American Automotive Leasing Association

April 8, 2015

The Honorable John Thune
Co-Chairman
Business Income Tax Reform Working Group
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Ben Cardin
Co-Chairman
Business Income Tax Reform Working Group
219 Senate Office Building
Washington, DC 20510

Dear Senator Thune and Senator Cardin:

Thank you for your work with the Senate Finance Committee Business Income Tax Reform Working Group (the "Working Group").

The American Automotive Leasing Association ("AALA") is writing to provide the Working Group background information relating to the commercial automotive fleet leasing industry, and present the industry's specific tax policy concerns relating to capital cost recovery and the treatment of debt capital. As a general matter, AALA strongly supports retaining current law relating to the tax treatment of debt. However, if Congress were to consider limiting the deductibility of interest, it would need to consider the consequences for the financial services industry. More specifically, to the extent that tax reform addresses the concept of "net interest"—as it must do if the tax code is to account for the unique role of interest in the financial services industry—AALA strongly advocates that the concept of net interest also be applied to leasing companies, and that net interest for those companies be computed in a way that properly takes lease payments into consideration. In addition, AALA strongly supports retaining current law capital cost recovery rules for cars and light trucks.

AALA is a national industry association comprised of commercial automotive fleet leasing and management companies. Membership includes domestic and international companies as well as family-owned businesses. AALA also has an associate member category that is open to any company or organization with an institutional interest in the automotive leasing industry. Founded in 1955, AALA remains the only industry association representing companies that lease and manage vehicle fleets for other businesses, governments, and utilities. Thus, AALA strives to educate public officials and lawmakers on the key business issues that impact commercial fleet lessors, management companies and their customers.

The commercial automotive fleet leasing and management industry is a major contributor to a vibrant U.S. economy. Commercial fleet lessors annually purchase approximately 1,000,000 new domestic vehicles for long-term use. Those purchases account for a very substantial percentage of the domestically produced vehicles sold in the United States. (Historically, commercial fleet lessors have purchased a far lower percentage of vehicles sold by foreign manufacturers.) Moreover, because vehicles that are part of commercial fleets tend to be driven more than most vehicles, fleet lessors have a disproportionately large economic impact because of their relatively high utilization of auto supply chain goods and services such as tires, auto parts, and repair services. In addition, commercial fleet lessors—which are responsible for maintaining vehicles and maximizing their fuel efficiency—also are key to promoting greater innovation and productivity in one of our economy's most prominent sectors. Their fleets tend to be newer, safer, and more fuel efficient than the general public.

To finance the acquisition of many hundreds of thousands of vehicles each year, commercial fleet lessors use considerable debt. That debt is used very responsibly—for decades, AALA's members have enjoyed very high credit ratings, and their payment history has been consistently excellent. Even throughout the recent recession, AALA's members maintained very solid balance sheets, and never needed—or sought—any type of financial bailout. Their securitizations performed extremely well and credit losses, if any, are generally measured in basis points.

AALA and its members are very focused on the evolving policy debate over the relative tax treatment of debt and equity, and we wish to provide the Working Group with our assessment of the competing assertions made in the course of that debate. Most fundamentally, we wish to highlight for the Working Group that our members' experience with the responsible use of debt is contrary to the central premise of those who are seeking to change current law—that is, notwithstanding what some assert, debt and equity are, in fact, quite different. Although debt and equity both may be used to obtain capital for business purposes, they are not the same and, for that reason, should not be treated as the same under the tax code. Payment of debt is contractual, and is a required cost of doing business paid at such intervals and upon such terms as may be set by creditors. Returns of, and on, equity are discretionary, and are paid solely out of profits at intervals set by the company, not by stockholders. As a result, there is a significant difference in the cost of debt and equity. Financing large portfolios of vehicles purely with equity would be so prohibitively expensive and difficult to raise that it would greatly limit the ability of companies to procure these assets and would dramatically increase the cost, which would ultimately be passed on to our customers through higher prices.

Congress should carefully consider the externalities of modifying the existing treatment of debt and equity. Market conditions and an individual company's circumstances, not the tax code, should determine whether a company chooses to lease or purchase a vehicle. In particular, leasing is a market response that permits the allocation of economic benefits in a highly efficient way. Leasing permits companies which choose to lease vehicles to maximize their economic position with a minimum of transaction costs. Yet the leasing industry, which over the course of many decades has become one of our nation's great economic success stories, depends on the responsible use of debt financing. Because the interest paid on that debt, which is a major cost of doing business for AALA's members, is a legitimate business expense, it is generally deductible. Any limitations on the deduction of interest would drive up our costs very significantly, and be devastating to our industry and the many businesses and employees who depend upon us.

