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REMARKS OF SECRETARY JACOB J. LEW AT THE BROOKINGS INSTITUTION

As prepared for delivery

WASHINGTON - Let me thank everyone for being here today. The Brookings Institution has long been at the center of important public policy discussions and a source of innovative solutions to help create jobs and grow the economy. It is a pleasure to be with you this morning.

Last night in the State of the Union, the President put forward a series of proposals to keep America's resurgent economy 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 the President laid out includes strategies to make it easier for families to buy a home; for students to 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; for businesses and consumers to defend themselves against cyber attacks; and, for states and cities to rebuild their infrastructure and expand their broadband networks.

In last night's address, the President also made it clear that we need to knock down barriers on things like paying for child care, saving for college, and building a secure retirement so that the middle class can get ahead even as we revamp our business tax system so that businesses of all size can compete in today's global economy, making our nation a more attractive place for companies to locate, grow, and create the kind of high paying jobs that support families.
Just prior to the State of the Union, the President outlined a key part of his vision to raise wages and incomes, and strengthen the standing of working families. It includes a new strategy to simplify our complex tax code, make it fairer by eliminating some of the biggest loopholes, and uses the savings to responsibly pay for the investments we need to help middle class families get ahead and grow the economy.

Today, I want to spend some time discussing America's business tax system, and why we need to fix it to promote long-term growth and broad-based prosperity. Let me say at the outset that our entire federal tax code needs to be overhauled. It has been almost 30 years since we last rewrote it, and since then, the tax system has become heavily burdened by loopholes and inefficiencies. I was proud to be involved in the negotiations on Capitol Hill that resulted in the last major reforms to our tax system in 1986, when we demonstrated that working together across party lines to do hard things is good for our country. While our views on individual tax reform may be far apart, there is a broad set of business tax reforms on which we should be able to agree. I continue to believe that 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 will also be one-time revenue during the transition — and we can use some of that to create jobs rebuilding our roads, repairing our tunnels, and renovating our airports. The fact is, there is a growing bipartisan consensus in Washington on how to achieve business tax reform, and we have a unique opportunity <u>now</u> to get this done.

Before turning to business tax reform, I want to talk about the strengthening economic recovery. Over the past 5 years, our private sector has created more than 11 million jobs. That is the longest streak of private-sector job growth in our nation's history. Last year alone, American businesses created nearly 3 million jobs — more private-sector jobs than any calendar year since 1997, and in the month of December, the private sector added 240,000 new jobs. The unemployment rate is now 5.6 percent, the lowest rate in six and a half years.

At the same time, GDP posted strong gains in the second and third quarters last year, and many private forecasters project above-trend economic growth to continue. Just this week, the International Monetary Fund revised its 2015 economic outlook, and revised its projection for the United States upwards while lowering its forecasts for most other countries. Our overall growth has been supported by increases in household wealth, a gradually improving housing market, a growing manufacturing sector, and a flourishing auto industry.

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. Thanks to Wall Street reform, consumers have a watchdog in place while our financial system is stronger and more resilient, and now key agencies responsible for putting in place financial reform have increased funding to do their important work. In conjunction with the President's all-of-the-above energy strategy, we are safely developing American-made energy, and we are now the world's leading producer of petroleum and natural gas. Finally, because of the economic expansion and the tough choices we have made in recent years, the federal government's financial condition is significantly improved and our budget deficit has been cut by two-thirds.

As I travel to other countries advocating for American workers and businesses, my counterparts often remark at how much better the United States has recovered, and they try to learn from the steps we have taken to turn around the U.S. economy. It is important to remember that this recovery is not an accident but rather the result of the determination of the American people, the resilience of our businesses, and policy choices made by President Obama, the prior administration, Congress, and the Federal Reserve.

Despite this unmistakable progress, there is more work to do to make sure that we sustain our economic growth and that prosperity is more broadly shared. As part of that effort, the President is putting forward business tax reform to help fuel economic growth, encourage businesses to create good, high-paying jobs in America, and expand opportunity so our nation's economic gains build a strong middle class. 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, and this year, this is an area where members of both parties and the Administration can work together to make progress for the American people.

