Comments on the Senate Finance Committee Staff Discussion Drafts on International Tax Reform and Cost Recovery and Tax Accounting

Business Roundtable
January 17, 2014

Business Roundtable appreciates this opportunity to provide comments on the two staff discussion drafts released by Chairman Baucus of the Senate Finance Committee pertaining to international tax reform and cost recovery and tax accounting (the "discussion drafts").[1]

Business Roundtable is an association of chief executive officers of leading U.S. companies working to promote sound public policy and a thriving U.S. economy. Business Roundtable's CEO members lead U.S. companies with $7.4 trillion in annual revenues and more than 16 million employees.[2]

I. OVERVIEW

Tax policy has a profound impact on business investment, economic growth and job creation. Business Roundtable supports a competitive, pro-growth tax framework that promotes economic expansion and levels the playing field for U.S. companies competing in global markets. Tax reform must address the competitiveness of all businesses to fully strengthen the U.S. economy, enhance job creation, and enable American workers and businesses to compete effectively.

To this end, Business Roundtable believes that tax reform should include setting the corporate tax rate at 25 percent and adopting a modern international tax system, consistent with the principles of our major trading partners around the world. The Roundtable believes

[1] Senate Committee on Finance, Chairman's Staff Discussion Draft of Provisions to Reform International Business Taxation, November 19, 2013; and Senate Committee on Finance, Chairman's Staff Discussion Draft of Provisions to Reform Cost Recovery and Accounting, November 21, 2013.

[2] Roundtable member companies comprise more than a third of the total value of the U.S. stock market and invest $158 billion annually in research and development – equal to 62 percent of U.S. private R&D spending. Our companies pay more than $200 billion in dividends to shareholders and generate more than $540 billion in sales for small and medium-sized businesses annually. Roundtable companies give more than $9 billion a year in combined charitable contributions.

these goals can be achieved in a revenue-neutral manner, without burdening individuals or small businesses.

Business Roundtable understands that tax reform will require a careful and balanced examination of existing tax preferences and that reform of the U.S. international tax system will be accompanied by appropriate safeguards to protect the U.S. tax base. Existing corporate tax preferences should be analyzed for their growth effects relative to the growth that can be achieved through a lower rate and a more competitive tax system.

Any review of existing tax preferences should not unfairly target or favor any industry, but rather should be undertaken with the objective of providing a lower corporate tax rate and modernized international tax system that would better promote economic growth. All revenues from corporate base-broadening measures should be applied to corporate rate reduction and to modernizing our international tax system. If base broadening revenues were instead used for other purposes, corporate tax reform would result in a net tax increase on America's businesses and impede U.S. competitiveness in the global economy.

The business leaders of the Roundtable are encouraged by the growing bipartisan support for the goal of pro-growth tax reform that would increase the competitiveness of American businesses and create jobs. Now is the time for policymakers to strengthen their efforts to identify and agree upon the right policy solutions to unleash strong and sustained growth in America.

Chairman Baucus' staff discussion drafts demonstrate significant work undertaken by the Senate Finance Committee to address the many complexities of the U.S. tax code. This effort reflects the reality that America's current tax system has fallen behind the rest of the world, undermines competitiveness, is endlessly complex, and does not support a growth agenda for the future. However, several of the proposals in the international discussion draft would make American companies even less competitive than their non-U.S. counterparts.

Business Roundtable also believes that tax reform should achieve a 25 percent corporate tax rate and that the Committee's efforts, as initiated in the domestic discussion draft, should be guided by this objective. Accordingly, we believe that further work and significant revisions to these discussion drafts are required, and this is described in more detail in this submission.

II. COMPREHENSIVE TAX REFORM: THE TIME IS NOW

Tax reform to promote economic growth

Reform of the U.S. business tax system – including its treatment of both domestic and international income – is of critical importance to the growth of the U.S. economy. The U.S. economy continues to underperform relative to its potential at great costs to workers, businesses, and taxpayers. Gross domestic product in 2013 was more than 10 percent less than the trajectory forecast by the Congressional Budget Office in 2008. Realizing the economy's full potential should be the nation's top priority and will require the concerted efforts of Congress to restore America's status as the most attractive destination for investment in the world.

The ability of American companies to be competitive in both domestic and foreign markets is essential to improving economic growth in the United States, reducing high rates of U.S. unemployment, and providing for rising American living standards. U.S.-headquartered companies with operations both in the United States and abroad directly employed 23 million American workers in 2011 (the most recent year of government data for this sector).[3] A total of 71 million jobs in the United States – nearly half of the private sector workforce in the United States – were supported either directly or indirectly by U.S.-headquartered globally engaged companies.[4] A loss of U.S.-headquartered companies through a steady decline in their ability to compete globally would place at risk millions of American jobs that depend on these companies.

