April 15, 2015

The Honorable Rob Portman
The Honorable Charles Schumer
Co-Chairs, International Tax Reform Working Group
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable John Thune
The Honorable Benjamin L. Cardin
Co-Chairs, Business Tax Reform Working Group
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Submitted via: International@finance.senate.gov
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Dear Co-Chairs Portman, Schumer, Thune and Cardin:

Thank you for your leadership in undertaking U.S. international and business tax reform. The Medical Device Competitiveness Coalition ("MDCC"), which is composed of the undersigned seven medical device manufacturers with significant operations in the United States, has been working for over four years to advocate for corporate tax reform that modernizes and simplifies the international tax rules and enhances the competitiveness of companies with significant U.S. operations conducting business in global markets.

U.S. medical device manufacturers lead the world in the design and development of innovative devices that save and improve the lives of patients around the world. The global nature of our business and the highly specialized nature of our products make it vitally important that we locate business operations close to our customers, both within and outside the United States. International sales currently represent more than half of global sales for many device manufacturers, with future growth in foreign markets anticipated to exceed domestic growth. Even with this international growth and an uncompetitive U.S. tax system, U.S. medical device companies source much of their global manufacturing and research in the United States. As a result, international growth fuels more U.S. manufacturing and research jobs.

Key Principle for Tax Reform: Competitiveness

MDCC believes competitiveness should be the guiding principle of tax reform. This principle encompasses the competitiveness of businesses with significant U.S. operations in global markets, competitiveness of the United States as a home country for global businesses, and competitiveness of the United States as a location for innovation, manufacturing and investment. The medical device industry illustrates all three of these aspects of competitiveness.

While the United States is currently the world leader in medical device innovation and manufacturing, the U.S.-based medical device industry faces both immediate and long-term challenges from foreign competitors. Most of our foreign competitors are based in countries with corporate tax systems that provide those companies with a competitive advantage – not only lower corporate tax rates, but also more favorable rules for the tax treatment of international earnings that don't lock-out those earnings from domestic investment. Moreover, many foreign countries offer significant incentives to attract foreign direct investment in research and manufacturing. The tax imbalance faced by our industry has been exacerbated by the medical device excise tax, which policy-makers should consider as they analyze the impact of existing disparities in the tax treatment of different industries.

The Need for Corporate Tax Reform

The medical device industry is already experiencing tax reform in the marketplace and in other countries even though the United States has yet to reform its corporate and international tax system. In the marketplace, U.S. companies compete for customers and acquisition targets with competitors domiciled in countries with more competitive tax systems. In other countries, the G-20/OECD BEPS project and other actions will lead to higher foreign taxes on U.S. multinationals, depriving the U.S. Treasury of any hoped-for revenue. At the same time, foreign countries are adopting tax policies designed to attract investment and jobs. The competitiveness of U.S.-based companies, companies with significant U.S. operations, and the United States as an investment location are threatened the longer the United States waits to enact corporate and international tax reform.

As our comments below demonstrate, domestic and international tax policies are intertwined. Addressing one without the other under currently contemplated revenue constraints would fail to produce a competitive tax system. In particular, MDCC is concerned that enacting international reform alone would leave the high U.S. corporate tax rate in place and result in a "hybrid" international tax system that is predominantly worldwide rather than territorial.

International Tax Reform

Dividend exemption system: MDCC strongly supports efforts to reform U.S. international tax rules to be more closely aligned with those of most other developed countries. A dividend exemption system would permit companies to deploy funds for business-driven purposes without overly burdensome tax costs, making the United States a more competitive home country for U.S.-based medical device companies, leading to increased investment in U.S.-based operations.

Base erosion: As a general principle, MDCC's view is that where a company has priced intangibles on an arm's length basis, and where the company has substantial activity, for example, manufacturing, in the jurisdiction in which such intangibles are used, the resulting foreign income (or loss) should not be subject to current U.S. tax under any anti-base erosion measures. However, if policymakers choose to enact anti-base erosion measures that target "low-taxed" foreign subsidiary earnings without regard to business substance, such measures should be drafted in a way that balances concerns about base erosion with the key objectives of business tax reform – competitiveness and simplification.