On paper, we have one of the highest corporate income tax rates in the world, but in practice, there is a wide disparity in effective corporate tax rates. Some corporations pay little or no income tax at all, while others pay the highest rate in the developed world. Even worse, our tax system allows American companies to shift profits overseas to avoid paying U.S. taxes, and actually drives businesses to look for ways to move jobs and their tax home, at least on paper, out of the United States to countries with lower tax rates. Over time, our tax code has become increasingly loaded down with special interest loopholes, deductions, and assorted tax subsidies. Some were good ideas whose time has now passed; others were special-interest giveaways from the beginning. The end result is a system rife with industry-specific tax breaks and widely disparate effective tax rates from one sector to the next, often providing incentives that do not reflect what our economy needs today. For instance, oil and gas producers are rewarded with a number of special-interest tax breaks that unfairly reduce the taxes of oil companies far below what other industries, like retail and manufacturing, pay on *their* earnings.

Yet, even with all these loopholes, the current tax system makes it too hard for businesses to launch, grow, and invest in the United States. It is too hard for businesses to create the middle-class jobs our country needs. And it is too hard for U.S. businesses to compete with companies headquartered overseas.

Moreover, our business tax system is far too complicated — particularly for small businesses. One estimate suggests that a small business, on average, devotes hundreds of hours plus spends thousands of dollars, to comply with the tax code. We can and must reduce this burden.

Our business tax system actually skews business decisions in ways that make it harder for the economy to grow. Too many investment decisions are shaped by tax considerations when they should be driven by what will best enhance productivity and growth. Our tax code should favor the best businesses that create the most economic value — not those that are best at taking advantage of tax deductions.

The choice between debt accumulation or reduction, between investments in real estate or manufacturing should not be driven by tax planning; and when it is, it hurts economic growth and America's working families. When our system rewards businesses for having the best lobbyist or most creative accountant, it shifts resources away from the core mission of growing the economy and creating jobs. For example, the tax system has become so distorted that in some tax haven countries, American multinational corporations report foreign profits that are several times larger than the entire economic output of those nations. This does not reflect the reality of the economic situation and it erodes both our tax base and confidence in the fairness of our tax system.

Last year, we saw how our broken tax system drives businesses to engage in highly unpopular transactions to get out of paying taxes. We saw a spike in the number of companies pursuing corporate inversions, and we saw the public outrage that followed.

An inversion takes place when a U.S. company buys a foreign company and declares it is no longer an American-based business. For many firms, these deals are little more than a tax-avoidance scheme because renouncing U.S. citizenship allows them to lower their tax bills. I have consistently said that while inversions may be legal, they are wrong. But unfortunately, we have a tax code that encourages these decisions. And we need to fix the tax code so companies will have neither the incentive nor the ability to invert simply to avoid taxes.

To be clear, cross-border mergers done for genuine business reasons make companies more efficient and productive. In a global economy, we are better off when businesses are free to invest across borders, and we benefit greatly from foreign companies choosing the United States as a destination for investment.

But it is a very different case when mergers with foreign companies are really tax avoidance plans. The United States is still the best place for so many companies to do business — our rule of law, our intellectual property rights, our innovative and entrepreneurial culture, and skilled workforce are unparalleled. Many companies that invert want to take advantage of U.S. infrastructure, education, and rule of law, but avoid paying their fair share of taxes — which only shifts the tax burden to others. This damages our country's finances and is not fair, because small businesses and middle-class families end up paying more of the tax bills.

That is why the administration acted in September to help level the playing field and make sure everybody plays by the same rules. We made it harder for companies to complete an inversion if they keep most of their business in the United States and eliminated certain techniques inverted companies use to avoid paying U.S. taxes. These measures are making a difference. They stripped away some of the economic benefit of inversions, and since they were announced, we have seen a decline in the pace of these transactions, and some deals were abandoned entirely.

While our action was important and it helped, it is not a complete solution. It is a short term response to one symptom of a dysfunctional tax system. The real answer is business tax reform that addresses the root causes of this problem, eliminates this loophole for good, and closes the door on other wasteful and inefficient loopholes that make our tax system unfair, uncompetitive, and overly complicated. And this can only be done through legislation.

