

WRITTEN STATEMENT  
SUBMITTED BY THE AFL-CIO  
TO THE HOUSE COMMITTEE ON WAYS AND MEANS

HEARING ON “TAX REFORM AND SMALL BUSINESSES: GROWING OUR ECONOMY  
AND CREATING JOBS”  
May 23, 2018

On May 23, 2018, the Ways and Means Committee held a hearing on the effect of Tax Cuts and Jobs Act (TCJA) on small business, the economy, and job creation and invited submissions of written testimony from the public.

We submit this written testimony on behalf of the AFL-CIO, a voluntary democratic federation of 55 national and international labor unions representing 12.5 million working men and women.

We believe the TCJA will not help small business, grow our economy, or create jobs, but will instead have the opposite effects.

The TCJA will have harmful effects on small businesses, the economy, and jobs because (1) it creates a tax incentive for large corporations to locate production offshore; (2) it increases health care premiums for owners and employees of small businesses and other individuals in the non-group health insurance market; (3) it significantly reduces federal tax revenues, which will be used as an argument for budget cuts that harm working people and weaken the foundations for long-term economic growth and shared prosperity; and (4) its poorly designed pass-through provisions add more complexity and confusion to the tax code, while benefiting millionaires rather than Mom and Pop small businesses.

The TCJA fails to live up to the claims made by its supporters. Rather than fueling a boom in business investment or wage increases for working people, the TCJA’s corporate income tax cuts have led primarily to stock buybacks that boost stock prices and CEO pay.

Finally, the TCJA represents a missed opportunity for much-needed tax reform that (1) eliminates the tax incentive for outsourcing jobs; (2) stanches the loss of U.S. corporate tax revenue through the shifting of domestic profits offshore; and (3) generates the tax revenue we need for public investment to create and support good jobs and full employment.

## **OFFSHORING**

The TCJA adopts a “territorial” corporate tax system that largely exempts the offshore profits of U.S. multinationals from U.S. taxation, thereby encouraging the outsourcing of production to lower-tax foreign jurisdictions.

According to the Center for Budget and Policy Priorities ([CBPP](#)), “This system risks creating a large, permanent incentive for U.S. multinationals to shift overseas not just profits on paper but

actual investment as well. This could lead to a reduction in capital investment in the United States and thereby wind up reducing U.S. workers' wages."

In addition, according to the [CBPP](#), "the provisions [that the TCJA] offers to stem abuse are likely to be largely ineffective and potentially create other perverse incentives." Specifically, two provisions designed to reduce the incentive for corporations to shift high-return assets (such as intellectual property) to low-tax countries may increase the incentive to locate [tangible](#) assets offshore, according to the [Congressional Budget Office](#) (CBO). "The GILTI (tax on global intangible low-tax income) and FDII (deduction for foreign-derived intangible income) provisions affect corporations' decisions about where to locate tangible assets. By locating more tangible assets abroad, a corporation is able to reduce the amount of foreign income that is categorized as GILTI. Similarly, by locating fewer tangible assets in the United States, a corporation can increase the amount of U.S. income that can be deducted as FDII. Together, these provisions may increase corporations' incentive to locate tangible assets abroad."

According to the Institute on Taxation and Economic Policy ([ITEP](#)), the overall effect of the permanent international provisions of the TCJA, which actually lose revenue, "is that companies' offshore earnings will at most be taxed at half the rate on domestic earnings, with many companies paying nothing in U.S. taxes on these earnings."

While supporters of the TCJA claim it reverses incentives for outsourcing, these claims have not been borne out in the case of [Harley-Davidson](#). In September 2017, House Speaker Paul Ryan (R-WI) visited a Harley Davidson plant in Wisconsin to highlight the benefits of the GOP tax bill. Yet the TCJA tax windfall to Harley-Davidson—a profitable company with \$800 million to \$1 billion in pre-tax profits—appears to have provided the capital to fund a plan to outsource U.S. jobs. Following passage of the TCJA, the company announced the layoff of 800 workers at a plant in Kansas City, the opening of a new factory in Thailand, and a plan to buy back 15 million shares currently valued at \$700 million.

Harley-Davidson says the new plant in Thailand is unrelated and that it is not outsourcing jobs, but Richard Pence, a machinist at the Kansas City plant, says, "Part of my job is being moved to York [Pennsylvania], but the other part is going to Bangkok."

Greg Tate, a representative of United Steelworkers District 11, which represents about 30 percent of the workers at the Kansas City plant, blames the TCJA: "They have the capital now to move Kansas City, to shut it down. All of that money really came from the tax cut plan, so it kind of had the opposite effect of what it was supposed to do."

## **HEALTH CARE PREMIUMS**

The TCJA will increase health insurance of premiums for millions of Americans by repealing the individual insurance mandate of the Affordable Care Act (ACA). Small businesses consistently rank the cost of health care as one of their top concerns, yet repeal of the individual mandate will increase costs for small business owners and employees who rely on the individual marketplaces for health insurance coverage.

