

**CEO PERSPECTIVES ON HOW THE TAX CODE
AFFECTS HIRING, BUSINESSES, AND
ECONOMIC GROWTH**

HEARING

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE**

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

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**CEO PERSPECTIVES ON HOW THE TAX CODE
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ECONOMIC GROWTH**

WEDNESDAY, JULY 27, 2011

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:09 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Conrad, Bingaman, Wyden, Stabenow, Nelson, Menendez, Cardin, Hatch, Snowe, Enzi, Cornyn, Thune, and Burr.

Also present: Democratic Staff: Russ Sullivan, Staff Director; Blaise Cote, Tax Research Assistant; David Hughes, Tax Advisor; and Jeff VanderWolk, International Tax Counsel. Republican Staff: Tony Coughlan, Tax Counsel; Maureen McLaughlin, Detailee; and Christopher Hanna, Senior Tax Policy Advisor.

**OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR
FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE**

The CHAIRMAN. The hearing will come to order.

Benjamin Franklin wrote, "When men are employed, they are best contented."

Today, too many men and women are unemployed. These are Americans who have worked, want to work, and will work again.

Our economy rests on the foundation of businesses, big and small, providing the goods and services that the market demands. And many Americans' livelihoods rest on businesses providing jobs, which are currently in short supply.

The unemployment rate is hovering around 9 percent. Poverty has increased—14 percent of Americans now live in poverty, including more than one-fifth of all U.S. children.

Many who are unemployed have been searching for work for more than a year. These Americans need a job and the certainty that comes with going to work every day.

In this environment, the business community has an opportunity and an obligation to help get Americans back to work. Businesses need to step up to the plate by preserving good-paying jobs and creating new ones. This means not just waiting for demand to fully recover, but giving Americans a chance, including the long-term unemployed.

We want to make sure our tax code supports efforts to create jobs. Our ultimate goal is not simply economic growth for growth's

sake or profitability for business owners alone. But job creation cannot occur without this growth.

We know that American businesses face obstacles achieving growth. Our economy is slowly recovering from the most significant recession since the Great Depression. Consumers are saving more and spending less. Banks are more cautious in their lending practices.

At the same time, competition is getting tougher in an increasingly globalized economy, and major new players are emerging in developing countries.

In 1960, exports accounted for 3.6 percent of America's GDP. Today, they account for nearly 12.5 percent. And sales are growing faster in markets outside the U.S. than they are here at home in most industries.

In today's global economy, we simply cannot afford for the tax code to hamper businesses' ability to compete and create jobs here at home. We need corporate tax rules that encourage job creation and widespread economic growth.

Last year we began a comprehensive review of America's tax system to understand how our tax code became so complex. More recently, we have held hearings addressing the need for tax reform.

These hearings have looked at the goals we want our tax system to accomplish and whether it effectively meets those objectives. Of course, the tax code should raise the revenue necessary to finance the operations of the Federal Government, but we also want our tax system to spur long-term economic growth which can benefit more folks in Montana and across the country, and we want it to promote fairness and certainty.

Americans need a tax code that helps them get back to work. Today's witnesses can help us understand the effect our current code has on U.S. businesses and their hiring practices. They represent some of the largest employers in our country.

I am grateful that they are here today with us to discuss whether the tax code imposes undue burdens on businesses and what ideas they may have to help improve investment, foreign investment in the U.S., as well as domestic investment here in the U.S.

We are looking forward to hearing what factors drive their decisions about whether to hire new employees. We need to identify the policies that are the most effective in helping these business leaders create more jobs.

Do we need to support innovation more effectively? Do we need to develop a more highly educated workforce? How can we level the playing field for U.S. companies competing overseas? How do we reduce incentives to locate new jobs abroad rather than here at home?

I ask each of our witnesses to take off your hat as an advocate of your company. I ask you instead to tell us what your experience as a CEO has taught you about what is best for our country.

So let us focus on how the code can help our businesses create good-paying jobs today, and let us work together to improve the tax system to ensure widespread prosperity for all Americans.

[The prepared statement of Chairman Baucus appears in the appendix.]

The CHAIRMAN. I would now like to turn to Senator Hatch.

**OPENING STATEMENT OF HON. ORRIN G. HATCH,
A U.S. SENATOR FROM UTAH**

Senator HATCH. Well, thank you, Mr. Chairman.

I would like to thank Chairman Baucus for calling this hearing today, and I would like to welcome each of you CEOs here, who have come here to participate in the committee's continuing dialogue about tax reform.

With so many of our fellow Americans out of work and struggling to find a job, it is refreshing to see that your companies, collectively, employ over 1.6 million people—1.6 million Americans. That is pretty good with you four folks.

Today, we are here to learn how the corporate tax affects your businesses. The corporate tax is the third-largest source of Federal revenues behind the individual income tax and payroll taxes.

Corporate income tax revenues as a percentage of total Federal revenues have steadily declined since the 1940s and 1950s. During much of the 1990s, corporate tax revenues averaged about 11 percent of Federal revenues. Last year, corporate tax revenues were less than 9 percent of our total Federal revenues.

The corporate tax is generally considered to be the most inefficient of all taxes, and tax scholars have debated for years as to who really bears the burden of the corporate tax.

We know that, although corporations cut the checks to the IRS, corporations do not ultimately pay taxes, people do. But which people? Is it the shareholders of the corporation or maybe the employees of the corporation or the consumers? The most recent research in this area seems to indicate that a substantial percentage of the burden of the corporate taxes is borne by employees in the form of lower wages.

In addition to inquiries about where the burden of the corporate income tax truly falls, I think it is important for this committee to focus on how the corporate tax system encourages the use of debt rather than equity. If the corporation is in need of additional funds, our current tax system encourages the corporation to borrow money rather than raising money by issuing stock.

Now, how is that? By making any interest payments on the borrowing deductible, whereas any dividends paid are not deductible. From a business standpoint, the increased use of debt by corporations makes a corporation more vulnerable to the risks of bankruptcy and other downturns in the economy.

Dividends not being deductible means that corporate profits are taxed twice, once at the corporation level and again at the shareholder level.

As a result of this tax treatment, we have seen a decline in the use of traditional corporations. In 1980, 75 percent of all business income was earned by traditional corporations. In 2007, that figure was only 36 percent. From 75 percent to 36 percent.

Equalizing the corporate tax treatment of debt and equity would reduce or eliminate distortions in at least four ways: number one, the incentive to invest in non-corporate businesses rather than corporate businesses; two, the incentive to finance corporations with debt rather than equity; three, the incentive to either retain or distribute earnings, depending on the relationship among the corporation, the shareholder, and the capital gains tax rates; and four, the

incentive to distribute earnings in a manner to avoid or reduce a second level of tax.

We also need to consider once again the issue of repatriation. Many U.S. multinational corporations earn money overseas and will typically want to bring that money back home to the United States. However, our corporate tax system discourages or penalizes U.S. multinational corporations, including Utah multinational corporations, from repatriating foreign earnings by imposing a 35-percent residual U.S. tax at the time of repatriation.

As a result, several high-profile U.S. multinational corporations are sitting on large piles of cash earned from foreign operations; yet, these same corporations are borrowing money.

One of the reasons is that their cash is trapped offshore, and these corporations will be subject to a 35-percent U.S. tax on repatriating their cash back to the United States. As a result, because of our corporate tax system, these corporations keep their cash offshore and borrow money here in the United States.

One way of alleviating the problem of cash that is trapped offshore is for the U.S. to reform its corporate tax and international tax rules by, for example, adopting a territorial tax system.

Finally, no discussion of corporate tax reform can conclude without consideration of the corporate tax rates. Our corporate tax system has a top rate of 35 percent. When coupled with a State corporate tax, the tax rate is usually about 39 percent. As a result, the U.S. has one of the highest corporate tax rates in the world.

Our corporate tax system is in need of reform, and the high corporate tax rate needs to be a major part of this discussion.

Now, I am very interested to hear what our witnesses have to say today with regard to our corporate tax system and how it affects hiring, businesses, and economic growth.

Again, Chairman Baucus, thank you very much for scheduling this important hearing, and I am certainly one of those really most interested.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. Thank you, Senator, very much.

I would now like to introduce our witnesses. First is Mr. Michael Duke. He is the president and CEO of WalMart Stores, the world's largest retailer, employer of about 2.1 million people.

Second, Mr. Thomas Falk, chairman and CEO of Kimberly-Clark. Kimberly-Clark is the world's top maker of personal paper products.

The next witness is Mr. Gregory Lang, the president and CEO of PMC-Sierra Semiconductor Manufacturing Company.

And, finally, Mr. Larry Merlo, president and CEO of CVS Caremark Corporation, the leading drugstore chain and pharmacy care provider.

Gentlemen, you probably know the rules or at least the custom and practice here. Your statements will automatically be included in the record, and I would encourage you to summarize your statements for about 5 or 6 minutes. I also encourage you to be candid, say what is on your mind. You know, life is short. Let us make the most of this. [Laughter.]

All right. Mr. Duke, why don't you begin?

STATEMENT OF MICHAEL T. DUKE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, WALMART STORES, INC., BENTONVILLE, AR

Mr. DUKE. Chairman Baucus, Ranking Member Hatch, members of the committee, I appreciate the opportunity to testify today.

We urgently need to modernize our tax code, and I thank you for taking on this issue. The ultimate outcome must be a strong, vibrant, job-creating U.S. economy.

I hope all of you know your local WalMart store back in your home State. But let me start with a few words about the company that we run out of Bentonville, AR.

Every week we serve 106 million unique customers, about one-third of the U.S. population. The business model that has earned our customers' trust is simple. We give them everyday low prices by passing on savings from our everyday low-cost operations.

Last year, WalMart paid \$4.7 billion in corporate taxes in the United States, which was 3 percent of all corporate income taxes collected by the U.S. Treasury. Our effective corporate tax rate was 32.2 percent. Many companies who will testify before you theoretically face similar tax rates, but we actually pay them.

But we are not here to ask for sympathy. The question is not whether WalMart can get by as a company under the current tax structure. The real question is: is this structure the best approach for our country? We believe that it is not.

As we begin this discussion, it is important to understand how WalMart's operations at home and around the world contribute to the U.S. economy. In the U.S., we operate over 4,400 stores and clubs, and we employ almost 1.4 million associates in the United States. I am happy to say that the domestic business is still growing.

Every store that we build means new jobs, construction jobs, an expanded local tax base, and more opportunities for U.S. suppliers.

WalMart is also growing around the world, which is good for the U.S. economy as well. Our international growth allows WalMart to source more goods from U.S. companies to sell in our stores around the world. Seventy percent of our top international suppliers are U.S. companies, which creates and sustains American jobs.

We are also one of the largest purchasers of American agricultural products. Last year, we directly exported nearly \$40 million worth of Washington apples, California asparagus, Florida grapefruits, and other crops. Likewise, we look for opportunities to use American products as we build stores, like the LED parking lot lights, which are mostly manufactured in North Carolina.

The best way that I can say it is that, when WalMart goes overseas, we bring American companies with us. When we grow, they grow.

So how do we reform the tax code to drive growth here at home and encourage America's competitiveness abroad? My advice is straightforward. Lower the corporate rate as much as you can, make the tax base as broad as you can, and move to a territorial system as quickly as you can. Without any of these three components, it will be impossible to achieve a fiscally responsible, simplified, and competitive tax system.

And we need comprehensive solutions, not piecemeal attempts to repeal this or that incentive. We will give up the existing incentives that benefit us if it means getting rid of them in a reformed system. Taking these steps will help American companies compete abroad, and I believe WalMart is more likely to export Washington apples or California asparagus than our foreign competitors.

Yet, these foreign competitors have an advantage because they pay less in corporate income tax. For example, we compete in China against Tesco from the U.K. With the U.K. territorial system of taxation, Tesco pays 25 percent to China on their business profits there and no additional tax when they bring money back to the U.K. In our case, we pay 25 percent to China, plus an additional 10 percent to cover the differential between the U.S. statutory rate and the Chinese rate when we bring that money home.

The result is that we are often outbid for retail sites because companies with lower overall tax rates have a lower cost of capital. When we do win, we pay more overall.

The keys to reform are to lower the corporate rate, get rid of existing incentives that benefit some industries over others, and level the international playing field with a territorial system.

If we take these steps, we will drive the virtuous cycle that I have described with more U.S. exports, more investment, and more job creation at home.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Duke appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Duke.

Mr. Falk, you are next.

STATEMENT OF THOMAS J. FALK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, KIMBERLY-CLARK CORPORATION, IRVING, TX

Mr. FALK. Good morning, Chairman Baucus, Ranking Member Hatch, and distinguished members of the committee. Thank you for this opportunity to share my views on the need for changes in our tax system.

First, I would like to provide a brief overview of Kimberly-Clark and our global businesses, and then I will address the three reasons we believe the current U.S. tax system hinders growth and puts American companies and workers at a competitive disadvantage.

Kimberly-Clark will be 140 years old in 2012. So we have been around through lots of different tax systems and grown our company through the years. And, through the years, we have been providing consumers with the essentials for a better life, with brands like Kleenex, Scott, Huggies, Pull-Ups, Kotex, Poise, and Depend.

We estimate that one out of every four people around the world uses our products every day, and they buy lots of them at WalMart and CVS as well.

In fact, I would expect that everyone in this room has used a Kleenex or changed a diaper at some point in time in their lives. We will not ask for a show of hands here.

But you may not know that we are also a leading provider of safety products that help protect both workers and the environments in which they work. Also, if you have been a patient in a

hospital, you would find that medical professionals count on Kimberly-Clark for products essential to the health and hygiene of their patients and staff, including surgical drapes and gowns, face masks, exam gloves, and infection control and pain management products.

So our company touches people's lives in many parts of the economy. Our consumers live in more than 150 countries. So we have to have a global presence to serve them. And because many of the products we sell are lightweight, bulky, and costly to ship, we have to manufacture our products close to where our consumers live and work.

Now, the U.S. market is our largest market, but the categories there in which we compete are mature, often growing at the rate of population growth. Like many companies, the developing and emerging markets represent our biggest growth opportunities.

For example, moms in the U.S. use about five diapers a day to care for their babies. In developing and emerging markets, moms may only use five diapers a week. This opportunity will represent a huge growth opportunity for us as these economies grow.

To be successful in any market, businesses need fertile ground on which to grow. That fertile ground includes access to skilled employees, reliable availability of energy, and other essential resources, and a competitive, stable, and predictable tax and regulatory environment.

So I would like to now address the three key ways we believe our tax system could improve the fertile ground in the United States and lead to more investment, job creation, and economic growth in our country.

First, we need to have a more competitive tax rate. The combined Federal and State tax rate in the U.S. averages approximately 39 percent, which significantly exceeds the rates in most other countries. The average combined tax rate among the member countries of the OECD is now 25 percent and is expected to decline further. In the competitive global market, U.S. companies are at a significant disadvantage versus non-U.S. companies who benefit from lower tax rates in their home countries—39 percent here, 25 percent elsewhere. When a U.S. company seeks to grow outside our home country, we are way behind before we even get started.

Second is taxation of worldwide earnings. In addition to its high tax rate, the U.S. taxes worldwide earnings of U.S.-based companies. Most developed countries do not tax their local companies in a similar manner.

Under the current U.S. system, all repatriated income is subject to U.S. tax, which creates an incentive for companies to leave their cash outside of the U.S. If we were able to freely bring our foreign income back home to the U.S., we would have the freedom to invest those earnings in product development, new capital spending, or return them to our shareholders, who, in turn, could invest in the U.S. economy. Cash trapped outside the U.S. is more likely to be invested overseas, creating foreign instead of American jobs.

The current tax system causes many U.S.-based multinationals to delay bringing their foreign earnings back home. Rather than restrict the free flow of capital, we need a territorial tax system that

encourages companies to deploy capital in a manner that supports the needs of the businesses and creates jobs.

And, third, we need to simplify our tax rules. It is no secret that our U.S. international tax system is highly complex. You may not know that I was a CPA once, and I actually completed corporate income tax returns early in my career.

The complexity of our current tax code is now understood by only a handful of international tax experts. This complexity requires U.S. companies to devote significant resources just to try to comply with the rules. Time and money spent on these activities takes away resources that could be spent on product innovation and market growth.

We need a system of international taxation that reduces the cost of administration, reduces the risk of error, and is easier to monitor. Now, I do not know if we will ever come up with a system that is so simple that even I could fill out Kimberly-Clark's tax return, again someday in the future, but that is a worthy goal.

American companies have a terrific base of talent, an unrivaled track record of innovation, and some of the greatest products and brands in the world. Unfortunately, we are disadvantaged against other global competitors as a result of the U.S. tax system.

So, to continue to prosper and deliver the essentials for a better life to consumers for another 140 years, Kimberly-Clark must grow both at home and around the world. We are committed to creating jobs, to developing new innovation, and to reinvesting for future growth everywhere we do business.

To do this, we need a tax system that is competitive with our global competitors. We need a tax system that is less complex and easier to administer, and we need a tax system that does not penalize us for earning money outside the U.S., but encourages us to redeploy it freely for future growth.