U.S. corporate tax system is out of line with the rest of the world

The U.S. corporate income tax system is an outlier relative to the tax systems of our trading partners, putting the United States at a distinct disadvantage. Countries around the world have been focused on lowering their corporate tax rates and providing modern international tax rules to increase domestic investment and support the activities of their locally headquartered corporations as they seek to expand and sell into the global marketplace.

The combined U.S. federal and state statutory corporate tax rate is the highest among the 34 countries in the OECD at 39.1 percent – 14 percentage points higher than the average of the other OECD countries. A significant reduction in the statutory corporate tax rate is an essential element of meaningful corporate tax reform.

---

[3] Kevin B. Barefoot, "U.S. Multinational Companies," *Survey of Current Business*, November 2013.

[4] PwC, *Economic Impacts of Globally Engaged U.S. Companies*, Business Roundtable, July 2013, available at: http://businessroundtable.org/sites/default/files/BRT_Final_Report_Economic_Impacts_of_Globally_Engaged_US_Companies_July_2013.pdf

The United States is the only G8 country to use a worldwide tax system, which imposes tax on the active foreign earnings of its corporations when the earnings are remitted home as a dividend. The other G8 countries and 28 of the 34 OECD countries use territorial tax systems ("exemption systems") that generally exempt from domestic taxation active foreign earnings remitted home as a dividend.

In the immediate post-World War II era, American companies were dominant players in global commerce, and unfavorable tax rules had less impact on American companies' ability to compete in global markets. But over the past 30 years, market competition from around the world has grown significantly. American companies now find that their closest competitors are based in countries with corporate tax rates that are lower than the U.S. rate and with international systems that are more favorable to their global operations than the U.S. rules. Within the OECD, 93 percent of the non-U.S. companies in the Global Fortune 500 in 2012 were headquartered in countries that use territorial tax systems. As recently as 1995, only 27 percent of these foreign competitors were headquartered in territorial countries.[5]

Summary

The combined effect of the high rate of U.S. corporate tax and the worldwide U.S. tax system makes it more difficult for U.S.-headquartered companies to compete effectively in foreign markets, reduces the reinvestment of overseas earnings back into the United States, and discourages new investment in the United States by both U.S.- and foreign-headquartered companies. Reform of the corporate income tax – a tax determined by the OECD to be "the most harmful type of tax for economic growth" – can provide for a strong and sustained resurgence of the U.S. economy.[6] It is with this background and perspective that we provide below the Roundtable's comments on the broad policy issues addressed in the staff discussion drafts on (i) international tax reform and (ii) cost recovery and tax accounting.

III. INTERNATIONAL TAX REFORM

The discussion draft proposes substantial reforms of the U.S. international tax system. These include a "minimum tax" on foreign income; taxes on pre-enactment foreign earnings; interest allocation rules; and changes in the manner in which transactions between related U.S.-controlled foreign subsidiaries would be taxed.

Business Roundtable believes these reforms would have the unintended effect of making many American companies even less competitive than their non-U.S. counterparts. Such an

[5] Business Roundtable, *Comprehensive Tax Reform: The Time is Now*, July 2013, pp. 3-4, available at: http://businessroundtable.org/sites/default/files/BRT_Comprehensive_Tax_Reform_final.pdf
[6] OECD, *Tax Policy Reform and Economic Growth*, 2010, p. 3.

unparalleled international tax system would move U.S. tax policy in exactly the wrong direction, making the U.S. system further divergent from the systems adopted by other major developed countries in recent decades.

A modern international tax system *structured similarly to the territorial tax systems of other OECD countries* is essential for U.S.-headquartered companies to be competitive in foreign markets and have the same ability to reinvest foreign earnings at home as their competitors.

Minimum tax proposals

While the proposed alternative reforms ("Options Y and Z") contain some elements of an exemption-type system, overall they are most notable for their overturning of current law rules providing for the deferral of active foreign business income, and their consequent harmful impact on U.S. competitiveness, which would result in reductions in U.S. employment and U.S. investment.

A repeal of deferral for active business income – either as proposed by the minimum tax on income taxed below 80 percent of the U.S. rate ("Option Y"), or through current taxation of 60 percent of all active business income ("Option Z") – would place U.S. companies at a *significant competitive disadvantage* relative to their foreign-based competitors.

