

TTC/EY Tax Reform Business Barometer:

Views on the prospects for federal tax reform and
key tax reform issues

October 2013



The Tax Council (TTC)/Ernst & Young LLP (EY) Tax Reform Business Barometer assesses business tax professionals' current views on the prospects and key aspects of federal tax reform. The barometer measures the expected likelihood of the different stages and key elements of federal tax reform. The initial barometer reading was from September 2013; this barometer tracks the views reported during the period September 30 to October 8, 2013.

Key results:

- ▶ Despite concerns over the federal government shutdown and the debt limit, business tax professionals put the median¹ likelihood of some progress on federal tax reform at 70% for a detailed tax reform plan to be released by the Chairman of the US House of Representatives Committee on Ways and Means this year. Respondents had a median expectation of 35% that the Senate Finance Committee Chairman will put forward a tax reform plan.
 - ▶ These median likelihoods are lower than last month's barometer, 80% and 50%, respectively, reflecting not only the uncertainties associated with the current budget impasse, but also the reduced time available this calendar year.
- ▶ The median respondent had a three-in-ten expectation that the House Ways and Means Committee will pass tax reform legislation by the end of this year. The median respondent had a one-in-twenty expectation that the Senate Committee on Finance would pass tax reform legislation this year.
- ▶ The business tax professionals had a median expectation of 20% in early October that federal tax reform will be enacted by the end of 2014, down slightly from 23% in September.
- ▶ Seventy-three percent of respondents ranked the revenue-neutrality vs. revenue-raising issue as the biggest or second biggest hurdle to federal tax reform, followed by reluctance to reduce major individual tax expenditures (52%).
 - ▶ Those percentages declined from last month, while the percentage citing the "Remaining time in CY2014 given other legislative priorities" rose from 18% to 27%.
- ▶ Forty-two percent of the respondents said federal tax reform would definitely or likely help their organization, while 28% said it would definitely or likely hurt their organization. The others said it would not cause a significant change (14%) or were unsure (16%).

The TTC/EY Tax Reform Business Barometer defines tax reform as legislation that substantially broadens the tax base or changes the tax rate for either corporate or individual taxpayers.

The barometer is a monthly survey completed by approximately 100 leading US tax executives and practitioners that tracks trends in the views of business tax professionals while tax reform is debated and developed in the US Congress. The survey results are based on an online survey conducted by EY's Quantitative Economics and Statistics practice.

Important milestones and elements of tax reform

There is a strong desire among policymakers, the business community and the public for a tax system that is simpler, more conducive to economic growth, and fairer. The chairmen of the House and Senate tax-writing committees have expressed their goal of achieving tax reform by 2014 and have held numerous hearings and solicited feedback in a variety of ways on key elements of tax reform over the past several years. President Obama has called for federal tax reform in his FY14 budget and described key elements in the Administration's Framework for Business Tax Reform, released in February 2012. Whether Congress and the President can achieve federal tax

¹ The median represents the expectation where half of the respondents expect this likelihood or higher likelihood, and half expect this likelihood or lower.