Mr. Chairman, this is an important debate. Many businesses today face critical decisions about future investment and growth. You and your colleagues have the opportunity to create a level playing field for U.S. businesses to compete and win on a global basis.

Thank you for giving me the opportunity to share my views on creating a tax system that supports the growth of American companies and that enables the growth of the American economy.

I would be pleased to take any questions you may have.

[The prepared statement of Mr. Falk appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Falk, very, very much.

Mr. Lang, you are next.

STATEMENT OF GREGORY S. LANG, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PMC-SIERRA, INC., SUNNYVALE, CA

Mr. LANG. Chairman Baucus, Ranking Member Hatch, and members of the committee, my name is Greg Lang, and I am the president and CEO of PMC-Sierra.

We generated about \$635 million in revenue in 2010 and are a leading semiconductor innovator, transforming networks that connect, move, and store digital content.

I am also a member of the Semiconductor Industry Association Board of Directors and the chair of the SIA's Tax Reform Working

Group, so I can offer a perspective on the semiconductor industry, as well as a mid-sized technology company.

I would like to thank the committee for the opportunity to present our views on how the U.S. tax code can promote job creation and sustained economic growth for our country. Before summarizing my recommendations for tax reform, I want to emphasize the importance of this industry to our Nation, and the reasons why corporate tax reform is essential to the continued growth and leadership in this critical industry.

First, semiconductors are essential for innovations in every aspect of our modern economy and national security. Semiconductors are the enabling technology for advanced communications, manufacturing, health care, information technology, as well as national defense and homeland security.

We are a fundamental building block of the broader \$1.1-trillion technology industry which supports 6 million jobs. Studies show that semiconductors and the information technologies they enable represent 3 percent of the economy, but drive 25 percent of economic growth.

Third, semiconductors are a global industry, with capable competitors around the world. Today, the U.S. industry holds approximately a 50-percent share of a \$300-billion worldwide market and represents America's largest export industry. In fact, the semiconductor industry, as a whole in the U.S., earns approximately 80 percent of our revenue today as export revenue.

Finally, the semiconductor industry is a key driver of U.S. innovation. The industry invests 17 percent of revenue in research and development, an amount higher than virtually any other sector.

Chip companies account for seven of the top 15 patent recipients in the U.S. In short, maintaining U.S. leadership in semiconductors is in our national interest and should be made a top priority of the Congress.

Tax reform is one part of an agenda to ensure that the U.S. remains a leader in innovation and economic growth. Given the strategic nature of the chip industry, other countries are actively targeting our sector with generous credits, grants, and reduced tax rates. In fact, China has specifically included our industry in their latest 5-year plan, with a number of incentives focused on drawing more investment into China.

To maintain U.S. leadership, our country must have a more competitive global tax structure. For example, it costs approximately \$1 billion more to build and operate a semiconductor manufacturing facility in the U.S. compared with other countries. Now, despite the perception that that may be due to labor differences between a high and a low labor rate country, in fact, the main cost differences are in tax benefits and other incentives.

To achieve a more competitive tax environment for the U.S., fundamental reform is necessary and must focus on three key elements. First, the U.S. should adopt a globally competitive tax rate. The OECD average rate is approximately 25 percent. For PMC, our emerging competition is in China, where the rate is approximately 15 percent for new technology businesses. In contrast, the combined Federal and State corporate tax rate is approximately 39 percent.

Many countries offer substantial tax holiday incentives for new high-technology investments, which effectively lower the rate to zero or single digits. While the U.S. need not match these incentives, tax reform must be competitive with rates of competing countries.

Second, our worldwide tax system creates an additional disincentive for U.S. companies. Meaningful tax reform should include a move to a territorial approach. A territorial system would enable companies to repatriate their profits to invest and create jobs in the U.S.

The U.S. is the only major OECD country with a global tax system. Combined with the highest tax rates, this is an enormous penalty for U.S. companies competing on a global scale.

Finally, comprehensive tax reform should provide strong and permanent incentives to encourage research and development in the U.S. R&D is the lifeblood of the semiconductor industry, but the R&D tax credit in the U.S. is weak compared to our global competition, and has lapsed 13 times in the last 3 decades.

The current R&D credit is complex and unreliable. Given the competition for investment and jobs around the world, it is insufficient to encourage R&D job growth here at home.

The semiconductor industry was invented here, and the U.S. can remain the leader. But industry leadership is not an entitlement. It is not guaranteed. At PMC, we must compete, day in and day out, and we have proven that we can compete and win on a level playing field.

Just as government's policy supported this critical industry in the 1980s when the U.S. semiconductor market was specifically targeted through harsh trade practices by foreign governments, corporate tax reform and other policies can help maintain the future and pace of American enterprise and innovation.

I would be happy to answer any questions.

[The prepared statement of Mr. Lang appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Lang.

Finally, Mr. Merlo?

STATEMENT OF LARRY J. MERLO, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CVS CAREMARK CORPORATION, WOONSOCKET, RI

Mr. MERLO. Good morning, Chairman Baucus, Ranking Member Hatch, and members of the committee, and thank you for holding this important hearing today and for allowing CVS Caremark the opportunity to share our views on tax reform.

CVS Caremark Corporation is the leading pharmacy care provider in the U.S., headquartered in Rhode Island, and we are dedicated to helping Americans achieve their best health outcomes at lower costs.

We employ over 200,000 people in the U.S., including more pharmacists and nurse practitioners than anyone else in the Nation, and we have a high effective tax rate of 39 percent.

Now, some think of us as the Nation's leading drugstore chain because we operate more than 7,200 CVS Pharmacy stores in 44 States, here in the District, and Puerto Rico. In fact, 75 percent of

all Americans in our markets live within 3 miles of one of our stores.

Others see us as a leading pharmacy benefits manager, or PBM. And I think, as you know, PBMs assist health plans, unions, and governments to design prescription drug benefit options that best meet their members' needs, and help drive down costs.

That being said, we think that CVS Caremark is more than just a PBM and a drugstore chain. We consider ourselves a part of the fabric of American society, working to improve the lives and health of our customers, and to provide those services at the lowest possible cost.

Because of that thinking, we have made significant investments in our people, and in our infrastructure here in the U.S. We believe that is our obligation as part of the American business community.

Now, as a measure of our commitment, over the past 5 years, CVS Caremark has reinvested more than \$10 billion of our earnings in our domestic operations and our employees, but we do believe that we can do more. Our company is committed to making significant future investments in our service offerings, our technology, our people, and other improvements to our infrastructure and operations.

Tax reform is important to CVS Caremark because it will lower our cost of capital and enable us to make even greater investments in our business.

For CVS Caremark, the key component of any tax reform is a reduction in the maximum corporate tax rate. Such reform would specifically allow us to accelerate our investments in jobs, and in our infrastructure. And the return on those investments will benefit us all in the form of lower overall health care costs and better health outcomes for consumers.

CVS Caremark's Federal effective income tax rate is approximately 35 percent, and our combined Federal and State effective income tax rate is approximately 39 percent. Together, with our more than 200,000 employees, we generate Federal payroll and corporate income tax revenues of approximately \$3.7 billion annually, and more than \$4.3 billion when similar State, local, payroll, and income taxes are considered.

Now, we have a high effective tax rate for two principal reasons, the first being that many of the tax policies that help industry have limited application to CVS Caremark; and secondly, we have consistently chosen to reinvest our earnings and create jobs here in the U.S.

In order to continue to be successful in an increasingly global marketplace, CVS Caremark must control costs, we must raise capital, and we must efficiently reinvest our earnings. And, although we have worked hard managing our operations and controlling costs to provide both capital for our business and returns for our shareholders, our high effective tax rate not only limits the amount of earnings available for reinvestment, but it also makes CVS Caremark less attractive to global investors.

Reducing the maximum rate to create a more competitive tax structure for U.S. corporations so we can effectively compete is both a thoughtful and responsible policy move.

As I stated earlier, CVS Caremark is dedicated to improving care and lowering costs for millions of Americans. Lowering the corporate tax rate will accelerate our investment in U.S. jobs and infrastructure, all of which will ultimately help us lower overall health care costs and grow our economy.

So, I would like to thank the distinguished members of the committee for your attention today, and I would be happy to answer any questions you might have.

[The prepared statement of Mr. Merlo appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Merlo.

I think there is a general feeling here in the Congress that we clearly need to reform the corporate tax code, and the individual as well, probably, because there are so many pass-throughs now compared with not too many years ago. And the reform generally we are talking about today is to lower the rate, broaden the base, move to a territorial tax regime, and so forth.

That is sort of, in the abstract, what needs to be done.

The next level of questions, though, is, if that is all pursued, to what degree will that encourage more job growth in the U.S. rather than more job growth overseas? If the corporate rate is lower, the base is broadened, and a lot of tax expenditures are eliminated, presumably, profits are higher and you get more flexibility as to where you locate your plants and your operations, et cetera.

But I think a lot of Americans are going to be thinking, particularly with unemployment rates so high, "Gee, all that sounds nice, but what assurance do we have, we Americans, that as a consequence of this change, more jobs will be in the U.S. rather than more jobs overseas?"

So let me start with you, Mr. Duke. I would like each of the four of you to just briefly touch on that.

Mr. DUKE. Thanks, Mr. Chairman. First, I would say that, in the growth overseas, when WalMart grows overseas, we bring American companies with us, and I would welcome any members of the committee, in travels to other markets, to let us show you a Wal-Mart store and the products that are in a WalMart store in countries outside the United States.

Whether it is the agricultural products that would come from the U.S. or U.S. beef that we export to markets around the world, those products that are on the shelves that are produced by American companies would be an example.

The other would be, even here in the United States and the growth and opportunity here in the U.S., since we operate and build retail stores, our employment is at store level. We are not manufacturing the product, but we deliver directly to the consumer. And, in that relationship with the consumer, we certainly have more opportunity for growth to more consumers here in the U.S.

One of the interesting—

The CHAIRMAN. So, essentially, you are saying there would be more jobs created in the U.S. than created overseas.

Mr. DUKE. Absolutely.

The CHAIRMAN. With these changes.

Mr. DUKE. We would do both. There would be—

The CHAIRMAN. But more in the U.S., though. That is my question.

Mr. DUKE. Now, for a store that is open overseas, clearly, it would be some of both, and I am not able to quantify one compared to the other, because we open small stores and large stores. But it will create jobs in the United States to support stores that are opened outside the United States.

The CHAIRMAN. My time is pretty limited.

Mr. Falk, could you take a shot at that, please?

Mr. FALK. I will build on where Mike took off. Ultimately, you want U.S. business to be competitive in a global market. So you could take the opposite approach and say, "Well, what happens if we do nothing and the rate continues to rise, while OECD rates continue to go down?"

That is just going to mean American business is less competitive, and we are going to see job loss over time. So getting us back to a level playing field is critically important.

From Kimberly-Clark's perspective, we do virtually all of our research and development in the U.S. And so we have—as we grow overseas, we do more R&D here. We bring back roughly \$350 million a year in royalties on our intellectual property that is owned in the U.S.

So, as our business grows, we are going to do more R&D and have more staff support for that, here in the U.S.

The CHAIRMAN. Mr. Lang?

Mr. LANG. Yes. Just to build on the R&D perspective. In 1990, the U.S. had the number-one R&D tax credit in the world. It was a model for many around the world. Today, it is effectively the number 24 R&D tax credit around the world.

And this is an area where having the incentives to actually develop in the U.S. has a real impact on decision-making, and I will give you one small company example, which is my own.

We, in the last year, 2010, added about 20 percent to our employee base; so about 20 percent hiring, which is very good given the economic climate.

That is the good news. The bad news is only about 15 percent of those were in the U.S. And a lot of folks might immediately conclude that those jobs were actually sent overseas to India, to China; but, in fact, a third of those jobs actually went to Canada, where they have one of the most aggressive R&D tax credits in the world.

So I think our brothers up north have maybe something that we can learn from here. It is not the only decision made in terms of where to hire, but they have done a very effective job at neutralizing some of the differences between geographies and making it an incentive to invest in their local market.

The CHAIRMAN. Mr. Merlo?

Mr. MERLO. Well, Mr. Chairman, since we are a domestic company, I will only talk about the U.S., and I will cite two examples.

In my remarks, when I talked about accelerating investments in our infrastructure and creating jobs, when you look across the health care space, we have a problem with our health care system. There is about \$300 billion that is spent annually on unnecessary medical costs as a result of poor compliance and adherence of prescription drugs.

We believe we can accelerate our investments in terms of bringing products and services that are solutions to that problem that will improve the health of those we serve and, at the same time, lower the overall cost of health care across the country.

A second example I would cite: I think many of you know that we operate the largest number of in-store retail clinics. Today we have about 600 of them. We have plans to double the number of clinics over the next 5 years.

We believe that that provides an important source of primary care, acknowledging that there is a shortage of primary care physicians across the country, and that is expected to get worse over time.

So we believe—again, another example—we can accelerate our investments in the growth of retail clinics and, again, provide a service to Americans across the country.

The CHAIRMAN. Thank you. My time has expired.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman.

This question is for the entire panel. Ideally, tax policy should not distort business decisions, but, unfortunately, the current U.S. tax code does exactly that. It is highly distortive. It is characterized by a high statutory rate, lopsided incentives that encourage the use of debt instead of equity, as I said in my opening remarks, and, actually, it discourages or penalizes U.S. multinationals from repatriating foreign earnings back to the United States, where they can be invested and create U.S. jobs.

My question for the entire panel is: Is it not true that lower corporate taxes would create more investment opportunity in the United States? It would seem to me that a lower U.S. corporate tax rate makes it more likely that proposals for investment in the U.S. will meet your targeted rate of return, and that makes it more likely that investment will be made here, which, in turn, would support the growth of U.S. jobs.

Am I wrong about all this?

Let's start with you, Mr. Duke.

Mr. DUKE. Senator Hatch, you are absolutely correct. Comprehensive tax reform and a lower overall rate would create more incentive and more desire to invest, and I think that is what we are about: the creation of jobs and opportunity and competitiveness for U.S. companies. We agree.

Mr. FALK. Yes. I would build on Mr. Duke's comments. A lower tax rate lowers our cost of capital, and that makes more projects attractive. And so, as we go through and look at how to allocate our capital resources, lowering the rate in the U.S. would make more projects attractive to us in the U.S.

Mr. LANG. And, for a global business, I think lowering the effective tax rate allows us to invest in the U.S. without being penalized, and I think today it is a penalty.

Mr. MERLO. And, Senator, from the CVS Caremark perspective, again, acknowledging that we are a domestic company, yes, this would help us accelerate our investments, as I acknowledged earlier, in terms of bringing products and services to market faster and in a more robust fashion.

Senator HATCH. Well, thank you all. Just a quick follow-up question.

Mr. Falk, you note in your testimony that there have been proposals recently to “move the U.S. tax system further away from competitive global norms” by ending deferral of tax on a U.S. company’s foreign earnings.

That has been a suggestion by some in this administration. Now, this would actually burden U.S. companies with an even higher tax rate. Now, it seems to me that we cannot create the type of jobs that we desperately need if the tax code punishes companies that are headquartered here.

Would you comment further on the effect this would have on your company, and on the U.S. economy?

Also, if there were an accompanying tax rate reduction that were significant enough, would that make the repeal of deferral acceptable?

Mr. FALK. Well, Senator, you are certainly right that ending deferral would add further complexity to the tax code and drive up the cost for multinational companies, and it would be viewed as anti-business by the large multinationals.

So I think the challenge would be to say, how do we get a competitive global tax system with a competitive rate applied to a competitive base, which would be more of a territorial system and that would set American companies up to compete on an even keel with other multinationals around the world?

Senator HATCH. Thank you. Let me just ask one other question then. This could be a question for the entire panel.

The grand deal I hear being proposed by all of you gentlemen is that you are willing to have a broader tax base, meaning getting rid of a lot of tax expenditures, deductions, credits, et cetera, in return for a significantly lower corporate tax rate.

Now, that is a grand deal that interests me a great deal. I would like to help you with that. However, I do have a concern that I wanted to probe to see if you had any similar concerns.

What if you agree to get rid of a lot of tax expenditures, and you get the corporate rates down, say, to 25 percent or even lower for the first year of tax reform. But what if Congress, over the course of the next few years, increases the corporate tax rate right back up again to 30 percent or even all the way back to 35, but without the various tax expenditures?

Does that concern you? Are you concerned that a good part of the deal might only be temporary, but the bad part could be permanent? How do you get past that concern?

Mr. Duke?

Mr. DUKE. Sir, we are not competitive today. American companies are at a disadvantage today, and we do believe we need to move ahead with the comprehensive tax reform.

Clearly, I believe that it would be important to remain competitive, and it would be very, very important to measure, over time, the competitiveness, and ensure that American companies stay competitive.

It would clearly not be in the interest of American jobs to then increase the tax rate, and we would clearly not want to see that.

Senator HATCH. Mr. Falk?

Mr. FALK. I would just build on Mr. Duke's answer. One of the challenges in running a business today is the level of uncertainty that is out there. And so, uncertainty on tax policy does not help.