According to the [CBO](#), ending the ACA individual mandate will result in 3 million more people being uninsured by next year and a 10 percent increase in health insurance premiums in the non-group market, where insurance is purchased individually.

Without the individual mandate, some healthier enrollees may decide to go without insurance and wait until they get sick to enroll. This will leave the remaining pool of enrollees in the marketplaces less healthy on average, driving up average [premiums](#).

On May 23, 2018, Blue Cross Blue Shield Vice President Kris Hatlmeyer [said](#) he expects “substantial” premium increases for 2019 in the individual marketplaces, due in part due to repeal of the individual mandate. Haltmeyer estimated that average premium increases nationwide will be in the “low teens,” but there will be major variation across areas, ranging from the low single digits to up to 70 or 80 percent. He said the premium increases are “related to the loss of the mandate and then underlying medical costs. Those two things have the most impact on the rate increases.”

## **REVENUE LOSS AND BUDGET CUTS**

According to the CBO, the TCJA will cost [\\$1.9 trillion](#) by 2028—significantly more than originally estimated. If the past is any guide, this revenue loss (and the resulting increase in the federal deficit) will be used as an argument for cutting programs that benefit working people and reducing public investment that supports good jobs and a strong economy over the long term.

Right on cue, [some Republicans](#) have already started calling for cuts to Medicare, Medicaid, and Social Security to make up for the lost tax revenue. Moreover, President Trump has proposed a [budget](#) that cuts Medicaid and health care subsidies by \$763 billion, with annual cuts reaching \$128 billion by 2028.

There is a double standard here. When it comes to programs that benefit working people and investments that create or support good jobs, Republicans want us to believe that America is broke. But when it comes to wasting trillions of dollars on tax giveaways to Wall Street, big corporations, and the wealthiest people in our country, it seems that money is no object.

## **COMPLEX PASS THROUGH RULES BENEFITING MILLIONAIRES**

The TCJA provides many owners of pass-through businesses—partnerships, S corporations, and sole partnerships—a temporary tax deduction of 20 percent on qualified business income.

These pass-through provisions, which cost \$265 billion, have been advertised as a tax cut for Mom and Pop small businesses. However, they are extremely regressive. According to an analysis by the Center for Budget and Policy Priorities ([CBPP](#)) of estimates provided by the Joint Committee on Taxation (JCT), “Some 61 percent of the benefit from the 2017 tax law’s 20 percent deduction for pass-through income will flow to the top 1 percent of households in 2024,

compared to just 4 percent for the bottom two-thirds.” The main beneficiaries of these provisions are not Mom and Pop small businesses.

The TCJA’s pass-through provisions make the tax code even more complex and more confusing—two complaints frequently voiced by small businesses. A leading tax expert [concludes](#) that the new rules “achieved a rare and unenviable trifecta, by making the tax system less efficient, less fair, and more complicated. It lacked any coherent (or even clearly articulated) underlying principle, was shoddily executed, and ought to be promptly repealed.”

Furthermore, the gap between the new top individual rate (37 percent) and new top pass-through rate (29.6 percent) may encourage wealthy individuals, who can afford high-priced accountants and lawyers, to game the system by declaring themselves pass-through businesses.

Finally, according to the [CBO](#), “the deduction gives owners of pass-through businesses an incentive to underreport their reasonable compensation—a tactic that has been used successfully to avoid self-employment taxes in the past and that is not available to wage earners. In addition, the deduction’s different treatment of different industries could further affect economic decisions.”

## **BUSINESS INVESTMENT, JOB GROWTH, AND WAGE GROWTH**

While it is still too early to determine the ultimate effects of the TCJA, evidence that the new law has resulted in more business investment, job creation, and wage growth is extraordinarily weak.

As Senator Marco Rubio [said](#) recently, “There is still a lot of thinking on the right that if big corporations are happy, they’re going to take the money they’re saving and reinvest it in American workers. In fact, they bought back shares. A few gave out bonuses. There’s no evidence whatsoever that the money’s been massively poured back into the American worker.”

Indeed, there is no clear evidence to date of a significant increase in business investment due to enactment of the TCJA. According to the Economic Policy Institute ([EPI](#)), nonresidential investment growth in the first quarter of 2018 was slightly faster than in the last quarter of 2017, but slower than rates of growth in 2011 and 2014.

With regard to the long-term effect of the TCJA, the only permanent tax cut in the new law is its reduction of the corporate income tax rate. As [EPI](#) explained in its testimony submitted to the Committee last week, the “evidence based on past experience with corporate rate cuts—either in the United States, in international peer countries, or in individual U.S. states—argues strongly that capital investment and pay for most American workers will not noticeably increase due to the TCJA.”

