Statement of Alfred P. West, Jr. on Corporate Tax Reform and the Deficit

Strengthening of America Commission

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I am Al West, founder and CEO of SEI Investments and the chairman of the American Business Conference – ABC -- a group of leaders of midsize growth firms from various industries, based in Washington, DC.

SEI began in 1968 as a two-person firm specializing in creating computer-simulated training technology. Today SEI employs 2,200 people. They provide technology-based financial services to 7,000 clients and manage or administer $424 billion in mutual fund and pooled or separately managed assets. Since 1987, SEI's total return to our shareholder-owners has averaged 17.1 percent annually, compared with a 9.7 percent annual return for the S&P 500. Growth through investing, innovating, and constantly changing is what we are about.

The CEO members of the American Business Conference are proud to support the Strengthening of America – Our Children's Future forums. We are especially gratified by today's session on pro-growth tax reform.

Growth, and the jobs and prosperity it creates, allows our citizens to pursue their interests and ambitions. It enables investors – that means most Americans – to earn a fair return on their decision to save for the future. It supports our cultural institutions. It makes possible the protection of the environment. It permits us to care for the elderly, the poor and the disabled. Finally, it allows us to protect ourselves from the enemies of democracy.

Going straight to the point of these hearings, any program to get our indebtedness must start with economic growth. While growth alone cannot get us out of the hole we've dug for ourselves, growth is necessary to help us accept other painful measures that we will have to take such as curbing federal spending, particularly health care spending. Growth can also contribute to increased federal revenues which must also be part of any comprehensive debt reduction plan.

In that context, I am here today to do two things.

The first is to endorse, from the growth company perspective, the importance of adopting a credible program to stabilize the federal debt. The second is to suggest a couple of ideas to make the corporate tax more pro-growth.

Let me start by saying, first, that I share your concern about the fiscal outlook for our country. I know enough about financial markets to understand how quickly they can turn. We're living in a dream world if we think lenders will continue to finance our growing debt at rock bottom interest rates. If things go on as they have, there will be a day of reckoning.

So we have a choice. Either we solve our fiscal problems ourselves, based on our national priorities, or let our creditors do the job for us. The second choice isn't a very pretty one, since it will lead to higher interest costs, an even greater debt, and, I suspect, inflation.

If we want to avoid the pain, we must act. Following the election, plans along the lines of Simpson/Bowles and Domenici/Rivlin must be taken up in a serious way. Strong leadership from the White House will be a prerequisite for progress.

In my opinion, nothing would have such an immediate, positive effect on growth as embracing a debt reduction plan and actually sticking with it. Temporary tax cuts, tax extenders, tax patches, and threats of falling off the fiscal cliff have all contributed to business uncertainty and a corresponding reluctance to invest and to hire. Waffling is ruinous.

Going now to my second topic, making the corporate tax more pro-growth, it seems obvious that reform is necessary. Everyone knows about the code's complexity. Today, there is much talk about raising revenues by "cleaning out" the individual and corporate income taxes of their advantages and subsidies and lowering rates.

My colleagues at the American Business Conference and I would strongly support any effort to reduce the corporate rate by weeding out so-called tax preferences or tax expenditures, thereby broadening the corporate tax base.

Quite candidly, though, doing this seems like a heavy lift. Behind every tax preference is a determined business constituency protecting it. This does not mean we should abandon in the near term base-broadening reform. But longer term, we should recognize that the problem with the corporate income tax is the corporate tax itself. Even a corporate tax free of preferences would still be anti-growth because it reduces the return on investment in corporations.

This is because tax law treats corporations and their investors as if they were separate entities. Corporate profits are largely subject to a double tax, first at the corporate level and then at the investor level.

Anyone starting a business today recognizes this. There has been an explosion in recent years of the number of firms organizing themselves as Subchapter S corporations or as partnerships. These so-called pass through entities avoid the corporate tax entirely. And not all are small businesses. Over 14,000 Subchapter S corporations have revenues of more than $50 million. We are thus in the position of having businesses of similar size selling similar products and services, yet facing different tax obligations based solely on the way they are organized. This makes no sense.

Some believe that larger pass through entities should be forced to pay the corporate tax as part of the base-broadening agenda. But why add to the universe of companies burdened with a double tax on their profits and forced to submit to the complexities of what most observers agree is a terrible tax?

To maximize growth and encourage investments, the profits of all companies, however they are organized, should be subject to one level of taxation. The best way to do this is to get rid of the corporate income tax and treat all businesses as pass-throughs. But I realize that’s highly unlikely. So, a second-best option is to integrate the corporate tax with the individual tax.

Integration is not a new idea. In fact, most other countries have integration already. Here in the United States, the best fundamental tax reform idea in recent years – the USA Tax – was fully integrated. The Bush Administration proposed its own integration plan, although it went nowhere. Instead, in 2003, the Administration pushed through Congress a reduced personal rate for dividends as a form of partial integration. That reform was in the right direction, but the lower tax on dividends paid by individuals led to accusations of unfairness.

A better approach would be to allow dividends to be deductible at the corporate level. If we did that and taxed dividends as ordinary income at the individual level, we could go far toward achieving integration and pay for a significant share of its costs. Absent integration, proposals to tax capital gains and dividends at the individual level as ordinary income will considerably increase the double tax on corporate earnings forcing further discouraging and distorting investment.

Along with integration, to further promote growth I recommend making the corporate tax territorial. Most of the new growth opportunities for American business are located outside of our borders. International expansion of growth businesses is absolutely necessary. It is also a precondition for preserving and expanding their market share domestically.

Our current worldwide tax system is not well-suited to assist American companies to take advantage of these future international opportunities. It is also a compliance nightmare. There are hardly any other developed countries that do not already have a territorial system, making the U.S. corporate tax increasingly uncompetitive. That means we stand in severe danger of sending corporate headquarters abroad, which would cost jobs and harm whole communities depending upon a corporate presence.

In closing, I recognize that these two pro-growth tax reform suggestions, integration and territoriality, would in the short term mean that the corporate income tax might yield lower revenues. I believe, however, that the growth and employment benefits these ideas would generate would in part pay for their adoption over time -- but only in part. In the short term, ways would have to be found to make up for foregone revenues. But that is the key strength of a comprehensive plan to reduce the debt. When everything is on the table, trade-offs are possible.

Those trade-offs, however, can only be made if there is genuine understanding of the desirability of economic growth and the crucial role the private sector plays in bringing it about. The late Democratic Senator Paul Tsongas, a friend of the American Business Conference, had it right when he said that, as a society, "everything we hope to do depends on an expanding economic pie. And only a vibrant, competitive, thriving private sector can create that."

I congratulate this commission for placing growth at the forefront of its examination of our debt crisis and I hope your hearings will increase public understanding of these important issues. Only through public understanding is real change possible.

Thank You