The President's plan meets this test; it is carefully constructed, and provides the basis for winning bipartisan support. To that end, I look forward to continuing conversations with Senators Hatch and Wyden and Representatives Ryan and Levin to make progress on reform. There is a great deal of overlap between the President's framework and recent Republican proposals, including the one advanced by the former chairman of the Ways and Means Committee, former Representative David Camp.

And like that plan, the President's proposal would use temporary revenue created by tax reform to rebuild our nation's roads, bridges, pipes, and ports. We know from past experience that switching to a new tax system will generate one-time transition revenues. The President's plan would use a portion of this temporary revenue to pay for long delayed one-time investments to upgrade our infrastructure, helping to address the funding gap we face to meet our long-term transportation, water, and electricity needs. And it will create good manufacturing and construction jobs and local economic activity right away. Rebuilding America's core infrastructure will have the long-term benefit of making America a more attractive place to invest and do business so that our economy is stronger for the future.

If we fail to meet our nation's infrastructure needs, we will pay a heavy price. Fewer jobs both now and in the future; a reduction in quality of life from long commute times, water main breaks, pollution, and power outages. And a rise in prices for goods and services that will damage small businesses and take a bite out of the salaries of middle class workers.

And we need to be very careful with how we use one-time revenues. We must not blow a hole in the budget by using one-time revenues to finance permanent spending on new items or to provide permanent tax cuts. Instead, we should use these one-time revenues to make responsible, one-time investments in our nation's infrastructure.

Let me now turn to the specific components of the President's framework for reform. The President's proposal for a new business tax system has five pillars that represent an attempt to chart a bipartisan path forward.

First, we need to lower rates and close wasteful loopholes. This will make our business tax system competitive, fundamentally fair, and fiscally responsible. The President's plan eliminates dozens of tax breaks and loopholes, and without adding to our deficits, reduces the current top corporate tax rate from 35 percent to 28 percent. This rate is in line with our trading partners, and it will help encourage investment in the United States. As we broaden the tax base, we can also create more certainty and make the system simpler and more efficient. And, we believe there is bipartisan support to move forward on this.

Second, we need to build on the resurgence of manufacturing in the United States. A vibrant U.S. manufacturing sector is fundamental to our capacity to remain innovative and competitive, and it is an important source of good-paying jobs for America's workers. That is why the President's plan makes it even more attractive for manufacturers to build and expand here rather than overseas. It lowers tax rates for domestic manufacturing to 25 percent. And it takes manufacturing incentives — including the Research and Experimentation Tax Credit — and makes them permanent. The Research and Experimentation Tax Credit jumpstarts private investment in research and technology, and it propels innovations that spark new jobs, new industries, and new breakthroughs in engineering and production. And this is another area of broad bipartisan support.

Third, Democrats and Republicans alike want to fix our backward international tax rules and root out the parts of the system that encourage companies to shift income and investment overseas. The international tax system is often looked at in terms of either what is known as a territorial system, in which a company located in a particular country only pays taxes on income earned in that country, or a system like that of the United States, in which that company must pay tax on worldwide income, regardless of the country where it is earned. The President's proposal strikes a sensible balance, and would move us towards a more hybrid system. What that means is we would create a new minimum tax on foreign earnings and make it simpler for a business to bring income back to the United States. It would also tighten the rules so that companies cannot use accounting techniques to avoid paying taxes, such as shifting profits to low-tax countries. Moreover, the President's strategy eliminates tax deductions that reward companies when they shut down operations in the United States and relocate abroad, and it provides tax breaks for companies that bring production back to the United States. With these changes in place, we can help encourage investment in the United States. The hybrid structure we propose has also been adopted by some Republican tax proposals, and again, should be an area where we can find bipartisan consensus.

Fourth, we all want to simplify and reduce taxes for small businesses — our nation's mom-and-pop stores, start-ups, high-growth firms, and entrepreneurs. The truth is, small businesses are a vital source of innovation, jobs, and growth. Small businesses embody the American principle that if you work hard and act responsibly, you can succeed. These are the businesses that we rely on to provide community stability, but they are also the ones that take the risks that lead to new technologies and new industries.

