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Victoria Lau

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The Contemporary Tax Journal’s Interview of Dan Kostenbauder

Part I on Tax Policy
By: Victoria Lau, MST Student

Dan Kostenbauder is the Vice President of Tax Policy at Hewlett-Packard Company (HP) where he has served for over thirty years. He has held different tax positions at HP including European Tax Manager, Head of State and Local Tax, and Head of Worldwide Transactional Tax. What elevates Mr. Kostenbauder to the level of a Tax Maven is his involvement in the tax legislation process in Washington, D.C. and state capitals throughout most of his career. He has cultivated relationships with high-ranking lawmakers and their staff members; helped explain tax concerns of high technology companies to legislative staff, has testified before the House Ways and Means Committee and Senate Finance Committee on several occasions.

SJSU CTJ: As the VP of Tax Policy at HP, what are you responsible for?

Kostenbauder:

My major responsibility is to represent HP with respect to tax policy. This primarily involves Washington, D.C. in relation to tax policy, but I also have responsibility for the States.

I also assist on specific tax policy matters in other countries, but this international role is primarily to consult with tax managers in the other countries by providing insights. On some issues like the R&D credit, I have been working on it since the mid 1980’s so in addition to the general policy and economic
arguments that support having an R&D credit, I am familiar with ways in which the R&D credit can be structured and how that may impact HP not only based on our situation today but also in anticipation of what may be happening in the future.

**SJSU CTJ: What was your career path to VP of Tax Policy?**


dan is always intrigued by major scientific advances. If he could have dinner with anyone, dan would dine with experts from the human genome and particle physics field.

**Kostenbauder:**

I have been in my current position for the last four years, but part of my job has been working at the federal level since 1985 and at the state level since 1992.

After completing both the NYU Law School and the LL.M. (in Taxation) program, I worked for a Wall Street law firm that specialized in taxation for five years. I realized that I did not want to live in New York City, but wasn’t quite sure where I wanted to go. I met a young lady who became and is still my wife. She suggested California and said “you’ll like California,” so we moved to California. We explored different possibilities, and HP fit a few important criteria. One was that it got us to California, and another was looking at the potential impact to HP. It provided us a leg up on the east coast companies as their tax departments were often home for the evening, so they spent their morning figuring out how any new proposal would affect their companies. It was quite interesting for me. There was a real advantage in being a California company because at the end of the day, I could make a phone call, usually to Larry Langdon who was the head of our tax department at that time. If there were any interesting new ideas, I could ask Larry what we thought about it and he could have someone spend a few hours in the afternoon looking at the potential impact to HP. Lester Ezrati, who subsequently became head of HP’s tax department, did an excellent job in providing this analysis. So the next morning, I would know what our views were and the type of impact on HP. It provided us a leg up on the east coast companies as their tax departments were often home for the evening, so they spent their morning figuring out how any new proposal would affect their companies.

I remember my first press interview very well. It was by Alan Murray of the Wall Street Journal who was one of the reporters covering tax reform. It was interesting because the reason I was doing the interview was that Chairman Rostenkowski proposed to capitalize R&D instead of expensing it under IRC §174 to help increase revenue for tax reform. The tech community didn’t really like that, so they had asked the CEO’s of IBM and HP to do an interview. Those individuals were not available and the tech community wanted a spokesman to speak out quickly and to do an interview in person. Since I was in Washington, I gave my first press interview.

After my efforts on the TRA of 1986, I spent a good bit of my time involved in federal tax policy while having responsibility for other areas in the tax department. We had an internal reorganization in the tax department in 1992, so I took responsibility for the state and local areas. Later in the 1990’s, I gave up the state income tax piece and took responsibility for the worldwide transactional tax group.

My role in federal tax policy has ebbed and flowed in terms of the amount of my time. Some years did not have big tax issues on the agenda so I spent relatively less time in Washington. During other years, I spent a lot more.