So it would help that comprehensive corporate tax reform would be coupled with a policy decision that we are going to make American businesses competitive in the global marketplace, and keep it that way for a long, long time.

Senator HATCH. Mr. Lang?

Mr. LANG. I think that certainty is similar to the example that I gave earlier on the R&D tax credit expiring 13 times over the last 3 decades. It is very hard to plan your business around the uncertainty involved with having to go through that question mark every few years.

Senator HATCH. I empathize with you there.

Mr. Merlo?

Mr. MERLO. I would just emphasize the point, Senator, that having a certainty and predictability in terms of being able to make our business decisions, I think, is one of the key elements of overall tax reform, and I would certainly encourage that.

Senator HATCH. Mr. Chairman, I am out of time.

The CHAIRMAN. Thank you very much.

Next, Senator Stabenow.

Senator STABENOW. Well, thank you, Mr. Chairman, very much. And welcome to each of you.

I want to follow-on—Mr. Lang, I am going to start with you—as it relates to the R&D tax credit. I could not agree more. It should be permanent. We have worked on that, a number of us, trying to make that happen.

But when we talk about the three prongs that each of you are talking about in terms of tax reform, one of those is eliminating tax expenditures or spending in the tax code.

And so I guess my question would be, as we look at this, how do we—how would you recommend that we evaluate tax expenditures? The R&D tax credit is a tax expenditure, and it is a very important one, I believe, and certainly I would not want to eliminate it.

But when we evaluate all of this, to me, it is very much about focusing on incentivizing innovation, research and development. I also think incentivizing manufacturing in this country is important, coming from a State that makes things.

And in the Recovery Act, I have championed the advanced manufacturing tax credit to incentivize a 30-percent tax cut for equipment, buildings, for making things here, for clean energy.

So I wonder if you might just speak, as we are reforming tax expenditures and looking at all of this, about how we should decide which ones to keep and which ones to eliminate, because I am assuming you would not want to eliminate all of them.

Mr. LANG. Thank you for your support in recognizing the importance of this part of our tax code.

But I believe that the challenge on the tax code, in general, is a multifaceted challenge, as you are well-aware. And our basis and our interest is getting to a point where the package, the overall system, is something that allows us to compete globally.

And so, when we are talking about R&D incentives, as well as the corporate rate, as well as a territorial system, we should be looking at how do we, as a country, enable our companies to compete most effectively.

That can be in the form of many different dimensions. But I think, very clearly, R&D incentives are being targeted very aggressively by certain countries who would love to have our R&D jobs relocated to their country.

So I think it is imperative for us to not stand by and let that happen, but actually to put a competitive system in place that allows us to invest at home and not be penalized for it.

The CHAIRMAN. So how do you do that?

Senator STABENOW. Right. Yes.

The CHAIRMAN. How do you do that?

Senator STABENOW. That was going to be—Mr. Chairman, you and I are thinking on the same wavelength, because how do we do that? On the one hand, we are talking about lowering the rate, eliminating tax expenditures or tax incentives, and yet we have a very big one called the R&D tax credit that is incredibly important.

I would also argue for looking at other countries right now, where we are competing with places like Germany, which is actually high-wage, high-cost, but has major manufacturing incentives, and they are taking our new clean energy manufacturing because they have manufacturing tax incentives.

And I would welcome anyone else who would want to respond, as well. But how do we do that while legitimately dealing with the other issues you raise, but, at the same time, knowing that we are competing because there are tax incentives in other countries?

Mr. FALK. I guess I will speak next. I guess my advice, too—this is not an easy challenge that you are facing—is to focus on getting the rate as low as you can and to get competitive with global economies around the world, because the marginal rate is where a lot of investment decisions get made.

So having a low marginal rate is much more important than incentive packages. And I would say, when it comes to making a choice between the marginal rate and an additional incentive package, I would choose the lower rate and get rid of the incentives.

Senator STABENOW. But, Mr. Lang, would you agree with that, if that meant the R&D tax credit?

Mr. LANG. I think having a competitive rate is important. I also believe that R&D incentives, as well as research funding in this country, have been a foundation for the IT industry that has really propelled growth for this country over the last couple of decades.

So I think it is a combination of factors. We need to be competitive as a country or we stand to lose something that was invented here.

Senator STABENOW. Not to be argumentative, but that is our dilemma, to be looking at competitive rates globally, but at the same time at the incentives that are also being given around the world, and we are losing because there are incentives being given in other countries.

Again, Mr. Chairman, on the manufacturing front, which I know you know I care deeply about, we are facing dilemmas because of

both financing mechanisms and tax incentives around manufacturing.

And I want to make sure that once we are done, Mr. Lang, with your R&D, that you are making everything here as well. And so that is my question as to how do we do that.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Nelson, you are next.

Senator NELSON. Mr. Lang, thank you for recalling that the semiconductor industry is so important. And you remember about 20 years ago when all of that business was about to go offshore and the United States decided that it was going to stop that trend, it put together a consortium called SEMATECH. And the proof is in the pudding, what you just told us. So congratulations.

I wanted to ask, Mr. Duke, in your testimony, you said, "In our view, the Bowles-Simpson Deficit Commission's corporate tax proposal represented a very good start because it endorsed these three components of reform."

There is a version of that that is circulating right now, which is the Gang of 6, and it basically gives huge deficit reduction back to the committees of jurisdiction. The biggest deficit reduction would come back to this committee, tax reform, what you have all testified to, health reform, et cetera.

Now, a big part of that tax reform is taking all of these tax preferences, otherwise known as tax expenditures, and getting rid of a lot of them, and instead taking that revenue that you gain from that and then allowing the tax system to be reformed, and to do just exactly what all four of you have testified, which is bring down the rates for everybody and simplify the tax code.

As a matter of fact, one proposal is to simplify it into three brackets for the individuals, and lower, of course, all the rates considerably, as well as the corporate rate.

Now, my question to you all is, boy, you are going to be stepping on some sensitive toes when you get rid of all those special tax breaks, otherwise known as tax expenditures.

So I would like your comment on it.

Mr. DUKE. Senator Nelson, first, I have to say I am not familiar with the specific discussions that you referred to that are taking place at the moment. So the details of the current dialogue I could not speak to.

What I can speak to, though, is this broad topic that you are really asking about, and we do believe that comprehensive reform does mean that willingness to put everything on the table, including all of those tax incentives that you are referring to.

And we think for the overall rate to be lowered—it needs to be in that mid-20 range to be competitive with other countries that we are competing with—it will require some difficult decisions around those incentives. And we do think comprehensive reform involves reviewing all of those in a very thoughtful way.

Mr. FALK. Yes, Senator Nelson. I guess I would build on that and say our Nation is facing a crisis, and, in a crisis, you can get amazing things done. Every one of us, as a CEO, has faced that in our businesses at some point, and you can drive a lot of change in a

short period of time and get things done that once were thought to be impossible.

And so I would urge you to be bold and come up with a tax system that makes American companies more competitive, and get some things done that could not be done in ordinary times.

Senator NELSON. It is kind of like the package becomes the— the whole becomes greater than the sum of its parts. But the sum of its parts is a lot of special tax preferences for individual interests that are not going to want to give them up, including preferences that inure to the benefit of your four companies.

Mr. FALK. To be specific, Senator, we do most of our R&D in the U.S. I take advantage of the R&D credit. We do a lot of manufacturing in the U.S. I take advantage of the manufacturing credit. I would trade both of those off for a competitive global statutory rate.

Senator NELSON. Mr. Merlo, you have a separate area. If this all came to pass and it came back here to the Finance Committee and we had to start doing some serious looking at where you take things out of the health care system, particularly, Medicare and Medicaid, do you want to make some suggestions?

Mr. MERLO. Well, I think that, similar to the discussion that we just had with the previous question in terms of, there are going to be puts and takes, I think that that is also true with our health care system, and, specifically, Medicare and Medicaid.

I acknowledge one of the challenges that we have, and I think that we have many opportunities to address the costs of Medicare and Medicaid and, at the same time, address some of the unnecessary costs and wasteful spending that we are seeing.

The example that I gave earlier was, \$300 billion is spent annually on unnecessary medical costs as a result of poor prescription drug compliance and adherence.

So I would encourage us to look at both of those as potential solutions to that challenge, recognizing that there are things that we can do to take costs out of the system, and, at the same time, keep Americans healthier.

Senator NELSON. Thank you.

The CHAIRMAN. Thank you.

Senator WYDEN. Thank you, Mr. Chairman. This has been a very helpful hearing.

I also want to note before we start, Mr. Falk, that, as the parent of 3-year-old twins, I am still stocking up on those diapers.

Mr. FALK. Well, thank you for the business, Mr. Wyden. We hope we have 100-percent market share in your household. [Laughter.]

Senator WYDEN. I am sure you are doing well.

The CHAIRMAN. And you are going to check next time.

Senator WYDEN. I am. I am. [Laughter.]

Mr. Chairman, I think you put your hand on the key question that people are talking about, and that is, how is this going to affect jobs? I think people in this country, that is what everybody is focused on, around the kitchen table, anywhere you go. And I want to ask a very specific jobs question.

If you all, as part of tax reform, were to give up tax deferral—that is the break, of course, that you get when you are doing business overseas; you defer paying tax until you bring the money home—and all of that money was brought back to our country and

used to slash rates dramatically when you are doing business in the United States so that we would be able to say you are then competitive with everybody around the world, would that not be a significant boost for job creation in the United States?

Let us start with you, Mr. Duke.

Mr. DUKE. So I think our position has been that each of these steps would be important, but it is important to look at the whole picture. And that is why we have continued to focus on comprehensive reform, operating on a global basis.

So we are growing in the United States already, and we want to continue that growth. I would say that competitiveness here is very, very important also. One of the retailers, our competitors, that has been growing in the United States recently is Tesco, which I mentioned earlier, a U.K.-based retailer, that does have an overall lower rate.

So growth in the United States and around the world is important, and we believe all of it should be looked at together.

Senator WYDEN. The reason I ask the question is, the Finance Committee said that your effective tax rate for 2010 was around 32 percent. If you abolish deferral and use those dollars for creating what I call red, white, and blue jobs, jobs in this country, your effective rate would go down considerably. You would be certainly in the mid- to low-20s.

That is why I am asking the question. Let us just go down the row.

Mr. FALK. Yes. In my particular situation—if you look at different markets around the world, our categories are growing at different rates. We talked about the young moms in emerging markets who today use five diapers a week who, within 5 years, will be using five diapers a day.

So our business in China today, we do about \$300 million. Within 5 years, we will be doing \$1 billion in China just to meet the demand of those consumers. And so for me, it is more about creating a system where we have free trade, free flow of capital, economies that generally thrive and prosper. And having a level corporate tax rate I think would be an underpinning of that.

Senator WYDEN. Mr. Lang, we touched on this yesterday.

Mr. LANG. Yes, we did. I need to start by saying that, certainly, having a system that allowed companies to bring the dollars back to the U.S. and put them to work in the U.S. can only be positive. Having those dollars overseas looking for overseas investment does nothing for us.

So bringing them home, I think, is something that I would strongly agree would be a positive for U.S. jobs.

The key question, though, comes down to, what is that rate, and is something in the low-20s really going to make it competitive with the other markets where we compete?

I think we all probably have some different countries, different places we compete, and different rates. In our business, most of the places we compete with are in the 15- to 17-percent statutory rate, and, as we know, with other special incentives, those rates can be substantially lower.

So my view of that and my concern about that would be finding that rate that would make it competitive, or make it neutral, and I think it would be below that low 20-percent range.

But I think that the general concept would be very positive, because it would simplify life and bring the dollars, and put them back to work here in the U.S.

Senator WYDEN. Mr. Merlo?

Mr. MERLO. Again, acknowledging that we are a domestic company, some of your question really does not specifically apply to CVS—

Senator WYDEN. You had a 38.9-percent effective tax rate, according to the Finance Committee's figures. So under this, for job creation in the United States, you would be one to see a very, very substantial rate reduction.

Mr. MERLO. And I think that that supports our goal of doing more in terms of products and services and accelerating our investments in our infrastructure, which will create jobs.

I think the question to my other panelists—I certainly concur with them, and I think that overall tax reform that does benefit multinationals in terms of bringing those dollars back to stimulate economic growth, accompanied by a meaningful corporate rate reduction, makes all the sense in the world.

Senator WYDEN. My time is up, Mr. Chairman.

I just wanted to say I am very interested in working with you, Mr. Chairman, and Senator Hatch on that point Senator Hatch made with respect to, when we have a Baucus-Hatch tax reform bill, that we have some way to try to keep in place that good work, and we do not unravel it so as to create uncertainty again.

I thought Senator Hatch's point was a very good one, and I am interested in working with you and Senator Hatch on it.

The CHAIRMAN. Thank you.

Senator Menendez?

Senator MENENDEZ. Thank you, Mr. Chairman.

Gentlemen, thank you for coming. I, with interest, have read your testimony. Let me start with Mr. Duke.

Mr. Duke, you have my former chief of staff working for you now, and I have come to be proselytized, because, if I read one more e-mail that says "Save Money, Live Better," I— [Laughter.]

Talk about branding, I will tell you. It is engrained. But he does a great job for you and did a great job for me.

Let me pick up on a point. We had a hearing yesterday, and it was a deficit hearing, and my colleague, Senator Conrad, made what I thought was a very good point. He pointed out that interest rates matter, and he said a sustained 1-point increase in interest rates would cost the Federal Government over \$1 trillion over the next decade. That is from the governmental side.

And I noticed that you were one of those CEOs who signed the Chamber of Commerce letter warning of the danger of default. And, in part, that letter says, "Treasury securities influence the cost of financing not just for companies but, more importantly, for mortgages, auto loans, credit cards, and student debt. A default would risk both disarray in those markets and a host of unintended consequences."

So my question is, beyond what it will cost the government, what would be the impact of a default on interest rates for your customers? And, if they are increased by this self-inflicted wound of a default—which we still hope and pray we can prevent—what do you think that would do to their purchasing power and to sales at companies like yours?

Mr. DUKE. Senator Menendez, thank you again for your comments about our colleague, and I appreciate the training that you provided and that worked very well. [Laughter.]

Related to this, I would have to, first, represent our consumers, our customers who are shopping in the store as, across America, they are watching the events take place here in Washington.

And there is both the real and the perceived, and I think both reality and perception have to be considered. Higher interest rates clearly would have an effect on consumption. And so the ability of the consumer to regain confidence, to start then reinvesting themselves as families across America, is important.

A default and the ripple effect, I think, would be impactful, and, representing our consumers, we think that that would be very, very difficult for the American economy to withstand at this point in time in our history.

The other factor is consumer confidence. I am out every week talking to customers in our stores, and, when I am talking to the customers who are shopping in our stores, I am not getting a sense of confidence.

So I measure my own consumer confidence when I am out talking to our consumers. And with the situation in the economy, with the job situation and other factors facing consumers, I think a default at this time would be devastating in both that reality and perception of consumers.

Senator MENENDEZ. I appreciate that.

Mr. Merlo, I want to follow on what my colleague, I think, is referring to in terms of repatriation of foreign profits, and I understand that CVS Caremark is not necessarily in that category.

But you do say in your testimony that you are paying almost an effective 35-percent rate, and, in essence, by paying a high effective rate, it seems to me that your company, and others similarly situated, is basically paying for the burden of loopholes and avoidance behaviors of other companies.

So, do you believe that aggressive use of avoidance methods by competitors or the ability of companies to be able to take their overseas earnings and convert them into tax benefits here at home that ultimately provide them with a much lower effective rate while you are still paying a higher effective rate, is a fair set of competitive standards?

Mr. MERLO. Well, I think it certainly does create some competitive challenges for us, acknowledging that we compete with domestic companies, as well as foreign nationals that have the opportunity to have a lower tax rate.

And I think it goes back to the theme of this hearing in terms of, we support an overall corporate tax reform review that would reduce our overall rate.

I would like to go back and just tag onto something that Mr. Duke mentioned about consumer confidence and bring us back to

the health care space, because we do see evidence of consumers today making decisions about when to get their maintenance prescription for a chronic condition filled, and we see evidence that they are getting it filled later, which means they are not taking their medications as prescribed and, in many cases, dropping off those therapies.

So we would be very concerned with any additional declines in consumer confidence and the impact that that would have on the health of Americans.

Senator MENENDEZ. I appreciate that.

I would like to work, Mr. Chairman, in our effort to repatriate foreign assets and do it in a way that would induce companies to do so. But when I hear that the choice is 5 percent as the rate to return that money on, it is very hard to tell a New Jerseyan who is paying 25 percent or higher in a tax bracket that we are going to do a 5-percent rate for repatriation of foreign corporate assets.

And, unless there is some connection with job creation that is tangible—because the last time we did this on a holiday basis, we did not really get the jobs—I think it is problematic.

So I am one of those—sign me up in the column that wants to find a way in which we can have nearly \$1 trillion of private sector investment in our country, repatriate it, but do it in a way that actually creates the jobs at the end of the day.

I thank you, gentlemen, for your testimony.