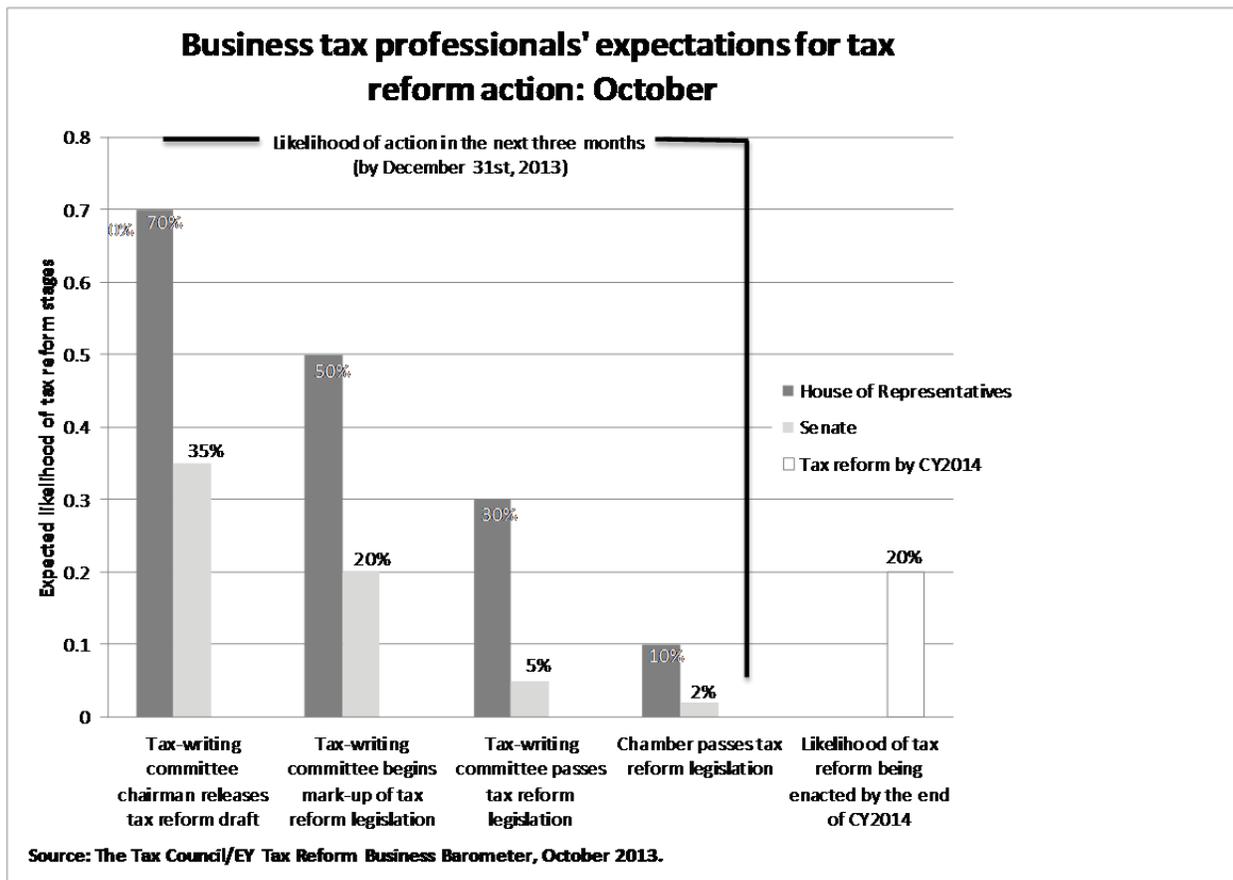
reform, as well as what type of tax reform will be included, however, are major questions facing the business community.

Federal tax reform will need to work its way through the legislative process with the release of detailed tax plans, movement of legislation through the House Ways and Means Committee, to the House of Representatives, to the Senate Finance Committee, to the Senate, and then to a Conference Committee before returning for approval by the House of Representatives and the Senate. Any final tax reform legislation will also need to be signed by the President.

Key elements of tax reform include whether it will be revenue-neutral, lose or raise revenue; whether reform will be comprehensive, affecting both individual and corporate income taxes, or limited to business taxes, the corporate income tax or only the individual income tax; and where the top individual and corporate income tax rates will be set.