As you know, the deduction for interest paid or accrued by a business, currently codified at Internal Revenue Code section 163(a), has been a part of the tax code from its inception, and properly so—interest is an ordinary and necessary business expense.

In the course of the tax reform debate, several rationales have been offered to justify possible changes to the current tax treatment of interest. However, those rationales do not comport with the experience of AALA's members. For example, President Obama's "Framework for Business Tax Reform", released on February 22, 2012, stated, "Additional steps like reducing the deductibility of interest for corporations should be considered as part of a reform plan" because doing so "will reduce incentives to overleverage and produce more stable business finances, especially in times of economic stress." Yet, as decades of experience have demonstrated, there is no need to create an incentive to reduce the use of debt among commercial fleet lessors. Even in times of economic stress, AALA's members have managed their finances responsibly. Moreover, AALA's members are neither too big to fail, nor do they pose a threat to the financial system.

Indeed, further limiting the deductibility of interest would lead to far more economic disruption than maintaining current law. The President's "Framework" states that "debt and the associated contractual covenants require ongoing payments of interest and principal and allow creditors to force a firm into bankruptcy". Yet, the inability to borrow needed funds at a reasonable after-tax cost also could force a firm into bankruptcy. For any firm, the increased costs that necessarily would result from further limits on the deductibility of interest would inhibit growth and job creation. Moreover, raising the cost of doing business for commercial automotive fleet lessors would increase costs for our customers and reduce demand for the hundreds of thousands of vehicles which AALA's members lease, and the billions of dollars of goods and services which our members annually purchase. In short, further limiting the deductibility of interest would achieve the very opposite of the goals tax reform is meant to serve, that is, boosting the competitiveness of U.S. businesses and spurring economic growth and job creation.

We recognize that, in addition to the general policy question of whether to limit further the deductibility of interest, the Working Group also must consider narrower technical issues relating to how interest is to be calculated. That issue is of particular importance to the financial services sector, of which commercial automotive lessors are a significant part.

To the credit of members of Congress and tax policy staff, you have been very attentive to the unique role of interest in the financial sector. For example, the Joint Committee on Taxation ("JCT") analysis of "Present Law and Background Relating to Tax Treatment of Business Debt" prepared in connection with the joint hearing convened on July 13, 2011 by the Senate Finance Committee and House Ways and Means Committee repeatedly acknowledged the differences between "financial" and "nonfinancial" business sector debt. In addition, current law clearly recognizes that leasing is very much a part of the financial sector. For example, Internal Revenue Code section 954(h)(4)(C), which relates to the tax treatment of financing income of certain controlled foreign corporations, defines the term "lending or finance business" as including the business of "engaging in leasing (including entering into leases and purchasing, servicing, and disposing of leases and leased assets)".

Of particular interest to AALA's members is the calculation of "net interest" expense. Former Ways and Means Committee Chairman Dave Camp incorporated the concept of "net interest" in the international tax reform package he released in October of 2011. Specifically, former Chairman Camp proposed suspending the deductibility of "net interest expense" of a domestic corporation that is a U.S. shareholder of a controlled foreign corporation in the same worldwide affiliated group to the extent of the lesser of (i) the excess domestic indebtedness ratio determined by the amount by which U.S. group members' debt gives rise to a domestic debt to equity ratio in excess of the worldwide group's debt to equity ratio over the worldwide group's debt, and (ii) an unspecified percentage of the domestic corporation's adjusted taxable income (EBITDA under rules of Internal Revenue Code section 163(j)(6)(A)).

To the extent that the Working Group or the Senate Finance Committee sees fit to utilize the concept of "net interest" in tax reform legislation, AALA urges that the term be made expressly applicable in the context of a leasing business such as that conducted by AALA's members. The concept of net interest is already readily understood and clearly defined for lending institutions, that is, the amount a lender receives from interest on assets minus the amounts the institution pays out for interest on liabilities. However, because leasing businesses are a different type of financial services entities than lending institutions, it is also very important that the definition of "net interest" contemplate the unique characteristics of leasing businesses. In particular, because lease payments include a component attributable to interest, that fact must be accounted for in any calculation of a leasing company's net interest.