The CHAIRMAN. Thank you, Senator Menendez.

Senator Thune?

Senator THUNE. Thank you, Mr. Chairman, for holding the hearing today, and Senator Hatch.

I appreciate our witnesses being willing to offer their expertise and insights. I think it is interesting that all four of the witnesses today agree on both the urgent need for tax reform as well as the direction in which we need to move, and that is a lower corporate rate and a territorial tax system that does not impose a second layer of taxation on the foreign earnings of our U.S. companies, and also in pointing out that the United States really is an outlier when you look at that.

We have the second-highest corporate tax rate in the world, and, of the G-8 nations, we are the only one now that has a worldwide tax system.

So I think a combination of those two factors makes it very difficult for U.S. companies to compete. And, as we begin to look at shaping a tax reform bill, Mr. Chairman, I would hope that we would take into consideration the testimony that was provided by our witnesses today and look at lowering rates, broadening the base, and putting American companies in a position where they can compete better globally.

Just a question. This is maybe a tough question for you to answer, and I would throw it out there to anybody.

But I would be interested in knowing, from each of you, if there is any targeted tax benefit that you would be willing to give up, if it were necessary to do so, in order to lower our corporate tax rate to a level that is commensurate with our major competitors and to move toward a territorial tax system, because that is the whole debate right now: what do we do with tax expenditures or

tax preferences? And, if we close some of those loopholes, or in order to be able to lower rates, we may have the necessity of closing some of those loopholes or doing away with some of those targeted tax benefits.

I am interested if any of you has any observations about things that you would be willing to give up.

Mr. DUKE. Senator Thune, we are willing to look at every benefit and believe that they all should be on the table for discussion.

And we do, as a multinational company, receive some benefit, though we are not into heavy R&D investment as a retail company. But there are benefits that we receive today that we think should be looked at as a part of an overall comprehensive plan.

Mr. FALK. Yes, Senator. I guess I would add that, I believe it is possible to have revenue-neutral corporate tax reform. We know that fiscal crisis is not easy, and this should not add to it. But I think everything should be on the table and, again, I would err in favor of lowering the rate.

And, if we can get the combined Federal and State rate in the U.S. down to 25 percent, which would imply a Federal rate of 22 or 23 percent, then I think a lot of these incentives become much less important.

Senator THUNE. One of the hallmarks of the increasingly global nature of the U.S. economy is the fact that a larger and larger percentage of the revenue, of course, of our U.S. businesses is earned outside the United States.

Now, there are those who view this as a negative and an indication that U.S. companies are moving operations abroad, and there are others, I think, who believe that it is a necessity in a world where 95 percent of the consumers and 75 percent of global purchasing power are outside our borders.

But could each of you describe briefly or discuss what this greater reliance on foreign revenue means for U.S. jobs, and do you view that to be a positive or a negative thing?

Mr. LANG. I will start. In the semiconductor industry, we are already about 80 percent overseas. So we kind of live and breathe this type of international footprint every day.

And I do not view it as a necessity. I think it is an opportunity. It is an opportunity for us to take things that we invent here, or that we grow here, and offer those products and services around the world and benefit from that, and leverage U.S. jobs and U.S. efforts to realize those gains.

So this is certainly not evil, and it is not a necessity. It is a wonderful opportunity, because the growth potential outside of the U.S. far exceeds what is available inside the U.S., and we should be pursuing all of that.

Senator THUNE. Does anybody else care to comment on that, foreign investment, good thing, bad thing, positive, negative?

Mr. FALK. I think it is a good thing. I think if we want the U.S. to be a competitive place to invest, we want U.S. companies to be competitive players in the global economy. And so, as economies outside the U.S. are growing faster, we want U.S. companies to be winners in those markets as well. That has to be good for jobs in the U.S. long-term.

Senator THUNE. This is for, I guess, Mr. Duke or Mr. Merlo, because your companies are in the retail business. You both have high effective tax rates. What does it mean when you compete abroad against companies that are not U.S.-based? And I guess it comes back more specifically to the question of, who are your major competitors, I guess I would ask, and where are they headquartered?

What challenges does the tax system present for you as you seek to expand in new markets around the world?

Mr. DUKE. Senator, I could quickly name three large multinational retailers that we compete against around the world—Tesco from the U.K., Carrefour from France, and Metro from Germany.

And it is interesting because, we are often competing for specific real estate sites to build new stores in markets around the world, and that means that there is an advantage in the calculation of return on investment. Their return would be at a higher rate.

As an example, Tesco in China, we would compete against frequently, and the 25-percent rate of tax in China would be all that Tesco would pay. We would pay the 25 percent, and then the additional 10 percent as far as the U.S. rate.

We also—and it comes into play related to even acquiring a business, and then, as I mentioned, Tesco is now building stores and growing in the United States. So we actually are opening the door for foreign retailers to have an easier entry to compete in the United States against U.S.-based retailers.

Senator THUNE. Mr. Merlo?

Mr. MERLO. And, Senator, I think Mr. Duke is spot-on. The only thing I would add is that we have other companies out there, like Ahold that operates food-drug combos here in the U.S., where the same principles that Mr. Duke mentioned apply and create some competitive challenges.

Senator THUNE. Great. Thank you. My time has expired. Thank you, Mr. Chairman. Thank you all.

The CHAIRMAN. Thank you, Senator.

Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman, and thank you very much for holding this hearing. I think it is so important.

I was part of the Fiscal Commission, as was the chairman of the committee. I have been part of the Group of 6. Both of them concluded that you have to have fundamental tax reform to broaden the base, to lower rates, and to help us be more competitive while, at the same time, raising some additional revenue to couple with entitlement reform and to couple with domestic spending reductions, in order to get our debt down.

That is the fundamental framework of both the Fiscal Commission and the Group of 6.

I would just like quickly to ask each of you, does that fundamental framework make sense to you?

Mr. Duke?

Mr. DUKE. Senator, the fundamental framework of debt reduction and fiscal responsibility certainly makes sense. And the comprehensive corporate tax reform we think is important. We do believe that all of this should be looked at on a long-term perspective.

I think earlier, other members of the discussion today mentioned the uncertainty. That is why our interest is in a long-term, comprehensive tax reform plan that we think would be able to lay out what the future would look like for American companies.

Senator CONRAD. Very important. And let me just say, fundamental tax reform, I do believe, cannot be done in 6 weeks or 6 months. I believe fundamental tax reform is such a complicated undertaking, it will take us well into next year. And Joint Tax just told us they could not score fundamental tax reform within the next 6 months, because they do not have a model that would allow them to do that.

Mr. Falk, in terms of the basic structure of a strategy to get at our deficits and debt, do you favor what the Commission and the Group of 6 have proposed?

Mr. FALK. Yes. It makes sense to me. I would echo Mr. Duke's comments. And once again, it has taken us more than a generation to get to this point in time. And so there are a going to be a lot of things that have to be dealt with to correct our problems and get our fiscal house in order, moving forward.

Senator CONRAD. Mr. Lang?

Mr. LANG. Yes. I would agree with the comments made here at a high level. Those sound like the fiscally responsible approach to addressing some of the major issues we have today.

Senator CONRAD. Mr. Merlo?

Mr. MERLO. I agree with the panelists. There is no question that comprehensive reform is going to have to be thoughtful, it is going to have a lot of elements to consider, and, just to emphasize the point about predictability and certainty, I think it is a key byproduct of the decision-making process.

Senator CONRAD. Well, I appreciate that. Let me go to a question on repatriation, because I have asked my staff to look into what happened in the last repatriation, and here is what they report to me.

A number of empirical analyses have been undertaken to assess the use of repatriated earnings and their impact on investment in U.S. growth and jobs. These studies found no evidence that firms used repatriated earnings to significantly increase domestic capital investment, employment, or research and development. Rather, earnings were largely used to benefit company shareholders through stock repurchase programs, even though this was explicitly prohibited by the measure.

The memo goes on to say researchers also found, specifically, with regard to employment, that a number of firms repatriating funds actually reduced employment in their domestic operations in the period after they repatriated funds.

For instance, tax economist Martin Sullivan found that three of the top five firms, in terms of the dollar amount of repatriation, reduced U.S. employment in 2005 and 2006.

I will not name the companies, but we have it all laid out here. I would just say to you that, clearly, fundamental tax reform needs to include how we are dealing with worldwide income.

In the Reagan administration, I served on a commission on taxing international corporate earnings. It was one of the most inter-

esting negotiations I was ever part of. It made this negotiation on the debt ceiling look relatively easy.

But let me just say that the argument that had been made by some in repatriation, that it is going to create jobs here, we did it, and it did not produce jobs here. That is the overwhelming evidence.

That does not mean we should not do fundamental tax reform, because, if we are going to be competitive, we have to get in the game. And our tax code was designed at a time when we did not have to worry about the competitive position of the United States. We were fully dominant when this tax code was developed.

I do not think anybody, if they were going to sit down and devise a tax code for the United States in 2011 or 2012, would come up with one that looked anything like this one.

My time has expired. I thank the panel for their testimony.

The CHAIRMAN. Thank you, Senator, very much for your work on the Commission and the Gang of 6, and, also, I do not think there is anybody that disagrees with your last statement, too. It is clearly time to overhaul an antiquated tax code. That is clear.

But it is not going to be easy. One thing I have learned around here, abstractions are easy, but sometimes abstractions are cruelty, because it is the specifics that really count.

For example, there is a lot of talk about lowering the rate and broadening the base. The current corporate rate, 35 percent Federal, by how much could the rate be lowered? If all tax expenditures were eliminated, you do not get very far. Let us just stick with the territorial system, if it is territorial.

You do not get very far. Maybe you get down to 29 percent, approximately. Then the next question is, what about interest expense? Do you want to eliminate interest expense? If you eliminate interest expense, then we start to make a little headway at getting the rate down quite significantly.

I suspect in all these other countries, it is the other tax systems which allow those countries to raise revenue, because revenue as a percent of GDP is generally higher in those countries, including probably business revenue, compared to the United States.

I do not know, I have to research this, but it could well be that it is a combination of income taxes in those countries and value-added taxes and so forth.

So it is not easy to get the rate down to levels that people talk about, say, a 25-percent corporate rate or lower. It is not easy at all.

It gets to the next set of questions of, which potential expenditures, if you will, are you willing to give up? Theoretically, it is everybody gives up everything. But there are some specifics.

For example, I know, Mr. Duke, at WalMart, the work opportunity tax credit is pretty important to your company.

And, Mr. Falk, I suspect section 199 is important to your company.

And for Mr. Lang, clearly, the R&D tax credit is pretty important.

So I am asking each of you. Are you willing to give up each of those for your companies? So long as everything is given up, then we get to questions that I think Senator Stabenow touched on,

namely, if Canada is giving such a great incentive to R&D, and, if we give up our R&D tax credit, will a lower rate make the United States semiconductor companies sufficiently competitive so they could deal with, or offset, that Canadian incentive?

I would just like you all to tell me the degree to which you are willing to give up some of the provisions that you currently use very significantly.

Mr. Duke?

Mr. DUKE. Mr. Chairman, with, first, the overall lower corporate tax rate that would be competitive in the global marketplace, such as in the mid-20s, for example, we would be willing to look at every aspect of those incentives that we participate in, and we believe that all should be on the table for discussion.

The CHAIRMAN. So you are basically saying you are willing to give it all up as long as your rate, your headline rate, the corporate rate is, say, mid-20s or something like that?

Mr. DUKE. Yes, sir, if we are competitive against other markets that we are competing against.

The CHAIRMAN. Mr. Falk?

Mr. FALK. I would give the same answer I mentioned in my comments, that we take advantage of the R&D credit, we take advantage of the manufacturing credit—we used to spend about \$0.5 billion in capital in this country every year—and we take advantage of accelerated appreciation.

As the rate drops from near 40 percent to 22, 23, or 25—

The CHAIRMAN. I am just talking about the Federal rate now. I cannot deal with the State and local.

Mr. FALK [continuing]. Those incentives are a lot less valuable.

The CHAIRMAN. Mr. Lang?

Mr. LANG. In the Semiconductor Industry Association Working Group, we have had this exact conversation, and I would agree that everything should be on the table. We should look at it as a whole package and look at what the end result is.

There were a number of things, from manufacturing incentives to acceleration on depreciation, et cetera, that were things that, at the right rates, would be worth putting aside.

So I think that, agreeing with other folks on the panel, we should look at everything, and, at the end of the day, the overall system needs to be competitive and allow us to compete in the global marketplace.

The CHAIRMAN. Well, we are clearly going to look at everything, but, after we look, we have to make some decisions. And I am kind of asking for guidance here, especially from your industry.

Is 25 percent sufficient to compete with the Canadians who have that break, assuming you do not have that break?

Mr. LANG. I think for our industry, the primary competitors are going to be in Asia, based on competition, and the effective rates there—excuse me—the statutory rates are 15 to 17 percent, often lower than that on an effective basis.

So I am concerned that, when we look at the details and go through the details, a mid-20-percent rate will not be competitive from a semiconductor industry perspective.

The CHAIRMAN. So you are concerned that it will not be low enough—the mid-20s might not allow you to compete in Asia or worldwide?

Mr. LANG. Yes, that is my belief.

The CHAIRMAN. Mr. Merlo?

Mr. MERLO. I agree with everything that has already been said. I think everything should be on the table. I think that is going to be an imperative in terms of simplifying the tax code, as well.

The CHAIRMAN. My time has expired.

Senator Hatch?

Senator HATCH. Thank you, Mr. Chairman. It is nice to talk about everything being on the table, but there are certain things that make you competitive with the rest of the world, and without any guarantee that the corporate rates are going to stay down, we have to consider all of this, and consider how this works in the future as well.

But let me just ask this question, for the entire panel.

In considering corporate tax reform, the focus is typically on the corporate tax provisions in our code. But how important is it to focus on the impact corporate tax reform will have on a companies' financial statements?

For instance, if a corporation has a net operating loss, or NOL, that it carries forward from year to year, this NOL can offset taxable income in future years. Thus, the NOL can be a very valuable asset to your companies.

Now, that is, the NOL can reduce taxes in future years. So, if a corporation has a \$100 NOL, it will reduce, given our 35-percent tax rate, corporate taxes by \$35. Thus, the corporations, under current financial accounting rules, rightly state that \$100 of NOL is an asset the company holds worth \$35.

However, if the corporate rate were reduced to 25 percent, then this NOL asset would only be worth \$25. Now, that is, in some real sense, the corporation would lose \$10 by virtue of the corporate tax rate going down 10 percentage points.

Now, this \$10 reduction would immediately show up as a \$10 reduction in the corporation's net income and would lower the corporation's earnings per share.

Now, I am very supportive of a corporate tax cut, there is no question about that. I would hope the effort to reduce the corporate tax rate would not be slowed down by these financial accounting considerations.

However, I can understand that those are real concerns that you have to be concerned with. Now, the R&D tax credit is absolutely critical. As you point out, 13 times, we have failed to re-up it. Both the chairman and I have worked very hard. I would like to make that permanent, because I think it would give you a competitive advantage in the rest of the world, because of the inventiveness and creativity of the American scientists and workers, especially in your industry.

But I would like you to share with me your thoughts on this business of how you handle these accounting matters. Should corporate tax reform take into consideration the financial accounting impact of reform?

Mr. DUKE. Senator, first, I think in the whole discussion of lowering the overall rate, say, from 35 percent to 25, as we discussed, even related to the incentives and credits, we recognize that there have to be tradeoffs for the formula to work.

We believe that the same would apply to your question about the NOL. It is worth it to have a permanent, long-term, comprehensive corporate tax revision that would have a competitive rate in the global marketplace, and that transition related to the questions about NOL, as well as credits, we think, would be worth the challenge.

Mr. FALK. My comment, Senator, would be, I would say, do the right thing for the country, and the accountants will figure it out. And so I would not worry about the financial accounting implications of this. I would say far more companies have a net deferred tax liability from taking advantage of things like accelerated depreciation, and so, as those reflect lower tax rates, they will enjoy an economic benefit from this change.

So I would not let the accounting get in the way of making the right economic decision for the United States of America.

Mr. LANG. We are—PMC is one of those companies that has NOLs on our balance sheet, and I would agree with the statements here. We should do the right thing to make America competitive, and do the right thing for the long-term structure of the business, and let the accountants figure out how the financial accounting is impacted.

Mr. MERLO. And, Senator, I am certainly not an accountant, and I agree with my colleagues in terms of, let the finance folks figure it out. We will have our staff get back with your staff on any further comments on that.

Senator HATCH. That would be great. There are a lot of complexities in trying to change the tax code. But it is not too complex to realize that we have to be competitive with the G-8 and G-20, and I would like to be more competitive. And I believe if we did that, you folks would create more jobs, you would create more opportunities, you would create more products to sell.

I just have seen you all these years, you are just terrific at what you do. And there are always a lot of tradeoffs in these types of issues, and we will just have to see what we can do.

But this has been a particularly valuable panel, as far as I am concerned, and I want to thank you all for being here.

The CHAIRMAN. Thank you, Senator. I thank you, too.

