% |
| Reduction in the domestic manufacturing deduction under Sec. 199 | 36.92% | 20.77% |
| Increase in taxation of international operations (e.g., reduction in foreign tax credits, end deferral, or transfer pricing changes) | 61.54% | 27.69% |
| Reduction of interest, rent, or royalty deductions | 10.77% | 20.00% |
| Codification of the economic substance doctrine | 65.38% | 9.23% |
| Other | 8.46% | 6.92% |

Source: Tax Policy Forecast Survey, February 2007, Miller & Chevalier