**SJSU CTJ: Why is tax policy important to HP?**

In his State of the Union Address in January 1984, President Reagan asked the Treasury Secretary Donald Regan to prepare “a plan for action to simplify the entire tax code so that all taxpayers, big and small, are treated more fairly.” Eleven months later, Treasury issued the “Tax Reform for Fairness, Simplicity, and Economic Growth: The Treasury Department Report to the President, November 1984” (commonly referred to as “Treasury I”).

Kostenbauder:

The broad concern is that our non-U.S. based competitors have more favorable tax rules because they generally operate under a territorial or dividend exemption tax system, and they very often have lower statutory rates as well. That competitive differentiation is a great concern. It is very critical over the long haul that the U.S. adopts a tax regime that makes U.S.-based companies more competitive. Our current tax policy certainly has its shortcomings and there are reasons for comprehensive reform. Reform will not only be good for HP and the tech community, but for the entire U.S. economy.

**SJSU CTJ: Was there a specific piece of legislation that you were involved in which is more memorable?**

Kostenbauder:

After the 9/11 tragedy, the U.S. economy was not doing particularly well. There was concern that there would be further economic malaise so questions were asked on how we could stimulate the economy. One idea ultimately became referred to as the Homeland Investment Act (HIA). I started working on that at the end of 2001. Efforts picked up in 2002 and by 2003, we had formed a coalition of companies that was fully organized and energetically supporting the legislation. In 2003, there was a Senate vote...
of 75 to 25 in favor of the HIA. The bill did not pass in the House that year but the Senate vote created a certain amount of momentum.

In 2004, I made fifteen trips to Washington and that was the most I ever did in one year. The provision met several criteria for my involvement: it was of major importance to HP, HP’s involvement could help move the legislation forward, and it had a realistic chance of being passed. You just have to be able to assess whether it was something you want to spend a lot of time and energy on.

The process of creating a record for legislation occurred through hearings. During 2003 and 2004, I testified once at the W&M and twice at the Senate Finance Committee. These hearings are a more formal step that allows the members of the tax writing committees to ask questions and involves submitting written testimony.

Outside the formal process, there are many steps that are probably more important; in particular, meeting with members of Congress and their staff. With respect to the HIA, we were regularly meeting with Congressmen and Senators where HP has a constituent relationship, as well as members of the tax writing committees.

We have also tried over the years to have relationships with legislators whether we have strong constituent relationships or not. An example would be relationships with the members of the tax writing committees such as with Chairman Baucus. Although he is from Montana, he went to Stanford and he has been supportive of many tech and international tax issues over the years. He recognizes that having a vibrant R&D community and manufacturing sector in the U.S. would be of benefit to the country overall.

I did a lot of press interviews on the HIA, including for the Wall Street Journal, the New York Times and local Silicon Valley papers.

The issue was active for about three years so the media was interested. HP was willing to speak to the press and I was the person who did most of the speaking. We had CEO support, and Carly Fiorina got personally involved. I had a meeting with her and W&M Chairman Bill Thomas.

There was a lot of very effective coordination with other companies. We agreed on the best political strategy at various stages. We ultimately saw it passed as part of the repeal of the extraterritorial income regime in the American Jobs Creation Act of 2004 [P.L. 108-357, 10/22/2004].

It is frequently a long process to pass legislation.

**SJSU CTJ**: Have you been involved in a piece of legislation that passed which surprised you?

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**Kostenbauder**: Another part of my job since the 1980’s has been to advise HP with respect to tax issues affecting philanthropy. There is a minor provision within the charitable contribution deduction that relates to donations of scientific equipment and apparatus to U.S. universities for research purposes. HP had for years made substantial donations of inventory to universities. There is a requirement that the inventory be “constructed” by the taxpayer and the definition is provided in the Code under IRC §174(e)(4)(C). Prior to the 1990s, it was not a problem for HP equipment to qualify, but as our vendors became more reliable and our supply chain became more sophisticated in the 1990s, it became less clear that HP could routinely meet the “constructed” requirement.