Senator Wyden, the chair is yours.

Senator WYDEN. Mr. Chairman, I just had one other question. I thank you.

The CHAIRMAN. All right. Go ahead.

Senator WYDEN. Mr. Duke, I was struck by your point with respect to your ultimate desire to have a tax rate in the mid-20s, and, to me, that is very much in the ballpark for tax reform. And I have tried to work with Chairman Baucus and colleagues on this for a lot of years.

Let me walk you through how I am looking at the math, and we would like to work with all you folks on this. Because deferral is so much money, like \$500 billion over 10 years, you get rid of that, and it is such a large amount, you use that to slash rates dramati-

cally in the United States, and I am absolutely convinced you can get in the mid-20s. And you also have the benefit of less gaming, and a more straightforward system.

My concern about going to a territorial system—and I have put myself to sleep at night trying to understand all the aspects of a territorial system—is that you will keep a lot of the complexity in the system. You will have lots of gaming and really, permanently, the question of transfer pricing, where somebody generates a sale one place, books the profit somewhere else, but especially you will have more business overseas rather than what Chairman Baucus started us off with in terms of more incentives for jobs in the United States.

And I personally think it will be pretty hard to get the rate in the mid-20s if you go to that kind of system. I was not able to figure it out, and there are a lot of other people a lot smarter than I am who can't.

Is it fair to say, at the end of the day, that you all are willing to work through a lot of these concepts so that we can get to the point we started with with Chairman Baucus's questions, that we have more American jobs and a greater level of competitiveness in these tough global markets, and are you all still open on the design of some of these components?

Mr. DUKE. Yes, sir. We are clearly open for discussion and development of these. I would tell you, sir, that even though we talked some about our growth outside the United States, this year, more than half of our capital investment is being invested here in the United States.

We will invest somewhere between \$12.5 and \$13.5 billion, and over half of it here. We have announced even recently our desire to build more stores and grow in urban markets in the United States, where jobs are needed and where product is needed.

So we clearly want to grow here in the U.S., but we also have opportunity to grow and to really help American companies by growing outside the United States, and we would love to work with you and discuss this in more detail.

Senator WYDEN. I think Chairman Baucus has to wrap up.

The chairman has been patient this morning, and I thank you.

The CHAIRMAN. Thank you, Senator. We do not have much time.

The question occurs to me—what about turning this around, changing the code to get more foreign investment in the U.S., in addition to more domestic investment in the U.S.? This is basically the subject of this hearing.

How do we get more foreign investment in the U.S.? A whole different subject—you do not have time. I am opening Pandora's box here.

Mr. FALK. Some of the same answers. I think you should lower the marginal rate for activity in the U.S., and move to a territorial-based tax system. You will make the U.S. a more attractive investment for companies all over the world.

Mr. LANG. Simplicity, predictability, those are all keys that we have been talking about all morning.

The CHAIRMAN. How much do we make ourselves less competitive because we have a system which is so complex? Someone once said that GE has 1,000 tax attorneys, for example, and it is my un-

derstanding that our system is more complex than the system in other countries.

Does that put America at a competitive disadvantage, on the margin?

Mr. FALK. Certainly, a simpler system would attract business to want to invest here and grow.

The CHAIRMAN. Thank you very, very much. This has been a very helpful hearing. I think we will have a lot more discussions. Thank you very much. But the goal is to get us to a much more competitive system.

Thank you very much. The hearing is adjourned.

[Whereupon, at 11:49 a.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

**Hearing Statement of Senator Max Baucus (D-Mont.)
Regarding How the Tax Code Affects Hiring and Business Growth**
As prepared for delivery

Benjamin Franklin wrote, "When men are employed, they are best contented."

Today, too many men and women are unemployed. These are Americans who have worked, want to work, and will work again. Our economy rests on the foundation of businesses, big and small, providing the goods and services that the market demands. And many Americans' livelihoods rest on businesses providing jobs, which are currently in short supply.

The unemployment rate is hovering around nine percent, and poverty has increased. Fourteen percent of Americans now live in poverty, including more than one-fifth of all U.S. children.

Many who are unemployed have been searching for work for more than a year. These Americans need a job, and the certainty that comes with going to work every day.

In this environment, the business community has an opportunity and an obligation to help get Americans back to work. Businesses need to step up to the plate by preserving good-paying jobs and creating new ones. This means not just waiting for demand to fully recover, but giving Americans a chance, including the long-term unemployed.

We want to make sure our tax code supports efforts to create jobs. Our ultimate goal is not simply economic growth for growth's sake or profitability for business owners alone. But job creation cannot occur without this growth.

We know that American businesses face obstacles achieving growth. Our economy is slowly recovering from the most significant recession since the Great Depression. Consumers are saving more and spending less, and banks are more cautious in their lending practices.

At the same time, competition is getting tougher in an increasingly globalized economy, and major new players are emerging in developing countries. In 1960, exports accounted for 3.6 percent of America's GDP. Today they account for nearly 12.5 percent, and sales are growing faster in markets outside the U.S. than they are here at home in most industries.

In today's global economy, we simply can't afford for the tax code to hamper businesses' ability to compete and create jobs here at home. We need corporate tax rules that encourage job creation and widespread economic growth.

Last year, we began a comprehensive review of America's tax system to understand how our tax code became so complex. More recently, we have held hearings addressing the need for tax reform. These hearings have looked at the goals we want our tax system to accomplish, and whether it effectively meets those objectives.

Of course, the tax code should raise the revenue necessary to finance the operations of the federal government. But we also want our tax system to spur long-term economic growth which can benefit more folks in Montana and across the country, and we want to promote fairness and certainty.

Americans need a tax code that helps them get back to work.

Today's witnesses will help us understand the effect our current tax code has on U.S. businesses and their hiring practices. They represent some of the largest employers in the U.S. I am grateful they are here with us today to discuss whether the tax code imposes undue burdens on business.

We are looking forward to hearing what factors drive their decisions about whether to hire new employees. And we need to identify the policies that are the most effective in helping these business leaders create more jobs.

Do we need to support innovation more effectively? Do we need to develop a more highly-educated work force? How can we level the playing field for U.S. companies competing overseas? How do we reduce incentives to locate new jobs abroad rather than at home?

I ask each of our witnesses to take off your hat as an advocate for your company. I ask you to tell us what your experience as a CEO has taught you about what is best for our country.

So let us focus on how the tax code can help our businesses create good-paying jobs today, and let us work together to improve the tax system to ensure widespread prosperity for all Americans.

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Testimony of
Mike Duke
President & Chief Executive Officer
WalMart Stores, Inc.

Before the
Committee on Finance
United States Senate

Hearing on CEO Perspectives on How the Tax Code
Affects Hiring, Businesses and Economic Growth

Wednesday, July 27, 2011

Chairman Baucus, Ranking Member Hatch, and Members of the Committee, I appreciate the opportunity to testify before you today on corporate tax reform.

We urgently need to modernize our tax code, and I want to thank you for taking on this issue. Modernizing our corporate tax code will be a difficult process, but it is the right thing to do for America and America's competitive position in the world. Ultimately, this effort must achieve the goal we all share: a strong, vibrant, job-creating U.S. economy.

I hope you all know your local Walmart store. But let me start with a few words about the company we run out of Bentonville, Arkansas.

We serve 106 million unique customers in the U.S., about one third of our population, every week. The business model that has earned our customers' trust is simple: we give them everyday low prices by passing on savings from our everyday low cost operations. "Save money, Live Better" is not a tagline; it is our mission. Other companies may keep cost savings for themselves, but we believe they belong to our customers.

Last year in the U.S., Walmart paid \$1.25 billion in state and local property tax. We paid \$630 million in state corporate income tax. We collected and remitted \$13.8 billion in sales tax. And we paid \$4.7 billion in corporate taxes in the U.S., which was about 3% of all corporate income taxes that were collected by the U.S. Treasury. Our effective corporate tax rate last year was 32.2%. Many companies that testify before you theoretically face similar tax rates; we actually pay them.

We're not here to ask for sympathy for our tax burden. Likewise, we recognize the many benefits we enjoy as a result of the taxes we pay, which support the communities where we live and work. The question for today's discussion is not

whether Walmart can get by as a company under the current tax structure. The question is whether this structure is the best approach for our country. We believe it is not.

As we begin this discussion, it is important to understand how Walmart's operations at home and around the world contribute to the economy here in the United States.

In the U.S. we operate more than 4,400 stores and clubs and employ almost 1.4 million associates across every state in the country. We have more than 1,900 stores in the 24 states you represent, and we employ more than 600,000 of your constituents. We also have suppliers in all of your states. Last year, we spent a total of \$65 billion with those companies, and this spending supported more than 1 million jobs in your states.

I'm happy to say that the domestic business is still growing. This year alone, we're investing more than half of our \$12.5 to \$13.5 billion capital expenditures budget in the U.S. to grow our business. Just last week, we announced we will build 275 to 300 stores by 2016 in "food deserts" - areas that lack convenient access to grocery stores, and this is just part of our growth strategy. When complete, more than 40,000 people will work in those stores. And every store we build also means construction jobs, an expanded local tax base, and more opportunities for our U.S. suppliers to sell their goods.

Walmart is also growing around the world. With our recent acquisition of Massmart in Africa, we now operate under 69 different banners in 28 countries, including Mexico, the United Kingdom, China, Japan, Brazil, Chile, and South Africa.

At the same time that we've grown our international business to more than \$100 billion, we've become the largest private employer in the U.S. In fact, since we began operating our first international store, we've created about 1 million jobs in America.

Like our domestic growth, our international growth is good for the U.S. economy. Our international growth allows Walmart to source more goods and technologies from U.S. companies to sell in our stores around the world. From Procter & Gamble to PepsiCo, 70% of our top international suppliers are U.S. companies. We sold nearly \$8 billion worth of products from these suppliers last year in our overseas stores, boosting their revenue and creating and sustaining American jobs.

We are also one of the largest purchasers of American agricultural products. Last year, we directly exported nearly \$40 million worth of Washington apples, California asparagus, Florida grapefruits and other American crops. We are also a large exporter of U.S. beef, ice cream, fruit juices, and many other products.

Likewise, we look for opportunities to use American products as we build our stores. For example, we are updating the lighting in our parking lots in many countries

using LED technology. We worked with GE to develop this application for LEDs, and the lights are now mostly manufactured in North Carolina.

The best way I can say it is this: when Walmart goes overseas, we bring American companies with us. When we grow, they grow.

One of our suppliers testified before the House Ways and Means Trade Subcommittee earlier this year. John B. Sanfilippo and Son, Inc, an Illinois-based nut processor, has used Walmart as a platform to expand the sales of its products internationally, from providing products to our stores in Mexico two years ago to supplying our stores in Chile, Japan, Central America and Brazil today. And because other retailers in Mexico saw this supplier's products on Walmart's shelves, Sanfilippo now supplies their local stores too. These international sales not only help support 1,800 jobs at the Illinois processor, but other nut farmers in California, Oklahoma, Texas, Kansas and almost every southern state.

So, with that as background, how do we reform the tax code to drive job growth here at home and encourage America's competitiveness abroad?

My advice to this committee is straightforward: lower the corporate rate as much as you can, make the tax base as broad as you can, and move to a territorial system as quickly as you can.

If the ultimate goal is to strengthen the U.S. economy and level the playing field for U.S. companies, these are the three key components of reform. Without any one of the three, it will be impossible to achieve a fiscally responsible, simplified, and competitive tax system. And we need comprehensive solutions, not piecemeal attempts to repeal this or that incentive to raise revenue for unrelated initiatives.

If the result is comprehensive reform, we support getting rid of existing incentives that currently benefit some industries over others. In fact, we will give up the existing incentives that benefit us, if it means getting rid of them all in a simplified, more competitive, and territorial system.

Taking these steps to reform America's tax code will help American companies compete abroad. When Walmart competes around the world, we don't compete against American companies. We are competing against companies like Tesco from the United Kingdom, Carrefour from France, and Metro from Germany. I believe that Walmart is far more likely to export Washington apples or California asparagus, for example, than our foreign competitors. Yet these foreign competitors have an advantage: they pay less in corporate income taxes than we do.

Corporate tax rates have been steadily falling internationally, but the U.S. is out of step. The average rate in developed countries is 25.1%, compared with 39.2% in the U.S. We need a rate that is meaningfully lower in order to spark investment and job creation.

Most other developed countries also have a territorial tax system because it helps their companies compete abroad. In overseas markets, we are paying both the tax rate in that jurisdiction *and* an additional U.S. tax rate when that income is repatriated. So for example, when we compete against Tesco in the U.K., they pay 26% to the U.K. while we pay 26% to the U.K. plus an additional 9% to the United States to cover the differential between the U.K. rate and the U.S. statutory rate.

To take this example further, we also compete against Tesco in China. With the U.K. territorial system of taxation, Tesco pays 25% to China on business there and no additional tax when they bring money back to the U.K. In our case, we pay 25% to China plus an additional 10% to cover the differential between the U.S. statutory rate and the Chinese rate when we bring that money home.

The bottom line is that we are often outbid for particular retail sites in other markets because companies with lower overall tax rates have a lower overall cost of capital and therefore more money to offer for sites. When we do win, we pay more overall than our competitors would have. Again, our system simply lags behind.

The keys to reform are to lower the corporate rate, get rid of existing incentives that benefit some industries over others, and level the international playing field with a territorial system. Pursuing reform in a half-hearted way – for example without the territorial system – will only make the effort more complicated. We would have to begin exploring messy trade-offs and could end up no better off than when we started. But if we take these three steps, we will drive the virtuous cycle I've described, with more U.S. exports, more investment, and more job creation at home.

We recognize that Congress is facing some significant challenges regarding the federal budget and the fiscal future of the nation, and we agree that tax reform should be considered with these challenges in mind. In our view, the Bowles-Simpson deficit commission's corporate tax proposal represented a very good start because it endorsed these three key components of reform.

We also understand that there will be issues surrounding how the transition to such a system would work. But while the path to reform may be challenging, the destination is actually pretty clear.

Let me close with one final thought. One reason Walmart has been successful is that we are not afraid to change. Our founder, Sam Walton, said: "Everything around you is always changing. To succeed, you have to stay out in front of that change."

We know this work will not be easy and won't happen overnight, but it does need to happen. The world has changed around us. For America to succeed in this century, we need to get out in front of that change.

Thank you, and I look forward to answering your questions.

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Appendix



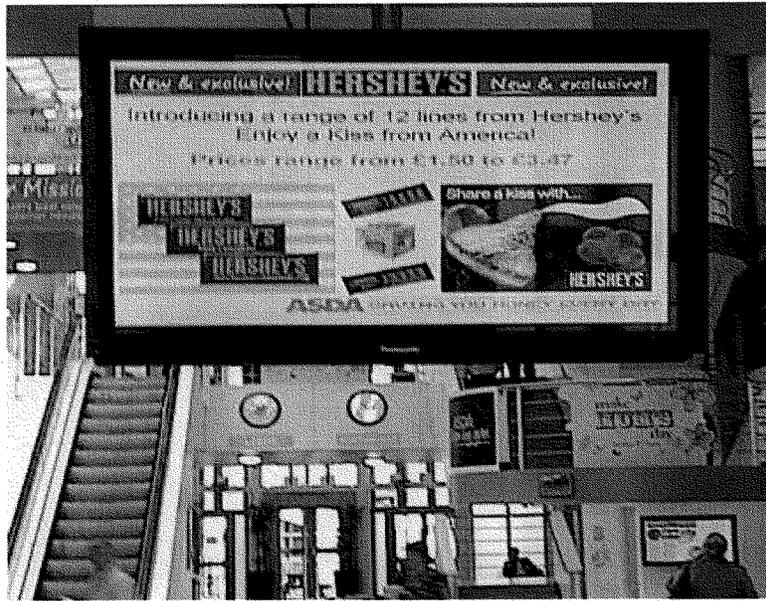
4th of July Promotion of U.S. brands – Chile



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4th of July Promotion of U.S. Beef – Chile



Hershey Product Launch – United Kingdom



Washington Apple Promotion - India

**Testimony of
Mr. Thomas J. Falk
Chairman and Chief Executive Officer
Kimberly-Clark Corporation**

**Before the
U.S. Senate Committee on Finance**

**Hearing on CEO Perspectives on How the Tax Code Affects Hiring,
Businesses, and Economic Growth
July 27, 2011**

Good morning Chairman Baucus, Ranking Member Hatch, and distinguished members of the Committee. Thank you for this opportunity to share my views on the need for changes in our tax system.

First, I will provide a brief overview of Kimberly-Clark and our global businesses, and then I will address some of the reasons we believe the current U.S. corporate tax system hinders growth, puts American companies and workers at a competitive disadvantage in the global marketplace and impedes economic growth in the U.S.

For nearly 140 years, Kimberly-Clark has provided consumers with the essentials for a better life. With brands like Kleenex, Scott, Huggies, Pull-Ups, Kotex, Poise, and Depend, we estimate that one out of every four people around the world use our products each day. We are also a leading provider of safety products that help protect both workers and the environments in which they work. In addition, medical professionals turn to Kimberly-Clark for a portfolio of products essential to the health and hygiene of their patients and staff, including surgical drapes and gowns, face masks, exam gloves, and infection control and pain management products. Our products and businesses touch a wide range of the economy around the world.