Base erosion recommendation: A carefully crafted "carrot and stick" approach could achieve a balance between base erosion concerns and competitiveness, and also provide an incentive for domestic manufacturing of innovative products. MDCC recommends the approach taken by former Chairman Camp's tax reform bill (H.R. 1, 113th Cong.), modified in the following respects:

- *Simplify the determination of embedded intangible income:* H.R. 1 provides a formula to measure intangible income that would subject a substantial portion of MDCC companies' active foreign subsidiary earnings to U.S. tax at 15 percent (the effective minimum tax rate for serving foreign markets) or 25 percent (the full rate applicable to U.S. market income). From MDCC's perspective, these rates would be anti-competitive. MDCC recommends this formula be modified to capture less foreign subsidiary income and bring the effective tax rate down to a more competitive level. MDCC has recommended treating a specific percentage – 50 percent – of a foreign subsidiary's active business earnings from sales or other dispositions of property as embedded intangible income.[1] MDCC would support other ways to allow for a lower competitive effective tax rate, such as increasing the intangible income deduction, or simply adopting a minimum tax with a broader base and lower rate (see discussion of minimum tax approaches below).
- *Expand the "carrot" to include all sales of products manufactured in the United States*: With respect to domestic manufacturing, H.R 1's reduced tax rate applies only to export sales, even though the United States is one of the largest markets for innovative products. MDCC suggests expanding this aspect of H.R. 1 to include intangible income attributable to all products manufactured in the United States. This would help maintain parity for U.S. companies with global manufacturing operations in serving foreign markets and create a real incentive for domestic manufacturing to serve U.S. markets.[2] Such an incentive would make the United States a more attractive location for both U.S. and foreign multinationals and would benefit wholly domestic companies as well.

Minimum tax approaches to base erosion: Minimum tax approaches generally adopt a worldwide tax on some base of active foreign subsidiary income. A reasonable effective U.S. tax rate on active foreign subsidiary income is the key to addressing lock-out and base erosion concerns without undermining the competitiveness of U.S. companies in global markets. U.S. companies are competing with foreign companies where they operate around the world, but only the U.S. companies would be subject to any proposed minimum tax regime. The effective tax rate on the worldwide tax base is therefore directly related to competitiveness.

A prime example is the ability of U.S. multinationals to expand internationally through foreign acquisitions. Foreign expansion benefits domestic employees,

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[1] This proposal is consistent with prior legislation where Congress provided for a simple rule in place of an otherwise complex determination of intangible income. See section 936(h)(5)(C)(ii) (50/50 profit split associated with the use of intangibles).

[2] The same simplified determination of intangible income – treating 50 percent of income from domestic manufacturing as intangible income – could be applied. Expanding the "carrot" in this fashion could also be viewed as a simplified and enhanced manufacturing deduction under section 199.

shareholders, and the U.S. Treasury. An incremental tax on the earnings of foreign targets that applies only to U.S. multinationals, however, would give foreign companies a clear advantage in competing for acquisitions. Similarly, foreign companies would also have an advantage in bidding for U.S.-based international businesses because the incremental U.S. tax on foreign operations could be eliminated to provide a post-acquisition synergy not available to U.S.-based bidders.

Some minimum tax proposals would apply the minimum tax only to foreign subsidiary income from serving foreign markets, subjecting U.S. market income to full U.S. tax.[3] Competitiveness concerns, however are not limited to serving foreign markets. Subjecting foreign subsidiary income to full U.S. tax, regardless of business substance, would put U.S. multinationals at a competitive disadvantage relative to foreign competitors, who would continue to be able to take advantage of local foreign tax incentives to manufacture for global markets, including the United States.