What was funny was that I had an opportunity to talk to a senior member of the W&M staff when there was a piece of legislation pending that focused on charitable contributions and tax exempt organizations. I told him about the issue and he was sympathetic. He arranged a meeting with the Head of the JCT [Joint Committee on Taxation]. I learned something new in this experience. My original solution involved broader language than necessary to resolve the issue for HP. During the meeting, we agreed to add the words “or assembled” in the clause and not provide a definition for assembled. This was a more elegant and less controversial approach that more surgically addressed concerns. With her help, the legislation passed in the House and Senate but never became law because the two chambers did not hold a conference to agree on the final bill. This went on for about six years. I did not ask for it the last time, but it had become a routine part of the bill. The Senate staff member included it when the bill was re-introduced at the start of a new term of the Congress, and the provision is now part of the Code. It is a good provision that encourages donations to universities. In the scheme of things, it was worth the time and trouble I put into it, which was not a whole lot compared to legislation like tax reform or HIA.

You can find the provision intended to encourage U.S. corporations to repatriate their foreign earnings to promote U.S. job growth under IRC §965 Temporary Dividends Received Deduction. It was created by the Homeland Investment Act (H.R. 767, 108th Cong., 2003-2004) and enacted by P.L. 108-357.

**Kostenbauder**: There must be a teacher or professor in my psyche, because one of the things you need to do in my position is explain things over and over to new people or to people you met before who might not have fully understood our viewpoint then, but have thought about it since you talked to them a year or so before. I have the patience. My career, however, has mostly involved doing “real” tax work, too, which I enjoy.

**Part II of this two-part interview features Mr. Kostenbauder views on recent discussions on tax reform.**
One of the most unusual items in Dan's office is this political button.
SJSU CTJ: If there is tax reform, what changes would you expect?

Kostenbauder:

Tax reform would include lowering the rates and broadening the base on both the individual and corporate parts of the income tax. The international rules would also include some type of base erosion provision. More broadly, HP would like to see a competitive hybrid territorial system that is comparable to other countries. The proposal that Chairman Camp has put out includes three options for a base erosion provision. We believe that a base erosion provision would be a component of a territorial system.

One big consideration is the challenge related to pass-through entities, because about half of the total business income in the U.S. is earned by pass-throughs rather than C corporations. Pass-through entities such as partnerships and S corporations are taxed largely under the individual provisions of the Code, so there is a need to revise the individual Code as well in a tax reform package. This will be politically challenging, with issues such as the mortgage interest, charitable, and state and local tax deduction. These individual provisions are popular and supported by a lot of special interest groups, so dropping them or cutting them back in order to lower rates will be difficult.

SJSU CTJ: For the mortgage interest deduction, can legislators make an effective argument that it benefits a small number of wealthy taxpayers?

Kostenbauder:

If the President makes an effort to explain it, he has the “bully pulpit” to make that type of argument. We shall see what happens in the months ahead, as all this needs to be sorted out in tax reform. Tax reform is not an easy undertaking because just resolving the transitional issues will be challenging. They go to elements of fairness. To the extent that it is viewed by most folks as “I gave something up, but have something in return” and “the system is now simpler and fairer,” the prospects for tax reform will be enhanced.

With the Tax Reform Act of 1986, the U.S. dropped the corporate rate from 46% to 34% and dropped the top individual rate from 50% to 28%. The U.S. certainly experienced a strong decade and a half of growth afterwards. There was a little recession in 1990, but the economy was strong until the 2000’s.

SJSU CTJ: Do you have any recommendation on how tax professionals can engage in tax policy issues and the legislative process?

Kostenbauder:

It is useful to pay attention to public debate about tax rules. These rules do not spring out of the minds of lawmakers in Washington and happen in a vacuum. A lot of folks are involved when it comes down to drafting legislative language and they are responding to political and economic forces. So by reading newspaper and magazines to stay informed, you can understand the reasons for the complexity of the tax code. It is always difficult to have direct input into the legislative process in Washington, but professional organizations representing the accountants and lawyers will certainly weigh in on technical issues, so providing feedback to these organizations on specific points is also a route open to tax professionals.