Both options would impose substantial U.S. tax on foreign earnings that foreign-headquartered competitors of American companies would not have to pay either to the United States or to their home countries. The broad taxation of active foreign earnings of American companies is not warranted under the guise of U.S. base protection as it extends broadly to foreign income with no connection to the U.S. tax base.

These proposals would have significant adverse impacts on American companies. U.S. exceptionalism cannot form a basis for modifying the U.S. international tax rules to the detriment of American companies.

Tax on pre-enactment earnings

The proposed 20 percent tax on unremitted pre-enactment foreign earnings is a tax of enormous scale. Under current law, U.S. tax on active business foreign earnings is generally only paid at the time it is remitted to the U.S. parent. The proposed tax would apply at the time of the transition to the new international system, changing the timing and, consequentially, the real value of the U.S. tax due on these earnings. Tax would be imposed on foreign earnings arising as far back as 100 years ago.

It is estimated that U.S. companies had approximately $2 trillion in unremitted foreign earnings at the end of 2012, with a substantial portion invested in foreign plant, property, equipment and working capital. If companies did not have sufficient cash holdings to pay this tax, they would need to raise funds through external borrowing, new share issuances, or divestitures. Even if companies had cash holdings available, use of the funds to pay the tax would reduce funds available for investment, hiring, research, acquisitions, and shareholder distributions.

Other specific proposals impacting globally engaged U.S. companies

There are several specific proposals in the draft that would disadvantage globally engaged U.S. companies relative to their foreign competitors both in competition in U.S. and foreign markets.

For example, the discussion draft proposes new limitations on the deduction of interest expenses for U.S. companies with global operations. The proposal would limit interest deductions of globally engaged U.S. companies on any debt incurred in the United States. Such a limitation would raise the cost of undertaking any debt financed investment in the United States by a U.S.-headquartered company. Likewise, the proposal would raise the cost of a U.S. company undertaking an equity financed expansion in foreign markets since the deductibility of U.S. interest expense would be determined in part on the basis of worldwide assets.

The discussion draft also would repeal the current entity classification system and eliminate the ability of American companies to redeploy cash between foreign operations without imposing immediate U.S. tax.

The long-standing policy in these areas helps level the playing field for American companies competing in the global marketplace, allows for the efficient consolidation of companies following a merger or acquisition, and permits globally engaged American companies to streamline their business structures. Helping American companies to manage capital, operations, and foreign tax obligations in a manner similar to that of their competitors should remain a goal in tax reform.

Business Roundtable supports the permanent inclusion of the CFC look through rule and the active financing exception – which is modified and made permanent in the international draft – under a reformed international tax system. Repeal of the check the box election and the CFC look through rule would disadvantage globally engaged American companies relative to their foreign competitors.

Summary

Business Roundtable strongly supports the objective of the discussion draft to improve the ability of American companies to compete in global markets through modernization of the U.S. international tax rules. The comments on the discussion draft are intended to highlight changes to reach this objective and maximize growth of the U.S. economy.

IV. COST RECOVERY AND TAX ACCOUNTING

The discussion draft proposes substantial changes to current law that generally slow capital cost recovery deductions for investments as well as tax accounting changes to inventory rules that accelerate the recognition of income in order to provide for a reduction in the corporate tax rate.

Business Roundtable supports setting the U.S. federal corporate tax rate at 25 percent and achieving this in a revenue-neutral manner. However, any base broadening should be guided by sound tax principles and focused on maximizing the growth that can be achieved by applying revenues from an expanded tax base toward rate reduction. Base broadening is not an objective in itself but only as a means to raise revenues for the purpose of growth-enhancing corporate rate reduction.

The discussion draft does not propose a specific corporate tax rate. Given the benefits of achieving a more competitive corporate tax rate, Business Roundtable encourages the Senate Finance Committee to reform the tax code to provide for a 25 percent corporate tax rate.

As base broadening provisions can only be evaluated in the context of the overall tax system to which they apply, it is difficult to comment in detail on specific proposals in the discussion draft without an understanding of other changes that may be made and the corporate tax rate that can be attained through these changes.