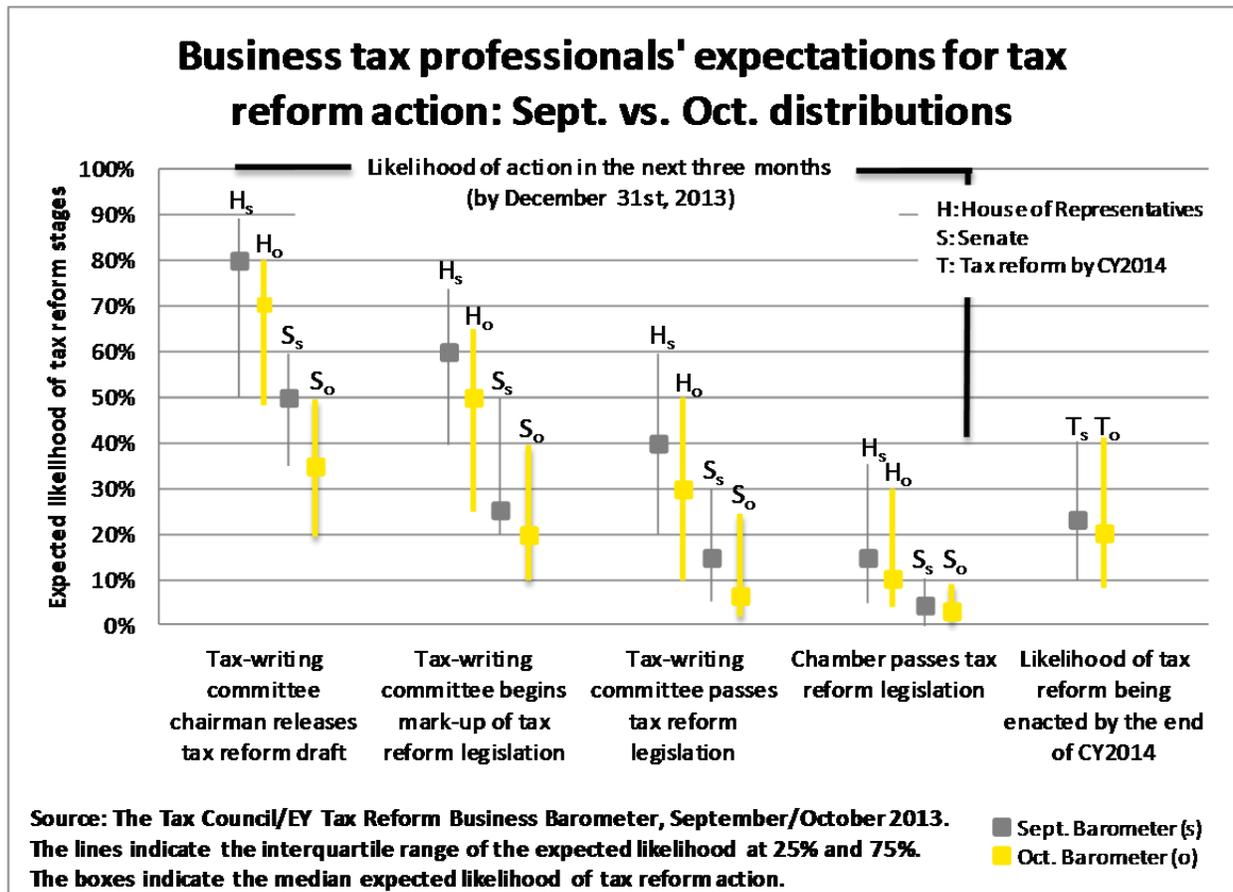
Prospects and timing of federal tax reform

Business tax professionals continue to think there is a good likelihood that the chairmen of the House and Senate tax-writing committees will put forward specific tax plans and that the House Ways and Means Committee and the Senate Finance Committee will begin a legislative mark-up of the tax reform legislation before the end of calendar year 2013. The October readings are somewhat lower than the September readings given an additional month has passed with much of the legislative space taken up with debate over a continuing resolution for the FY14 budget and the fast-approaching debt limit.



Business tax professionals also ranked the likelihood of tax reform being enacted by the end of calendar year 2014. At this early stage of the debate, the respondents put the median likelihood of federal tax reform in the next 15 months at 20%, just three percentage points lower than in September. Even if tax reform is not enacted by the end of 2014, the actions taken during the next 15 months (e.g., hearings, debates, chairmen's drafts, committee legislation, additional proposals) will influence any future tax reform.

The following figure shows the comparison between the October and September barometer readings, plus the distribution of expected outcomes between the 25th and 75th interquartile ranges. The figure shows the decline in expected prospects between September and October, plus the slightly wider range of expectations among the business tax representatives in October.



Key tax reform issues

Respondents were asked about their expectations of key features of final tax reform legislation. Those expectations could differ significantly from their objectives for federal tax reform. Some of the key findings, which did not change significantly from last month, are:

- ▶ Six-in-ten respondents continue to believe that a tax reform bill will raise revenue. Most of the others expect tax reform to be revenue-neutral.
 - ▶ Business representatives who think federal tax reform will be revenue-neutral are slightly more optimistic about the prospects of tax reform being enacted by the end of calendar year 2014 (median 25% expectation) compared to those who think tax reform will increase revenues (20%).