President Trump and Congressional Republicans promised that workers would see their pay increase by at least [\\$4,000 a year](#) due to the corporate tax cuts in the TCJA. However, there is no evidence that wage growth has materially picked up since the TCJA took effect. In May

2018, nominal wages were only [2.7%](#) higher than a year earlier. The slow pace of wage growth has actually puzzled economists, given the low unemployment rate.

Corporations seem to be dedicating the bulk of their tax windfall to dividends and stock buybacks, which only make the rich richer. U.S. companies completed a record [\\$178 billion](#) in stock buybacks in the first three months of 2018, and a record [\\$200 billion](#) in May 2018. According to [UBS](#), corporations are likely to spend more than \$2.5 trillion this year on share buybacks, dividends, and mergers and acquisitions activity.

While it is sometimes claimed that stock buybacks lead to job-creating investments, this is not the case. Stock buybacks boost stock prices and CEO pay in the short term, but over the long term they are a missed opportunity to reinvest in the company. Dividends and stock buybacks now exceed corporate earnings, which amounts to eating your seed corn.

## **A MISSED OPPORTUNITY**

The TCJA represents a missed opportunity for real tax reform that eliminates the tax incentive for corporations to shift jobs and profits offshore, which gives big corporations an unfair advantage over small business. In February 2018, Rep. Doggett (D-TX) and Sen. Whitehouse (D-RI) introduced the [No Tax Breaks for Outsourcing Act](#), which would eliminate the TCJA's incentives for outsourcing by, among other things, equalizing tax rates on domestic and offshore profits.

The TCJA also represents a missed opportunity to raise more corporate tax revenue by ending the shifting of domestic profits to offshore tax jurisdictions. According to the [CBO](#), the shift to a territorial tax system “is anticipated to encourage some further profit shifting, because corporations that shift profits from the United States to lower-tax countries can now repatriate them without paying taxes. That increase in profit-shifting will reduce the amount of income subject to U.S. taxes.”

Also according to the [CBO](#), about 80 percent of corporate profit shifting will remain in place under the TCJA, as U.S. corporations will continue to shift \$235 billion in profits annually. According to Brooklyn Law School professor [Rebecca Kysar](#), profit shifting will be reduced even less than estimated by the CBO, and the policy choice of applying the new minimum tax (GILTI) on a global rather than per-country basis will encourage profit shifting.

The TCJA also represents a missed opportunity to raise corporate revenue through the taxation of accumulated offshore earnings. Prior to enactment of the TCJA, U.S. corporations had accumulated an estimated [\\$2.6 trillion](#) in profits “offshore,” on which they owed an estimated [\\$750 billion](#) in taxes. Instead of making corporations pay taxes on these accumulated profits at the full 35 percent rate that applied when these profits were earned, the TCJA allows corporations to pay a discounted rate of either 8 or 15.5 percent. This “deemed repatriation” tax, estimated to raise \$340 billion, represents a windfall of over \$400 billion for a handful of corporations and rewards aggressive tax avoidance strategies using offshore tax havens.

The TCJA also represents a missed opportunity to use the revenues generated from deemed repatriation to fund a massive increase in infrastructure investment, which many Democratic and Republican members of Congress had previously supported. Instead, the TCJA uses these one-time-only revenues to pay for wasteful tax giveaways.

[CBO](#) projects the positive economic effect of deemed repatriation will be “small.” “Even though the term ‘repatriation’ suggests that the undistributed funds will return to the United States from abroad, they are often already invested in dollar-denominated fixed income securities issued by U.S. borrowers. The funds are outside the United States only in the sense of being owned by a foreign subsidiary of a U.S. corporation. In fact, MNCs have held a substantial fraction of their undistributed funds as long-term Treasury securities, CBO estimates. Finally, over the past decade, MNCs have paid large amounts of cash to their shareholders through share repurchases even as they have kept earnings undistributed, so it is unlikely that the foreign earnings represent pent-up dividends or investments waiting to happen.”

Finally, the TCJA represents a missed opportunity to raise sufficient revenues to increase public investment on a scale necessary to lay the foundations for full employment and good jobs over the long term. The reality is that the United States does not collect enough tax revenue. Revenues at the federal, state, and county level—as a share of the economy—are [lower](#) in the United States than in any other developed OECD country. The United States is also [23<sup>rd</sup>](#) among OECD countries in total social spending as a share of the economy, and total non-defense discretionary spending is at its lowest level since the Eisenhower administration. The failure to raise sufficient tax revenue and make sufficient public investment is threatening the economic future of the United States, and the TCJA makes this problem worse.

## **CONCLUSION**

Supporters of the TCJA have often touted its benefits to small business and the economy, but in fact the new law will have a harmful impact on both small business and economic performance. The TCJA wastes trillions of dollars on wasteful tax giveaways to millionaires, big corporations, and Wall Street that threaten our economic future.