Depreciation

Business Roundtable recognizes that changes to depreciation rules may accompany the effort toward corporate rate reduction, along with base broadening in other areas of the tax code so that no industry is unfairly targeted or favored. With regard to the particular recovery rates proposed in the cost recovery discussion draft, some Business Roundtable members are concerned that the proposed recovery methods for particular categories of property result in depreciation deductions significantly slower than economic depreciation.[7]

[7] Historically, tax depreciation has intended to provide cost recovery faster than economic depreciation, and some Business Roundtable members believe that accelerated forms of depreciation, including expensing under

Many of the underlying estimates of economic depreciation incorporated in the discussion draft are based on a 1979 report prepared for the Treasury Department. This analysis is now quite dated and concerns have also been raised that the range of assets analyzed by that study may be too limited to be extrapolated to the wide range of depreciable investments in the economy.[8]

Given the desire of the discussion draft to provide comparable incentives across all assets under a newly designed cost recovery system, and concerns that the original analysis on which the cost recovery allowances are based may be inappropriate, it is important that the Committee consider evidence provided by taxpayers on recovery rates that would better align cost recovery allowances for these investments with other assets.

Business Roundtable members have also expressed concern with the retroactive application of the new cost recovery rules to the remaining basis of assets still in service at the time the new depreciation rules are effective. This is a retroactive change to cost recovery for investments made in the past, based on the tax laws applicable at the time the investments were placed in service. We believe that retroactive proposals should generally be avoided as unfair to taxpayers who made business decisions on the basis of the law in place at the time. Congress should avoid enacting retroactive policies so that individuals and businesses can have a reasonable reliance on the laws in place at the time of their actions.

Tax accounting

A number of changes to tax accounting rules are designed to broaden the tax base to provide for a revenue-neutral reduction in the corporate tax rate. As described earlier, without an understanding of other changes that may be made and the corporate tax rate that can be attained through these changes, no specific comments are provided at this time on these proposals.

---

which capital expenditures are fully and immediately deductible when incurred, are most appropriate for tax depreciation.

[8] Most of the original estimates on which the discussion draft measures of economic depreciation are based come from Frank Wykoff and Charles Hulten, "Tax and economic depreciation of machinery and equipment," Office of Tax Analysis working paper 28, July 1979, available at: http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/ota28.pdf. As noted in a 2000 Treasury Report, "these estimates have a number of serious weaknesses, not the least of which is that the evolution of the economy over the past 20 years may have rendered them obsolete." (US Treasury, *Report to the Congress on Depreciation Recovery Periods and Methods*, July 2000, p. 31) A separate analysis by other Treasury economists noted that "Another serious problem is that most of the Hulten-Wykoff depreciation rates are based on extrapolations rather than on explicit statistical estimates based on used asset prices." (David W. Brazell and James B. Mackie III, "Depreciation Lives and Methods: Current Issues in the U.S. Capital Cost Recovery System," *National Tax Journal*, September 2000, p. 536)

Unaddressed issues

Although no specific proposal is included in the discussion draft on the research credit, a summary by the Senate Finance Committee Staff states that "the Chairman's staff is considering expanding and making permanent the research and development credit" and requested comments on this research incentive.[9]

The economic spillover effects of robust R&D activities as benefiting consumers and workers has been consistently documented. Moreover, a 2009 analysis by the OECD found that the United States ranked near the bottom third among industrialized countries – 24th out of 38 countries – in the R&D tax incentives offered.[10] A permanent and expanded research credit is one means to consider by which the United States can enhance incentives for technological development and promote economic growth.[11]

V. CONCLUSION

To enhance growth and U.S. job creation, the Administration and Congress must make America's tax system more competitive for all businesses. Business Roundtable supports comprehensive tax reform done right, including a 25 percent corporate tax rate and a modern international tax system similar to the tax systems of other developed countries.

Tax reform achieving these objectives, in a revenue-neutral manner, will be a fundamental force in reigniting the dynamism of the U.S. economy and providing for strong and sustained growth. Without reform, U.S. workers and employers will continue to fall behind our global competitors. The time is now to fix our outdated tax system, which is out of step with modern business realities and acts as a drag on, rather than a facilitator of, economic growth.

Business Roundtable appreciates the considerable effort represented in these discussion drafts and looks forward to working with the Finance Committee to help improve these proposals to achieve tax reform that will result in strong and sustained American growth.

---

[9] Senate Finance Committee, "Summary of Staff Discussion Draft: Cost Recovery and Accounting," November 21, 2013.
[10] OECD Science, Technology and Industry Scoreboard, 2009.
[11] US Treasury, *Investing in U.S. Competitiveness: The Benefits of Enhancing the Research and Experimentation (R&E) Tax Credit*, March 25, 2011.

Submitted by the Business Roundtable on January 17, 1014

Contact Information:

Matt M. Miller, Vice President
202-496-3263

Business Roundtable
300 New Jersey Avenue NW
Suite 800
Washington, DC 20001