Transition tax: MDCC acknowledges the importance of providing a transition rule that brings all taxpayers and all foreign subsidiary earnings into the new regime up front through a "deemed repatriation." A tax on historical foreign subsidiary earnings should be minimized, particularly with respect to earnings that have already been re-invested in the business. Although "deemed repatriation" would prevent lock-out of historic earnings represented by liquid assets, earnings already invested cannot be repatriated, so taxpayers would be required to find other means to pay the tax, including more debt and lower domestic investment. In addition, MDCC does not support "deemed repatriation" outside of business tax reform.

CFC look-thru: MDCC recommends that CFC look-thru be considered a permanent part of the current tax code and be maintained in a reformed system to create the most competitive international tax system as is possible given revenue constraints.

Interest expense disallowance: Expense disallowance would result in expenses that are not deductible anywhere. MDCC recommends including the thin capitalization approach taken by H.R. 1 rather than expense allocation to address any concerns about base erosion from using domestic debt to finance foreign operations.

Foreign tax credits: Any anti-base erosion proposal that subjects more active foreign subsidiary income to current U.S. tax needs to provide appropriate rules for foreign tax credits. MDCC recommends taking an approach that minimizes double taxation as much as possible.

Domestic Business Tax Reform

Domestic manufacturing incentive: As discussed above, MDCC recommends a carefully crafted "carrot and stick" approach that would strike an appropriate balance between base erosion concerns and competitiveness. Minimum tax approaches, on their own, risk sacrificing competitiveness to protect against base erosion and, over the long run, will lead to less domestic investment and less U.S. tax revenue. MDCC's

[3] *See, e.g.*, H.R. 1, the "Tax Reform Act of 2014" (113th Cong.) (40% deduction would be limited to foreign market FBCII); Baucus staff discussion draft (Nov. 2013) (Options Y and Z would treat all U.S. market income as subpart F income); *but see* Obama FY 2016 budget proposal (no distinction between U.S. market and foreign market income in applying proposed minimum tax).

recommendation to adopt a targeted "carrot" that provides a meaningful incentive for domestic manufacturing would counteract the adverse effects of any minimum tax "stick."

Research credit: The members of MDCC conduct a substantial amount of research in the United States and support a permanent and enhanced research tax credit as part of tax reform. The credit encourages new and continual research in the United States. The current credit, however, is not as competitive as it should be. According to the OECD, the tax incentive per dollar spent provided by the U.S. research credit ranks 24th out of 38 countries, at approximately seven percent.[4] For MDCC members, the credit as a percentage of research costs incurred in the United States is even lower.

Lower corporate tax rate: A significantly lower corporate tax rate is a key component of tax reform. A lower rate will help minimize concerns about base erosion and make the United States a more attractive investment location for both U.S. and foreign-based businesses.

IP box proposals: In addition to a permanent and enhanced research tax credit, some have proposed that the United States adopt a reduced tax rate for income attributable to certain intangible property (IP). MDCC does not support an IP box that is limited to patents. Although the medical device industry does utilize some patents, much of the industry's innovation is embodied in other types of intangible assets, such as know-how, manufacturing processes, and trade secrets. If policymakers consider adopting an IP box, MDCC strongly recommends that the definition of eligible IP extend beyond patents to include all medical technology related to the products and manufacturing processes that a company develops and commercializes. In addition, any nexus standards should be drafted in a manner that takes into account the global regulatory environment in which MDCC members operate.

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We very much appreciate the opportunity to provide our perspectives on business and international tax reform and the need to ensure that competitiveness is a key objective. We look forward to working with you and other members of the Senate in this important effort.

Sincerely,

BD (Becton, Dickinson and Co.)
Boston Scientific Corp.
Cook Medical, Inc.
Edwards Lifesciences Corp.
Medtronic, Inc.
St. Jude Medical, Inc.
Zimmer, Inc.

Cc: Chairman Orrin Hatch
Ranking Member Ron Wyden
Members of the International Tax Reform Working Group
Members of the Business Tax Reform Working Group

[4] OECD Science, Technology and Industry Scoreboard 2009.