A few facts tell the whole story. Small businesses employ half of our nation's workforce, and generate almost half of the nation's GDP. That is why making sure small businesses can flourish has been central to our economic strategy. Since the President came into office, we have extended new tax benefits to small business, supported lending to tens of thousands of small businesses, and reformed our patent laws so inventions can get to the market sooner.

While these steps have helped, we need to do more to strengthen small businesses and give them confidence to pursue long-term investments and hire for the future. The President's business tax reform plan does that by making tax filing easier for small firms and entrepreneurs and by allowing many more to use the cash method of accounting, which is the same common sense way most think about their own profitability. In addition, the President's plan would allow a small business to annually expense up to $1 million in investments. These permanent changes would free small business owners and entrepreneurs to direct more of their earnings toward expanding and hiring and less to complying with a complicated tax code. And by giving small business owners certainty on their taxes, it will free them to plan ahead to innovate and invest.

Finally, we want to fix our broken tax code and increase investment in a way that maintains current revenues. In other words, reform should be revenue-neutral in the short and long-run. We have come a long way, and our federal budget deficits have been falling rapidly. Independent forecasters project that over the 10-year budget window, and under the President's policies, our deficits will remain at a sustainable level relative to GDP. But we can only afford to cut business tax rates substantially if we eliminate loopholes and use these savings to avoid an explosion of future deficits. Lower rates have to be paired with eliminating loopholes and deductions. And any business tax break that is made permanent — including so-called extenders that are currently reauthorized year after year — should be paid for with revenue offsets that will also be there in the future.

Keep in mind loopholes, credits, and subsidies are forms of tax expenditures. They are spending that is done through the tax code, and because they represent lost tax revenue, we all help foot the bill for these expenditures. Of course, there are tax expenditures that make sense and that need to be protected — like the New Markets Tax Credit, expensing for small businesses, and the Research and Experimentation Tax Credit. But these tax incentives cost money and need to be paid for to maintain adequate revenue levels. And we cannot apply a double standard, as some have proposed, where we permanently extend business provisions without paying for them, without permanently extending critical improvements to the EITC, child tax credit, and college credits that help working families at the same time.

Since Congress reconvened a few weeks ago, the House of Representatives changed the way the costs of some legislation will be calculated, directing scorekeepers to use what is known as dynamic scoring. We think this is unwise given the uncertainty involved in dynamic scoring, the assumptions that have to be made, and the unequal treatment of tax cuts versus pro-growth investments funded through appropriations. While there may be different opinions on how to estimate the effects of legislation, no matter what barometer you use, in the end, nobody should want to blow a hole in our budget. We have to act responsibly and look at the costs of tax breaks and loopholes with a clear eye, and make sure legislation can meet the first test of being fiscally responsible.

Finally, we will need to hear the voices that support broadening the base to lower rates. Many — especially those in the business community — express interest in business tax reform and say they are for cutting loopholes and subsidies until they realize that a deduction or write-off they like has to be pared back. And we also know that many who will lose loopholes and tax breaks will fight hard for the status quo. It is important that we also hear from everyone else who agrees that a simpler tax code without loopholes and more competitive rates will help drive economic growth and job creation. The fact is, achieving a simpler, more sensible system that better harnesses the talent and skills of all Americans is going to require change and some sacrifice. The benefits of reform, though, will be shared broadly through greater job growth and economic activity.

Let me close by saying the message from the American people over the last few weeks and months has been clear. They want their leaders in Washington to find common ground, to compromise, and to get things done. And I believe that message has been received. The Murray –Ryan agreement created a framework that showed we can work through differences to find a path forward and the appropriations committees implemented this agreement with the spending bill that passed at the end of December. It was a sweeping piece of bipartisan legislation that contained many provisions and covered a lot of territory. Ultimately, no one got everything they wanted, and it was hard for both sides. But in the end, we reached an agreement that met our obligations, avoided an unnecessary self-inflicted wound, funded some key priorities and provided certainty that the government would run through the end of the fiscal year.

Looking ahead, we can build on this momentum and pass bipartisan business tax reform so that our economy is one where innovation and ingenuity thrive, where hard work and determination pay off, and where the opportunity to succeed is available to everyone. And I am confident that as long as we keep our focus on doing what is right for our economy and our nation, we will get this done.

Thank you.