AALA and its members are also focused on the longstanding debate with respect to modifying the Internal Revenue Code's capital cost recovery provisions. It is the experience of our members that current depreciation rules are not overly generous with respect to the treatment of cars and light trucks, and more closely approximates economic reality than some recent legislative proposals, such as former Chairman Camp's draft tax reform bill. The "Tax Reform Act of 2014" ("2014 Act") proposed to repeal the modified accelerated cost recovery system ("MACRS") recovery periods, instead proposing methods and rules substantially similar to the alternative depreciation system ("ADS") rules. The 2014 Act also proposed allowing a taxpayer to elect to take an additional depreciation deduction to account for the effects of inflation on depreciable personal property, calculated by multiplying the year-end adjusted basis in the property (determined without regard to inflation deductions) by the chained consumer price index rate for the year.

Further, the 2014 Act would have repealed several special depreciation provisions, including bonus depreciation. The 2014 Act would also have required the Treasury Department, in consultation with the Bureau of Economic Analysis, to develop a new schedule of economic depreciation, and submit a report to Congress containing the new schedule and other recommendations by December 31, 2017.

To a large extent, the determination of whether current depreciation schedules are overly generous or overly restrictive depends on whether the metric for establishing the depreciation schedules is an asset's useful life or its economic life, that is, the length of time an asset may be used or the rate at which it loses value, particularly as reflected in the asset's resale price. Thus, former Chairman Camp justified his proposal by stating that it would mean that, "in general, class lives would match more closely the true economic useful life of assets" by applying a straight-line method of depreciation.

Our members, in contrast, find that fleet-leased vehicles generally have useful lives that match or are somewhat less than the current-law period over which they may be depreciated. Unlike typical passenger vehicles, fleet-leased vehicles are generally driven great distances each day, often under less-than-ideal driving conditions (*e.g.*, terrain, loads, weather). As such, a fleet-leased vehicle's value may decline more rapidly than is reflected in the depreciation schedules, even with accelerated depreciation. In order to match economic reality, AALA strongly supports retaining depreciation for automobiles that is at least as favorable as current law.

In addition, AALA would like to draw the Working Group's attention to a significant externality of restricting depreciation beyond existing law: it is likely harmful to economic growth. There has been a recent awakening to this fact. For example, in its "Macroeconomic Analysis of the 'Tax Reform Act of 2014'", the JCT modelled the economic impact of the proposed curtailment of depreciation, noting that "[o]verall, the proposal is expected to increase the cost of capital for domestic firms, thus reducing the incentive for investment in domestic capital stock." Others outside of government have observed this effect as well. For example, in a recent article, Martin Sullivan, the chief economist for the influential Tax Notes publication, notes that:

> It is surprising to many, but it is nevertheless true that a plain vanilla, revenue-neutral business tax reform that lowers rates and pays for those lower rates by reducing depreciation allowances will actually reduce, not increase, economic growth.

As do many within and outside of government (including the members of the Working Group), AALA strongly believes that tax reform should foster economic growth. If growth is an aim of tax reform, curtailing depreciation is not a useful proposal.

AALA looks forward to working with the Working Group, and the full Senate Finance Committee, to help develop tax reform legislation that effectively addresses these important issues. In the meantime, if you require further information, please contact me at dfrank@wheels.com, or at (847) 544-4189, or AALA Executive Director, Pamela Sederholm, at Sederholm@aalafleet.com, (703)548-0777. Thank you very much.

Very truly yours,

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AALA MEMBER COMPANIES

Automotive Resources International – Mt. Laurel, NJ
Donlen Corporation – Northbrook, IL
Emkay, Inc. – Itasca, IL
Enterprise Fleet Management – St. Louis, MO
GE Capital Fleet Services – Eden Prairie, MN
LeasePlan USA – Alpharetta, GA
Element Fleet Management – Sparks, MD
Wheels, Inc. – Des Plaines, IL

ASSOCIATE MEMBER COMPANIES

Adrian Steel Company – Adrian, MI
Amerifleet Transportation, Inc. – Alpharetta, GA
Automotive Fleet Magazine – Torrance, CA
Fiat Chrysler Automobiles US LLC – Auburn Hills, MI
Ford Motor Company – Dearborn, MI
General Motors – Detroit, MI
Gulf States Toyota - Houston, TX
Nissan North America, Inc. – Franklin, TN
Professional Automotive Relocation Services (PARS) – Gainesville, VA
Safelite Solutions – Columbus, OH
Southeast Toyota, LLC - Deerfield Beach, CA
Toyota Motor Sales, USA – Torrance CA
VNG.co – Bala Cynwyd, PA
Wright Express Corp. (WEX) – South Portland, ME