We depend on continuous product innovations to meet the evolving needs of our customers and build our Personal Care, Consumer Tissue, Kimberly-Clark Professional, and Health Care businesses. This commitment to innovation has earned us the No. 1 or No. 2 brand share position in more than 80 countries.

The consumers we serve live in more than 150 countries, and we must have a global presence to serve them. Being close to our consumers, and the retailers through whom we sell our products, is necessary to effectively develop products which meet our consumers' diverse needs and to enable the effective marketing and efficient distribution of those products. Additionally, due to the nature of many of the products we sell, which are lightweight, bulky, and costly to ship, our manufacturing operations must be located close to the consumers we serve. Thus, we operate more than 100 facilities in 36 countries and employ 57,000 employees worldwide. More than 15,000 of those employees are based in the U.S. The rest work in other regions of the world and support our local businesses there.

Most of the products we sell in the U.S. are designed, developed, and manufactured here. In fact, a large portion of our annual \$300 million research and development budget is spent in the U.S. We have more than 1,400 employees conducting research in the U.S., and our U.S. manufacturing footprint is significant. We employ 10,000 people at 23 production facilities in 17 states.

The U.S. market is our largest market, but the categories in which we compete are mature. Although we already have a major presence outside the U.S. – almost half of our net sales are to consumers who live in countries other than the U.S. – we consider developing and emerging markets to be among our biggest growth opportunities. Profits generated by Kimberly-Clark's overseas affiliates are directly related to foreign business activity.

The U.S. Tax System Puts the American Economy, U.S. Workers, and U.S. Multinationals at a Disadvantage

Successful U.S.-based businesses, large and small, are an engine of growth for the American economy. As a group, U.S.-based multinationals employ nearly 22 million U.S. workers, more than 19 percent of the total U.S. private-sector workforce. In addition to directly creating jobs for American workers, U.S.-based multinationals indirectly contribute to a significant portion of U.S. economic activity and U.S. jobs through the purchase of goods and services from smaller U.S. businesses. The U.S. operations of the typical U.S.-based multinational buys more than \$3 billion in goods and services from more than 6,000 American small businesses, and relies on those small-business suppliers for more than 24 percent of total input purchases. U.S. small businesses are critically important partners with U.S.-based multinationals. The combined

direct and indirect employment generated by worldwide American companies is estimated at 42 percent of total U.S. private employment.

Foreign operations of U.S.-based multinationals also contribute to the generation of high quality jobs in the U.S. in areas such as manufacturing, marketing, research and development, headquarters activities, and stewardship. However, U.S.-based multinationals are losing ground in the global economy as foreign-based multinationals, not hindered by an uncompetitive tax system, emerge and grow. According to the Business Roundtable, in 1960, U.S.-based multinationals made up 17 of the world's 20 largest companies. By 1985 that number had fallen to 13, and by 2010 just six of the world's 20 largest companies were U.S. based.

To be successful, businesses need high performing and talented employees, a steady stream of innovation to keep pace with competitors and evolving consumer preferences, the willingness and capability to continuously improve all aspects of their business, stable and predictable energy and other input supplies and pricing, and a favorable tax and regulatory environment. As other countries provide these essentials for business success to a greater extent than the U.S., U.S.-based multinationals lose ground in the global economy. The result is slower economic growth, fewer American jobs and lower government tax revenue.

The U.S. system of corporate taxation puts American companies and the American economy at a disadvantage when competing in the global marketplace. The combination of a high statutory tax rate, taxation of worldwide earnings, and the complexity of our tax rules creates an uncompetitive tax environment for U.S.-based companies and discourages investment in the U.S. economy.

High Statutory Tax Rate

The combined federal and state tax rate in the U.S. averages approximately 39 percent, which significantly exceeds the rates in most other countries. For example, our largest foreign markets include Canada, the United Kingdom, Korea, and Australia, which have combined federal and local tax rates that range from 24 percent to 30 percent. Canada, the United Kingdom, and Korea all are expected to reduce their rates further in the near future. The average combined tax rate among the member countries of the Organisation for Economic Co-operation and Development (OECD) is now 25 percent and is expected to continue to decline.

Even many developing and emerging countries have lower income tax rates than the U.S. For example, China and Russia are among our most significant growth markets, and their tax rates are 25 percent and 20 percent, respectively. In the increasingly aggressive and competitive global market, it is difficult for U.S.-based multinationals to compete effectively with non-U.S. companies who benefit from lower tax rates in their home countries.

The higher tax rates in the U.S. also put American companies at a significant disadvantage when evaluating foreign acquisitions. Expansion through acquisition can be an effective approach for entering a new market segment, a new country, or acquiring technology. Due to lower tax rates, foreign companies can generally afford to pay more to acquire a non-U.S. company and still earn their targeted return. When U.S. companies lose out on these acquisitions, they lose ground in the global economy. The result is lower profits, fewer earnings repatriated to the U.S., smaller returns to U.S. shareholders and slower U.S. economic growth and job creation.

Taxation of Worldwide Earnings

In addition to its high tax rate, the U.S. taxes the worldwide earnings of U.S.-based companies, whereas most developed countries do not tax their local companies in a similar manner. With the recent adoption of territorial systems by Japan and the United Kingdom, the U.S. is the only G8 country where businesses are subject to a worldwide tax system. Under the current U.S. system, all repatriated income of U.S.-based companies is subject to U.S. tax which creates an incentive for companies to leave their cash outside the U.S. Repatriating foreign income to the U.S. facilitates reinvestment in product development, capital spending, or returns to shareholders. Free flow of capital is critical to attract economic investment.

Kimberly-Clark has a strong history of capital investment in the U.S. and of paying dividends to our shareholders. For each of the last five years, we have averaged more than half a billion dollars of capital spending in the U.S. In addition to supporting jobs at Kimberly-Clark, our investment generates jobs and economic activity at our suppliers and in the surrounding communities. 2011 marks the 77th consecutive year that Kimberly-Clark has paid a dividend, and we have increased our dividends paid per share for 39 years in a row. These dividends are an important source of income to our shareholders, which include a significant number of mutual funds, state and local pension plans, and individual investors. In addition to generating income

tax revenue, dividends stimulate the American economy when shareholders spend those dividends on everyday needs.

Our current system of taxation results in American companies facing much higher tax rates than most of their foreign-based competitors, which pay little or no home-country tax on income earned abroad. For example, one of our primary global competitors is headquartered in Sweden. Sweden has a 26 percent tax rate and exempts foreign-source dividends from domestic taxation. When competing in China, both companies pay the same rates of tax. However, the Swedish headquartered company can repatriate its foreign earnings to Sweden and reinvest those earnings in job creation and product development without paying additional tax. In contrast, for Kimberly-Clark, repatriation of those earnings to the U.S. results in an additional layer of tax. This residual tax causes many U.S.-based multinationals to delay repatriation of foreign earnings and, consequently, creates an artificial barrier to investment in the U.S. Rather than impede the free flow of capital, we need a tax system which facilitates the flow of capital to the best opportunities and enables job creation.

Ironically, the U.S. tax system even can result in U.S. companies paying higher tax on the profit earned on products sold to U.S. consumers than their foreign-based competitors who sell to those same consumers. U.S. companies, such as Kimberly-Clark, own their intellectual property in the U.S., conduct their research, development, and manufacturing in the U.S., and tend to have a significant percentage of income subject to the higher U.S. tax rates. In contrast, foreign-based competitors, who manufacture outside the U.S. and develop their intellectual property outside the U.S., tend to have a lower percentage of overall profit subject to the higher U.S. tax rates. As a consequence, U.S. companies are disadvantaged versus global competitors when doing business in their own "home" country. The consequence is lower after tax profits, less money available to reinvest in their businesses or to fund dividend payments to their shareholders.

Excessive Complexity

Finally, the U.S. international tax system is highly complex and this complexity disadvantages U.S.-based multinationals against their global competitors. As the global economy has exploded, many U.S. businesses now generate more sales outside the U.S. Because the

U.S. rules for taxing foreign-source income have become increasingly complex and uncertain, American companies have an additional layer of risk and administrative burden compared to their global competitors. The U.S. needs a system of international taxation that reduces the cost of administration, reduces the risk of inadvertent error, and is easier to monitor.

America Needs a Tax System Which Promotes Investment in the U.S. and the Creation of American Jobs

America needs a corporate tax system that encourages both foreign and U.S. companies to invest in the U.S. economy and to create jobs. The bedrocks of such a tax system are a competitive tax rate in line with global averages and the ability to efficiently move cash to the U.S. for reinvestment in the American economy.

A pro-growth environment should also support U.S.-based innovation. A permanent research and development credit would support innovation, job creation, and economic growth in the U.S. Innovation through robust research and development is key to a successful company. At Kimberly-Clark, we spend more than \$300 million annually on research and development and employ over 1,400 people at our U.S. research facilities. In addition to using the technology in our U.S. business, we license intellectual property related to proprietary technology and our well-known brands to our foreign affiliates. Royalties from our foreign affiliates support high quality U.S. jobs in our research and development function.

Recent proposals to move the U.S. tax system further away from competitive global norms by increasing U.S. tax on foreign earnings would put U.S. companies at a significant disadvantage. Retaining a worldwide system and ending deferral would impose an immediate 35 percent tax on foreign earnings of U.S.-based companies and require the payment of tax even though their U.S. operations may not generate sufficient cash from which to pay the liability. Burdening U.S.-based companies with a significantly higher tax rate than incurred by foreign competitors would significantly reduce the ability of U.S.-based companies to compete globally. This, in turn, would slow economic growth in the U.S. and impede the creation of U.S.-based jobs.

Recommendation and Conclusion

American companies have a terrific base of talent, an unrivaled track record of innovation, and some of the greatest products and brands in the world. But the rest of the world is catching up to us and the U.S. tax system creates an unnecessary competitive disadvantage to American companies and the American economy. A good first step to improving the competitiveness of the U.S. tax system is to reduce the combined federal and state tax rate to a level comparable to the combined rates in the rest of the OECD countries. The current combined U.S. tax rate is more than 50 percent higher than the average of the other OECD countries.

A second step would be to adopt a territorial system which exempts dividend income from U.S. taxation and taxes royalty income at a reduced rate. The current U.S. worldwide tax system imposes a significant tax on foreign earnings that are brought back to the U.S. for reinvestment here at home, discouraging job-creating domestic investment. By eliminating this extra layer of tax, the disincentive for American companies to reinvest their foreign earnings in the U.S. would be significantly reduced.

A third step would be to reduce the complexity of the U.S. tax system. The current complexity of the U.S. Tax Code requires U.S. companies to devote significant resources to ensure compliance. The time and money spent on those activities takes away resources that could be spent on product innovation, job creation and market growing activities. American businesses need a tax system that reduces the cost of administration, is stable and predictable, reduces the risk of error, and is easier to monitor.

To continue to prosper and improve the lives of consumers for another 140 years, Kimberly-Clark must grow our business at home and around the world. We must listen to the needs and desires of our diverse global consumers and continue to innovate and reinvest for future growth. To do all this, we need a corporate tax system that is competitive with global norms, is less complex and easier to administer, gives us the flexibility to manage our global operations in the most efficient manner, incentivizes the deployment of capital to the U.S., and promotes U.S. growth and job creation.

Thank you for giving me the opportunity to share my views on creating a tax system that supports the growth of American companies and enables the growth of the American economy and American jobs.

I would be pleased to take any questions you may have.

**STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF JULY 27, 2011
CEO PERSPECTIVES ON HOW THE TAX CODE AFFECTS HIRING,
BUSINESSES, AND ECONOMIC GROWTH**

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining employer perspectives regarding the tax code's impact on hiring, and business and economic growth:

I would like to thank Chairman Baucus for calling this hearing today. And, I would like to welcome each of the CEOs who have come here today to participate in this Committee's continuing dialogue about tax reform. With so many of our fellow Americans out of work and struggling to find a job, it is refreshing to see that your companies collectively employ over 1.6 million Americans.

Today, we are here to learn how the corporate tax affects your businesses. The corporate tax is the third largest source of federal revenues behind the individual income tax and payroll taxes. Corporate income tax revenues as a percentage of total federal revenues have steadily declined since the 1940s and 1950s. During much of the 1990s, corporate tax revenues averaged about 11 percent of federal revenues. Last year, corporate tax revenues were less than 9 percent of federal revenues.

The corporate tax is generally considered to be the most inefficient of all taxes. And tax scholars have debated for years as to who bears the burden of the corporate tax. We know that although corporations cut the checks to the IRS, corporations don't ultimately pay taxes — people do.

But which people? Is it the shareholders of the corporation? Or maybe the employees of the corporation? Or the consumers?

The most recent research in this area seems to indicate that a substantial percentage of the burden of the corporate tax is borne by employees in the form of lower wages. In addition to inquiries about where the burden of the corporate income tax truly falls, I think it is important for this Committee to focus on how the corporate tax system encourages the use of debt rather than equity. If a corporation is in need of additional funds, our tax system encourages the corporation to borrow money rather than raising funds by issuing stock.

How is that?

By making any interest payments on the borrowing deductible, whereas any dividends paid are not deductible. From a business standpoint, the increased use of debt by corporations

makes a corporation more vulnerable to the risks of bankruptcy and other downturns in the economy. Dividends not being deductible means that corporate profits are taxed twice — once at the corporation level, and again at the shareholder level. As a result of this tax treatment, we have seen a decline in the use of traditional corporations. In 1980, 75 percent of all business income was earned by traditional corporations. In 2007, that figure was only 36 percent.

Equalizing the corporate tax treatment of debt and equity would reduce or eliminate distortions in at least four ways:

- One, the incentive to invest in non-corporate businesses rather than corporate businesses;
- Two, the incentive to finance corporations with debt rather than equity;
- Three, the incentive to either retain or distribute earnings depending on the relationship among the corporation, the shareholder and the capital gains tax rates; and
- Four, the incentive to distribute earnings in a manner to avoid or reduce a second level of tax.

We also need to consider the issue of repatriation. Many U.S. multinational corporations earn money overseas, and will typically want to bring that money back home to the U.S. However, our corporate tax system discourages or penalizes U.S. multinational corporations from repatriating foreign earnings by imposing a 35 percent residual U.S. tax at the time of repatriation.

As a result, several high-profile U.S. multinational corporations are sitting on large piles of cash earned from foreign operations, yet these same corporations are borrowing money. One of the reasons is that their cash is trapped offshore, and these corporations will be subject to a 35 percent U.S. tax on repatriating their cash back to the United States. As a result, because of our corporate tax system, these corporations keep their cash offshore and borrow money here in the U.S. One way of alleviating the problem of cash that is trapped offshore is for the U.S. to reform its corporate tax and international tax rules by, for example, adopting a territorial tax system.

Finally, no discussion of corporate tax reform can conclude without consideration of the corporate tax rates. Our corporate tax system has a top rate of 35 percent. When coupled with a state corporate tax, the tax rate is usually about 39 percent. As a result, the U.S. has one of the highest corporate tax rates in the world. Our corporate tax system is in need of reform, and the high corporate tax rate needs to be a major part of the discussion.

I am very interested to hear what our witnesses have to say today with regard to our corporate tax system and how it affects hiring, businesses, and economic growth. Again, Chairman Baucus, thank you very much for scheduling this important hearing.

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**Testimony of Gregory S. Lang
President & Chief Executive Officer, PMC-Sierra**

**United States Senate
Committee on Finance**

**"CEO Perspectives on How the Tax Code Affects Hiring,
Businesses and Economic Growth"**

July 27, 2011

Good Morning Chairman Baucus, Ranking Member Hatch and other members of the Committee, my name is Gregory S. Lang. I am the President and CEO of PMC-Sierra, Inc., headquartered in Sunnyvale, CA. PMC-Sierra is a leading semiconductor innovator transforming networks that connect, move and store digital content. Building on a track record of technology leadership, PMC-Sierra is driving innovation across storage, optical and mobile networks.

In my role as President and Chief Executive Officer of PMC-Sierra, I currently serve on the Board of Directors of the Semiconductor Industry Association and my testimony today reflects discussions I've held with my colleagues within the industry. I would like to thank the Committee for considering ways that Congress, through the U.S. tax code, may promote job creation and sustained economic growth for our country. This is a top priority for the U.S. semiconductor industry.

PMC-Sierra (Nasdaq: PMCS) is headquartered in Sunnyvale, California and for 2010 reported net revenues of \$635.1 million. In 2010, we experienced a broad recovery following a difficult recession the prior year. Revenue growth resumed across all of our major businesses including enterprise storage and WAN infrastructure, and with the improved economic environment in 2010, we experienced 28% year-over-year growth in net revenues. It is important to note that PMC-Sierra and the semiconductor industry as a whole represent America's largest export industry¹, a leading driver of innovation and research, and a bellwether

¹ Source: U.S. International Trade Commission. Industry Defined By: NAIC Codes 336411 (Aircraft); 334413 (Semiconductors); 336111 (Automobiles); 324110 (Petroleum Refinery Products)

of the U.S. economy. In 2010 global semiconductor sales reached \$298 billion², with U.S. headquartered companies retaining approximately 50 percent of global market share. PMC-Sierra is just one of the more than 60 semiconductor companies headquartered in the United States that account for 80 percent of the nation's semiconductor production. Semiconductors are the building blocks that form the foundation for America's \$1.1 trillion technology and electronics industry, affecting a workforce of nearly 6 million Americans.