- ▶ Six-in-ten respondents also expect a tax reform bill to be comprehensive, including both individual and corporate tax changes. One-in-four think tax reform will be business only (which would include both corporate income, plus income on individual tax returns from pass-through), while one-in-ten expect only a corporate income tax change.
 - ▶ Respondents who think tax reform will be comprehensive (affecting households and all businesses) are more likely to think tax reform will raise revenue (71%) compared to 48% of respondents who think tax reform will be focused only on business income.
- ▶ The median expectation of the top individual tax rate in the final tax reform legislation is 35%, compared to the current 39.6%. The median expectation of the top corporate income tax rate in the final tax reform legislation is 28%, compared to the current 35% federal rate.
- ▶ The October barometer asked a new question of whether the respondents thought federal tax reform would help or hurt their organization. Eighteen percent said it would definitely help, 24% said it would likely help, 14% said it would not cause a significant change, while 20% said it would likely hurt and 8% said it would definitely hurt. Sixteen percent of the respondents were not sure of the effects without more details.
 - ▶ Business representatives who think federal tax reform will potentially be helpful to their organization are more optimistic (median 25% expectation) about the prospects of tax reform enactment by the end of calendar year 2014 than those that think tax reform will potentially be hurtful (10%).
 - ▶ Fifty-seven percent of those who think federal tax reform will potentially be helpful to their organization think tax reform will raise revenue overall. Seventy-five percent of the respondents who think tax reform will potentially be hurtful to their organization think tax reform will raise revenue.
- ▶ When asked which provision or aspect of the current federal tax system is most complex and burdensome, the majority of respondents mentioned various aspects of the taxation of foreign-source income, including foreign tax credits, transfer pricing, Subpart F and international tax rules generally. The Alternative Minimum Tax and the complexity of calculating and documenting credits and incentives were frequently mentioned.

Hurdles for federal tax reform

The survey asked participants to rank a number of potential hurdles to federal tax reform.

The respondents viewed the issue of revenue-neutrality vs. revenue-increases as the biggest hurdle facing tax reform, with 56% ranking it as the biggest hurdle, and 73% ranking it as the first or second highest hurdle. This is down from 61% and 83%, respectively, from a month earlier.

Reluctance to reduce major individual income tax expenditures – such as the mortgage interest deduction, the exclusion for employer-sponsored health insurance, retirement savings, charitable contributions and state/local tax deductions – was ranked the second most important hurdle facing tax reform. Reducing individual tax expenditures was ranked by 13% of the respondents as the biggest hurdle, and 52% ranked it as the first or second highest hurdle. This is down from 16% and 57%, respectively, from the last barometer reading.

Prioritization of tax reform by the President was ranked by 29% of the respondents as one of the top two hurdles of federal tax reform. The remaining time in calendar year 2014, given other legislative priorities, was ranked by 27% of the respondents as one of the top two hurdles, up significantly from last month. Fourteen percent ranked reluctance to reduce the corporate tax rate without reducing the top individual income tax rate as one of the top two hurdles.

Although the five hurdles remained in the same ranking, more respondents think that the remaining time in this Congress given its other legislative priorities is becoming more important. The current debate on government funding and the debt limit has moved tax reform to the sidelines. Resolution of the budget issues might include an expedited process for tax reform.

The initial barometer survey was conducted before the Congress returned from its August recess. The October barometer was completed just as the September 30, 2013 deadline for funding the government for fiscal year 2014 expired and the federal debt limit debate began in earnest. The reduced expectations for progress on tax

reform during the remainder of this calendar year were not unexpected given the shift in Congressional focus. It is likely that the prospects for federal tax reform and the expectations of leading US tax executives and practitioners will continue to change as Congress returns and begins its fall deliberations. The barometer will gauge changes in the expectations for tax reform, including each of the milestones in the legislative process and the key elements of federal tax reform over the remainder of the 113th Congress. Stay tuned.

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