Background on Semiconductors

America's semiconductor industry is critical to our country's economic growth and recovery. Invented here in the U.S., there isn't a single industry from agriculture to pharmaceuticals that has not been transformed by the innovation and success of the semiconductor industry.

Semiconductors, also known as microchips, are the fundamental enabling technology for the modern economy and an essential component of our nation's defense and homeland security, information technology, global finance, transportation, manufacturing, health care, and many other sectors of our economy. Indeed, semiconductors are components in a staggering variety of products – nearly everything with an on and off switch - and they are making the world around us smarter, greener, safer and more efficient.

In 2010, U.S. semiconductor companies generated over \$144 billion in sales, a record year for the industry.³ Our industry directly employs nearly 200,000 workers in the U.S., and at almost \$100,000 annually the average wage of semiconductor workers far exceeds the U.S. average.⁴ Further, studies show that semiconductors, and the information technologies they enable, represent 3 percent of the economy, but drive 25 percent of economic growth.⁵ Our industry drives unprecedented productivity across all sectors of the economy and spawns entirely new industries, it is truly an engine of growth and it is vital to our economy.

² 2010 World Semiconductor Trade Statistics (WSTS), Global Semiconductor Sales, <http://www.sia-online.org/news/2011/01/31/global-sales-reports-2011/global-semiconductor-sales-hit-record-298.3-billion-in-2010/>

³ 2010 WSTS, Global Semiconductor Sales, <http://www.sia-online.org/news/2011/01/31/global-sales-reports-2011/global-semiconductor-sales-hit-record-298.3-billion-in-2010/>

⁴ Source: SIA, U.S. DoL

⁵ March 2009, "Maintaining America's Competitive Edge", Dewey & LeBeouf, http://www.sia-online.org/clientuploads/directory/DocumentSIA/Research%20and%20Technology/Competitiveness_White_Paper.pdf



The Ideal American Enterprise

Our shared challenge is to examine the role that private industry can and must play in sustained job creation and lasting U.S. economic growth. We believe that our country should make America the most attractive place in the world to do business, and that we should seek to specifically promote and encourage seminal industries that uniquely contribute to lasting economic growth. To that end, the semiconductor industry can be an instructive model.

With its humble beginnings in the 1950's, the semiconductor industry has fueled America's transition to an innovation economy. One need not understand exactly how a semiconductor works to understand that this great American invention will continue to illuminate the path of progress for years to come. This industry not only enables incredible technological advances that affect modern life, it now sets the pace for economic growth the world over. High-paying jobs, billions in annual revenue and increasing exports make the semiconductor industry a model for American growth.

The semiconductor industry is a key driver of U.S. innovation. As a whole, the industry invests approximately 17 percent of revenue in research and development, an amount higher than virtually any other sector, and SIA member companies account for 7 of the top 15 patent

recipients in the U.S.⁶ With most of that R&D taking place in the United States that translates directly into high end U.S. jobs.

Harvard economist Dale Jorgenson has noted, "The economics of Information Technology (IT) begin with the precipitous and continuing fall in semiconductor prices." Professor Jorgenson attributes the rapid adoption of technology in the United States to driving substantial economic growth in the nation's gross domestic product since 1995. He notes, "**As a group, these [IT] industries contribute more to economy-wide productivity growth than all other industries combined.**"⁷

It is important to note that the semiconductor industry is export intensive, research intensive, and for those companies that manufacture, capital intensive, all attributes that contribute economic value and investment in the United States.

In the five year period from 2005-2009 total semiconductor exports averaged \$48 billion, on average, the highest of all exports; and were \$38 billion during the 2009 downturn, second only to petroleum refinery products. Last year, 82 percent of industry sales were outside the U.S. and over the past decade U.S. share of the market has remained around 50 percent. Further, about three-quarters of U.S. semiconductor industry R&D spending, 77 percent of U.S.-owned production capacity, 51 percent of U.S. industry worldwide employment, and 74 percent of the compensation and benefits paid by the U.S. industry are in the United States today.⁸

The combination of a global, high-export industry based largely in the United States and underpinning the \$1.1 trillion technology industry should serve as a primary model of the types of industries that government policies should promote and support. It is only pro-business and pro-growth policies targeted at high-yield industries that can provide lasting economic growth for America.

⁶ Source: "Patenting by Organizations 2010" April 2011, US Patent and Trademark Office

⁷ March 2009, "Maintaining America's Competitive Edge", Dewey & LeBeouf, http://www.sia-online.org/clientuploads/directory/DocumentSIA/Research%20and%20Technology/Competitiveness_White_Paper.pdf

⁸ March 2009, "Maintaining America's Competitive Edge", Dewey & LeBeouf, http://www.sia-online.org/clientuploads/directory/DocumentSIA/Research%20and%20Technology/Competitiveness_White_Paper.pdf

Opportunity to Maintain Leadership

And yet, despite this unprecedented growth and truly inspiring example of American innovation, we are a nation and an industry at risk. We are at a pivotal point in the future of not only the semiconductor and technology industry but also in the very nature of what will define our economy and country in five, ten and fifty years from now.

We have the opportunity now to decide if America will retain its leadership in this seminal industry or whether, by failing to adopt policies that foster economic growth, we will let this industry and others like it slip away to become the crown jewel of another nation.

Make no mistake, innovation will continue and the semiconductor industry will succeed. What we are here today to discuss is whether we as a nation want that innovation and all of the jobs, advancement, capabilities and benefits that come with it to stay and prosper in the United States, or whether we will allow it to succeed somewhere else. It is ours to lose and with it will go the underpinning of what has become the innovation economy. Unlike many traditional industries, the semiconductor industry has a global market, is highly mobile, can be located anywhere and is actively recruited by foreign governments every day.

This Committee has the unique ability to examine the factors that stand in the way of high-growth, high-yield and highly innovative industries like ours. We must examine how the U.S. government can unleash the economic potential in these key industries. I submit that we should not allow another country to out-compete us for semiconductor industry investment

I believe that corporate tax reform can be one of the most effective tools that the U.S. Congress can use to get America growing again and to maintain our leadership in technology. A more competitive tax structure will allow U.S. enterprise to build and invest more of their resources in the United States. A restructured tax code means that companies will have more capital to invest in their products, which will create a need for more long-term jobs, and provide for sustainable long-term growth for the U.S. economy.

Most importantly, a competitive tax system will eliminate the disincentives to building manufacturing and R&D facilities here in the United States and creating the jobs those facilities will provide. However, this is only one solution in a larger roadmap for an innovation ecosystem. Congress must also look to liberalize trade, high-skilled immigration reform, building our science and engineering infrastructure and reducing unnecessary regulatory burdens in order to build a truly competitive environment for U.S. companies.

Tax Reform Policy Objective: Global Competitiveness

While the U.S. semiconductor industry remains, at this time, the undisputed leader in this critical technology, it operates in a globally competitive marketplace, and other countries are aggressively pursuing leadership in this sector. Specifically targeted as a high-growth, strategically important industry, other countries actively recruit U.S. semiconductor companies to their shores by offering a combination of generous credits, grants, and reduced tax rates to invest and build operations in these countries.

A prime example of this situation is in the capital-intensive building and operation of a semiconductor fabrication facility. It costs nearly \$7 billion to build and operate a new facility in the United States. By comparison, it costs approximately \$1 billion less to build and operate that same facility overseas over ten years. The main cost differentials are not labor or materials as some might think. Instead the \$1 billion difference is made up in the form of tax benefits, holidays, grants and other benefits offered by other countries to recruit and attract semiconductor companies to their shores.⁹

In contrast, companies based in the U.S. operate at a disadvantage under current U.S. tax policy. The combination of high corporate tax rates and a weak and temporary research and development ("R&D") tax credit makes investments in the United States less attractive. A worldwide tax system puts American companies at a distinct disadvantage compared to their global competitors and acts as a disincentive to reinvesting foreign profits in the United States.

Corporate tax reform is one element of an innovation and competitiveness agenda that can help maintain U.S. leadership in this critical industry. It is worth noting that the semiconductor industry is diverse in its makeup. This industry includes manufacturers and non-manufacturers. Our business models vary considerably. Some companies are subject to greater degrees of taxation than others because of varying business models. Yet all agree that fundamental reform is necessary and that it rests on three key elements:

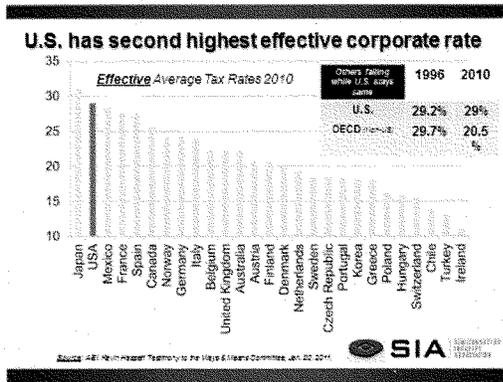
- **Reducing the corporate tax rate** to align more closely with globally competitive rates.
- **Adopting a territorial tax system** that is similar to those used by most of our global competitors.

⁹ Paul S. Otellini, "Impact of Taxes on U.S. Semiconductor Company Decisions," Intel Corporation (March 31, 2005) and Abbie Gregg, Inc., "The Paradigm for Financing Fabs," Albany Symposium 2005 on Global Nanotechnology (September 26-28, 2005). Statement of Craig R. Barrett before Subcommittee on Select Revenue Measures, House Ways and Means Committee (June 22, 2006).

- Enacting a permanent and robust package of incentives for research and innovation that compete with those in other countries.

Globally Competitive Tax Rate

The United States should adopt a globally competitive tax rate in line with the OECD average of 25 percent and with non-OECD country rates.



Currently, the U.S. combined federal and state corporate tax rate is 39.2 percent, approximately 14 percent above the OECD average of 25 percent. The U.S. rate may soon become the highest in the world if Japan follows through with its initiative to lower its corporate tax rate.

Perhaps more significantly, U.S.-based companies face significant competition from countries outside the OECD that have corporate tax rates well below the U.S. rate. For example, the rate is 15 percent in China for new high technology enterprises, 17 percent in Hong Kong, 25 percent in Malaysia, 17 percent in Singapore, and 17 percent in Taiwan. Moreover, most all of these countries offer substantial tax "holiday" incentives for new high technology investments, which effectively lowers the rate to zero or single digits.

I do not think it's reasonable for the U.S. to match these incentives dollar for dollar, especially when they amount to an effective rate of zero. Nonetheless, policymakers must be aware of these policies. Our current tax rates incentivize the location of high-tech operations

outside of the United States to avoid the high levels of taxation in the U.S., and while tax incentives are not the only factor in global competition, increasingly they can skew investment decisions.

Shift to Territorial Tax System

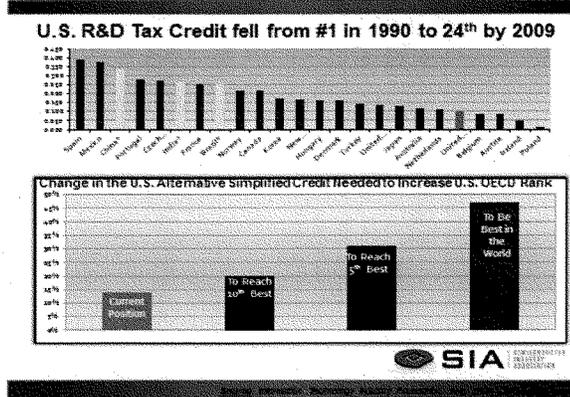
Our worldwide tax system creates an additional disincentive for U.S. companies. Meaningful tax reform should include a move to a territorial approach. This would subject U.S.-based companies to tax only where their products are sold, a system that almost all foreign competitors enjoy today. Our current deferral system encourages the reinvestment of capital outside the U.S.

A territorial system would enable companies to repatriate their profits to the U.S. without a heavy tax penalty, allowing American companies to make financial decisions concerning foreign profits based on sound economic principles. In designing a territorial tax system, Congress should consider the approaches adopted by other countries and ensure that U.S.-based companies have the benefit of systems similar to those of other countries.

Permanent and Enhanced R&D Credit

Finally, comprehensive tax reform should provide strong and permanent incentives to create jobs and encourage research and development ("R&D") in the U.S. The phenomenal advances in semiconductor technology and the ability of the U.S. industry to remain the world leader flows from the unique U.S. innovation ecosystem, leveraging university, industry, and government scientists and engineers performing a range of complementary research and development activities. This is the engine of the innovation economy, which we cannot allow to wither on the vine. America must actively pursue a research agenda in order to remain competitive with the rest of the world.

As noted previously, U.S. semiconductor companies invest an average of 17 percent of revenues in product-related R&D, approximately \$25 billion in 2010. This is one of the highest percentages of any industry. Coupled with capital expenditures of 11 percent of sales, our industry invests nearly 30 percent of its revenues to drive future growth. Even in the midst of decreasing revenues in the recession, companies like mine sustained their R&D investments. Yet, the R&D tax credit in the U.S. is weak compared with our global competitors and has lapsed 13 times over the past three decades.



Starting Point: Tax Reform

A similar situation confronted the industry in the 1980s, when the U.S. semiconductor market was specifically targeted through harsh trade restrictions by foreign governments. Fortunately, through Congressional and government action in enforcing U.S. trade laws and in partnering with the industry to regain its technological footing, the industry was restored as the world leader and continues to enjoy this leadership position today. As before, our government should act to maintain the future and pace of American enterprise and innovation.

Tax reform would be a tremendous step forward in unleashing the full potential of American innovation. However, this is only one solution in a larger roadmap for an innovation ecosystem. Congress must also look to liberalize trade, advance high skilled immigration reform, build our science and engineering infrastructure and reduce unnecessary regulatory burdens. All of these pieces advanced together could serve to transform our economy into a robust engine for innovation and prosperity.

In contrast, our current policy assumes that the U.S. will always retain our leadership position in semiconductors. The global landscape has changed and U.S. tax policy must change to meet this competitive challenge. I believe the Congress should work together to enable private enterprise to compete, innovate and grow the economy. The starting point is comprehensive pro-growth tax reform.

**Testimony Of
Mr. Larry Merlo
President and Chief Executive Officer
CVS Caremark Corporation**

Good morning Chairman Baucus, Ranking Member Hatch, and members of the Committee. Thank you for holding this important hearing today and for allowing CVS Caremark the opportunity to share our views on tax reform.

My name is Larry Merlo. I am the President and Chief Executive Officer of CVS Caremark Corporation, a domestic health care business headquartered in Woonsocket, Rhode Island that employs more than 200,000 Americans.

Today I would like to provide the committee with an overview of CVS Caremark's business and explain how we think our company and the nation as a whole would benefit from meaningful corporate tax reform.

As a leading health care company and the leading pharmacy care provider in the U.S., CVS Caremark is dedicated to helping Americans achieve their best health outcomes at lower costs. As a Fortune 25 company, each day we spend \$260 million doing business with over 44,000 different vendors – generating a total of \$95 billion of economic activity each year. We employ more pharmacists and nurse practitioners than anyone else in the nation, filling over 830 million prescriptions every year or 20% of the U.S.'s total prescriptions.

Some think of us as the nation's leading drugstore chain because we operate more than 7,200 CVS/Pharmacy stores in 44 states, the District of Columbia and Puerto Rico. Seventy-five percent of all Americans live within three miles of one of our stores in the markets where we operate. For others, we're a leading pharmacy benefits manager, or PBM. As you know, PBMs assist health plans, unions, and governments design prescription drug benefit options to best meet their members' needs and help sponsors drive down costs. Our PBM also provides beneficiaries with access to a network of more than 65,000 pharmacies in the U.S.

CVS Caremark is more than just a PBM and drugstore chain – we consider ourselves a part of the fabric of American society, working to improve the lives and health of our customers – and to provide services at the lowest possible cost. Because of that, we have made significant investments in our people and infrastructure; we believe that is part of our obligation as a participant in the American business community. Our organization, including our more than 51,000 pharmacists, pharmacy technicians, physician assistants and nurse practitioners, is focused on delivering expert pharmacy health care to consumers. Our strengths extend to areas that include retail clinics, specialty pharmacy, pharmacogenomics, technology and serving over 6 million Medicare Part D beneficiaries.

- **MinuteClinic** - We have invested capital and established nearly 600 retail based MinuteClinics in 26 states and the District of Columbia. MinuteClinics are staffed by board-certified nurse practitioners and physician assistants who utilize nationally recognized medical protocols to diagnose and treat minor health conditions, perform health screenings, monitor chronic conditions and deliver vaccinations. Since inception, we have seen more than 10 million patients at our MinuteClinics. We believe this is a service that not only helps improve patient health, but saves us all money by reducing health care costs through preventative care.
- **Specialty** - We operate the largest specialty pharmacy business in the U.S. We are investing in new products and services for patients with diseases like HIV or multiple sclerosis that require more complex treatments than simply taking a pill. Today four of the top ten most prescribed medications are specialty drugs and that number is expected to rise to seven out of ten by 2015.
- **Pharmacogenomics** – We have made a significant investment in this emerging field that focuses on providing the right drug and dosage to the right patient. By identifying how an individual's genetic variations are likely to impact the response to a particular treatment, we can minimize adverse drug reactions and lower costs overall.

- **Technology** - We invest heavily in state-of-the-art technology to support the services our caregivers provide. Our technology platform supports future clinical advances and helps us encourage patients to remain compliant with prescribed medications and closes gaps in care. The result is better health outcomes for our customers and lower overall health care costs for everyone.
- **Medicare Part D** - We are the second largest provider of drug benefits to eligible beneficiaries under the Federal Government's Medicare Part D program. Each year, CVS pharmacists serve more than 6 million beneficiaries and fill more than 245 million prescriptions under the Part D program.

In our view, CVS Caremark is the most integrated and effective pharmacy health care provider in the country today. But we believe we can do more, and we are expanding our role as a health care provider; and we are also growing our company to meet the needs of consumers and the changing U.S. health care system. Our company currently reinvests approximately \$2 billion back into our business each year and we are committed to making significant future investments in our service offerings, technology, training, drug adherence programs, retail clinics and other improvements to our infrastructure and operations. Our investments are geared towards lowering the overall cost of health care in this country and improving consumer health.

Impact of Tax Reform

Tax reform is important to CVS Caremark because we anticipate that it will serve to lower our cost of capital and enable the company to make additional investments in our core business. We support broad reform that enhances the competitiveness of U.S. companies around the world and encourages the free flow of capital. For CVS Caremark, however, the key component of any tax reform initiative is a reduction in the maximum corporate income tax rate. Reform that includes a corporate rate reduction would allow us to accelerate our investments in U.S. jobs, technology and infrastructure that would enable CVS Caremark to (i) more effectively manage pharmaceutical and health care costs, (ii) increase patient adherence, (iii) increase access to primary care services, (iv) improve health outcomes, and (v) educate our customers in health enhancing behaviors.

CVS Caremark's federal effective income tax rate is approximately 35% and our combined federal and state effective income tax rate is approximately 39%. Together with our more than 200,000 employees, we generate federal payroll and corporate income tax revenues of approximately \$3.7 billion annually.¹ When similar state and local payroll and income taxes are considered our annual tax payments exceed \$4.3 billion.

We have a high effective tax rate for two principle reasons, the first being that many of the tax policies that help industry have limited application to CVS Caremark, and secondly, we have consistently chosen to reinvest our earnings and create jobs in the U.S. That said, CVS Caremark does benefit from certain incentives such as the Work Opportunity Tax Credit and accelerated/bonus depreciation. Notwithstanding our use of some incentives, we support business tax reform that broadens the base by reducing expenditures and provides a consequential reduction in the maximum corporate tax rate.

In order to continue to be successful in an increasingly global marketplace, CVS Caremark must control costs, raise capital and efficiently reinvest its earnings. Although we have worked hard managing our operations and controlling costs to provide both capital for our business and returns for our shareholders, our high effective tax rate not only limits the amount of earnings available to us for reinvestment in our core business, it also makes CVS Caremark less attractive to global investors.

We are committed to growing our business in the U.S. Without a consequential rate reduction tax considerations will have to be an even more significant component of our overall investment analysis.

Conclusion

We believe that by lowering the corporate tax rate, you will enhance the competitiveness of U.S. companies, spur job creation, and help the economy grow.

¹Our payroll tax figures include both the employee and employer share of all federal payroll taxes and income tax withholdings.

Therefore, CVS Caremark supports tax reform that includes a meaningful rate reduction because we believe it will encourage investment in the U.S. by both domestic and foreign companies. Such reform will strengthen our company and accelerate our investment in domestic jobs, technology and infrastructure – all of which will ultimately help us lower health care costs and grow the economy.

As I stated earlier, CVS Caremark is committed to improving care and lowering health care costs for millions of Americans. We are excited about the possibility of having the ability to invest our earnings to do even more. Changes to the tax code such as those we have suggested will help us, and many U.S. companies like us, do just that.

Senate Finance Committee Hearing
“CEO Perspectives on How the Tax Code Affects Hiring,
Businesses and Economic Growth”
July 27, 2011
Responses to Questions from Larry J. Merlo

Questions from Senator Baucus

- 1) You’ve stated in your testimony how the U.S.’s high statutory tax rate influences businesses decisions, such as location of high-tech operations and where to reinvest earnings.

Please describe to me the level of significance that tax rates play in decisions such as location and reinvestment compared to other factors such as proximity to customers, availability of a skilled workforce, the legal and regulatory environment and so on.

CVS Caremark Response: Proximity to our customers or retail stores can be an important factor in deciding where to locate certain operations (e.g. Distribution Centers). However, for other functions proximity to our customers is not as important as technology continues to advance and the workforce becomes more mobile. Overall, we evaluate both the tangible (e.g. costs to operate) and intangible (e.g. legal and regulatory environment) factors when considering where to invest. We are attracted to areas with (i) stable, business-friendly government and fiscal policies, (ii) adequate infrastructure and (iii) a suitable labor force. It is difficult to rank the order of importance of each of these factors because they are all important and the weight can vary based on the type of investment. That said, higher projected operating costs are difficult to ignore/overcome.

- 2) Your written testimony suggests that foreign companies are generally subject to lower tax rates and therefore may be better able to attract capital than a U.S. business such as CVS Caremark.

Do you think that your business is threatened by foreign competitors that may enter the U.S. market and compete aggressively, with a tax cost advantage? If this is possible, is it happening already and, if not, why not?

CVS Caremark Response: We do monitor current and potential foreign competition. As you know, because returns on investment are determined on an after-tax basis, the higher a business’s tax costs are, the higher its pre-tax profits must be to achieve a competitive cost of capital. U.S. based companies must therefore generate higher returns than lower-taxed foreign competitors. Today we face foreign competition not only in our retail and real estate

businesses but also in the capital markets. Our investor base is comprised of less than 10% of international investors which is low for a company of our size.

Questions from Senator Hatch

- 1) Mr. Falk noted in his testimony that there have been proposals recently to “move the U.S. tax system further away from competitive global norms” by ending deferral of U.S. tax on a U.S. company’s foreign earnings earned through a foreign subsidiary. Would you comment on the effect this would have on your company and the U.S. economy? Also, if there were an accompanying tax rate reduction that were significant, would that make repeal of deferral acceptable?

CVS Caremark Response: *CVS Caremark is a domestic company with virtually no international operations so the elimination of deferral would not directly impact our tax footprint. Reducing the maximum corporate tax rate would strengthen our company and accelerate our investment in domestic jobs and infrastructure – which will ultimately help us lower health care costs and grow the economy. That said, we think it makes sense to carefully consider territorial taxation in combination with consequential rate reduction in an effort to make the U.S. tax system more competitive with the tax systems of our major trading partners.*

- 2) In considering corporate tax reform, the focus is typically on the corporate tax provisions in our tax code. But how important is it to focus on the impact corporate tax reform will have on a company’s financial statements? For example, if a corporation has a net operating loss (NOL) that it carries forward from year to year, this NOL can offset taxable income in future years. Thus, the NOL can be a very valuable asset to a company. That is, the NOL can reduce taxes in future years. So, if a corporation has a \$100 NOL, it will reduce, given our 35% tax rate, corporate taxes by \$35. Thus, corporations, under current financial accounting rules, rightly state that a \$100 of NOL is an asset the company holds worth \$35. However, if the corporate tax rate were reduced to 25%, then this NOL asset would only be worth \$25. That is, in some real sense, the corporation would lose \$10 by virtue of the corporate tax rate going down 10 percentage points. This \$10 reduction would immediately show up as a \$10 reduction in the corporation’s net income and would lower the corporation’s earnings per share. Should corporate tax reform take into consideration the financial accounting impact of reform?

CVS Caremark Response: *Upon enactment, corporate tax reform that includes a rate reduction will require an immediate, one-time accounting adjustment to affected companies’ balance sheets (i.e., deferred tax balances) and income statements (i.e., tax expense). It is important to note that this immediate, one-time adjustment could be favorable or unfavorable to a company’s bottom line in the year of enactment, however, it should not ultimately impact cash taxes paid. Therefore, we believe, the role that accounting considerations play in corporate tax reform should be minimal and limited only to alerting/educating investors,*

analysts, lenders, regulators and other users of financial statements so that they are aware of, and understand the nature of, this one-time non-cash accounting impact.

- 3) In the U.S., corporate profits are taxed twice: first, the corporation itself pays a tax on its profits; second, the shareholders pay a tax when they receive a dividend paid from those profits. This double taxation of corporate profits is widely seen as inefficient and unfair. But the question is: How should this problem be solved? The partial solution that Congress came up with in 2003 was to tax dividends received by individuals at the relatively low rate of 15%, instead of at the much higher ordinary income tax rates. However, this Committee recently heard testimony from a corporate tax expert who said the tax rate on corporations should be reduced radically, but the tax rate on dividends should be allowed to go up to higher ordinary income tax rates. That is, the expert advised that we take exactly the opposite approach of what Congress took in 2003 to address the problem of double taxation of corporate profits. Some have suggested that corporations be allowed a deduction for paying dividends, just like they are allowed a deduction for paying interest. What is your opinion on these matters. First of all, do you see the double taxation of corporate profits as a problem? Secondly, if you do think of the double taxation of corporate profits as a problem, what is the ideal solution? If given the choice between a low tax on dividends, or a low corporate tax, how do you come out on that? And, when answering, please remind us of your company's history of paying dividends.

CVS Caremark Response: *Since 1997, CVS Caremark has regularly paid a quarterly dividend and we expect this trend to continue. Therefore, CVS Caremark would benefit from reform that allows corporations to deduct dividends paid. That said, double taxation of corporate profits, whether appropriate or not, has been part of our system for decades, and the proliferation of pass-through entities seems to have isolated this issue mainly to publicly-traded entities. For CVS Caremark, consequential reduction in the maximum corporate income tax rate is the most important policy goal because it will make our company stronger and allow us to accelerate our investments in U.S. jobs and infrastructure.*

Questions from Senator Enzi

- 1) Each of you mentioned in your testimony the need for a significant reduction in the corporate income tax rate. In addition to impacting the "cash" tax that your companies will pay to the U.S. Treasury, a reduction in the corporate income tax rate could have significant financial statement implications, not the least of which is a potential "hit" to your bottom line. What recommendations do you have for this Committee regarding the method in which a potential corporate income tax rate reduction is implemented? For example, should it be a phased approach where the corporate income tax rate is lowered

over a period of years so as to provide a gradual impact on companies' net earnings in their financial statements?

CVS Caremark Response: *We recommend an immediate consequential reduction in the maximum corporate tax rate because it would create the best opportunity for CVS Caremark to accelerate our investment in domestic jobs and infrastructure – which will ultimately help us lower health care costs and grow the economy.*

Additionally, we are aware that upon enactment, corporate tax reform that includes a rate reduction will require an immediate accounting adjustment to affected companies' balance sheets (i.e., deferred tax balances) and income statements (i.e., tax expense). It is important to note that this adjustment could be favorable or unfavorable to a company's bottom line in the year the rate reduction is effective but ultimately should not impact cash taxes paid. Therefore, we believe implementation in a single year rather than over multiple years makes the most sense. Additionally, the role that accounting considerations play in corporate tax reform should be minimal and limited only to alerting/educating investors, analysts, lenders, regulators and other users of financial statements so that they are aware of, and understand the nature of, this one-time non-cash accounting impact.

- 2) Much of the discussion surrounding tax reform has been focused on “lowering the rates” and “broadening the base.” As this Committee considers broad tax reform, are there other types of tax systems we should be considering? For example, the House Ways and Means Committee recently held a hearing on alternative tax systems, such as value-added taxes. What are your thoughts on these alternative tax systems that move away from taxes on income and savings and more towards taxes on consumption? How might these types of taxes impact your hiring and investment decisions?

CVS Caremark Response: *Some of the key goals of tax reform should be simplification, certainty, job creation and economic growth. The addition of a second system of taxation does not seem to achieve simplification. Also, we do not believe the addition of a consumption tax will positively impact our hiring and investment decisions. These types of taxes can be regressive and may have a negative impact on health care costs because the tax results in higher costs for the consumer.*

Additionally, we have noticed a troubling and consistent trend with the fill rate of maintenance medication. Our analysis suggests that patients are forgoing physician visits and dropping off therapies due in part to the difficult economic climate. The addition of a consumption tax to the cost of maintenance prescriptions may further exacerbate this trend and result in overall increased health care costs.

- 3) I realize that all of the companies you lead are subchapter C corporations and are subject to the corporate income tax. And it makes sense that you have an interest in corporate tax reform and how that reform will impact your company, your employees, your customers, and your communities. However, many companies, especially many small businesses, are structured not as C corporations but rather as pass-through entities (e.g., partnerships, S corporations, and limited liability companies) that are subject to the individual income tax system. The Obama Administration has called for corporate-only income tax reform, and the latest reports are that a proposal could be forthcoming from the Administration this fall. Given the interaction between the corporate and individual income tax systems, do you think it is possible to do tax reform that is focused solely on C corporations, or does such a reform effort necessitate a broader view that encompasses the individual income tax system as well?

CVS Caremark Response: *We welcome a reduction in the corporate income tax rate by whatever vehicle is deemed most appropriate. That said, in general we believe a comprehensive approach to tax reform makes sense. We also believe that limiting the impact that tax policy has on business decisions and uniform taxation of similar economic activity regardless of structure, are worthy goals. Ultimately, growing the economy and creating jobs must be the most important consideration of any reform proposal.*

- 4) A series of proposals and recommendations have been offered to restore the nation's fiscal balance, with tax reform being a significant contributor to such an effort. Tax reform could have a significant impact on the organizational structure and operations of both small and large U.S. multinationals, as well as potentially significant financial statement impacts. Given this, it seems to be prudent to include appropriate transition rules in any tax reform effort. In your view, what should this Committee take into consideration as part of a potential transition plan in tax reform?

CVS Caremark Response: *The ability of taxpayers to rely on the tax law as it exists at the time an investment is made or a transaction is completed is an important component of the efficient and transparent operation of our tax system. Therefore, we believe that the Committee should consider transition rules as appropriate in the context of fundamental tax reform legislation to ensure that taxpayers do not incur an economic loss if they acted in good faith reliance on the laws as they existed at the time of a transaction or investment.*

- 5) The Deficit Commission proposed moving the U.S. system of international taxation to that of a territorial or dividend-exemption system. According to many in the business community, such a move would allow for U.S. companies to compete on a level playing field with foreign competitors and would eliminate the additional home-country tax due when earnings are brought home (a tax that many foreign competitors do not face because their home countries have already moved to a territorial tax system).

From the perspective of simplification, would it be prudent to include in a transition from our current system to a territorial system a reduced rate of tax on earnings that have not

yet been subject to U.S. tax in order to allow companies to bring home those earnings at a reduced tax rate and start fresh under the new system?

CVS Caremark Response: *Because we are a domestic company with very little overseas presence, we have no overseas earnings to repatriate. However, as part of comprehensive reform, we do think it is appropriate to consider some mechanism to encourage companies to repatriate overseas cash if it benefits the U.S. economy.*

COMMUNICATIONS

Comments for the Record

Senate Committee on Finance

Hearing on CEO Perspectives Regarding How the Tax Code Affects Hiring and Business Growth

July 27, 2011

By Michael G. Bindner
Center for Fiscal Equity
4 Canterbury Square, Suite 302
Alexandria, Virginia 22304

Chairman Baucus and Ranking Member Hatch, thank you for the opportunity to address these issues. I urge you to take the formal testimony with a large grain of salt.

The Distribution of Productivity Gains

CEOs and personnel in upper management have done quite well under the current tax code, which has seen their salaries absorb most of the productivity gains over the past thirty years while the wages of most workers have barely kept up with inflation.

Prior to the 1981 tax cuts, the income tax system was designed not to maximize revenue but to instead prevent the maldistribution of income by seizing outsized gains at the top of the income scale through the imposition of confiscatory rates. These rates were part of the original grand bargain with labor – which restricted the extent to which organized labor could invest pension funds in order to gain control of individual companies in exchange for protecting collective bargaining rights and limiting the incentives at the top for exacting outsized gains from employees.

This changed with President Kennedy's tax cuts and changed more profoundly during the tax cuts of the Reagan Administration. The tax cuts enacted in 2001 and 2003 finished the job, both through lowering rates and creating special tax rates for dividends, driving the effective tax rate for the wealthiest to 19%.

With the end of confiscatory tax rates, wage concessions were exacted from employees while unions were subjected to a frontal assault from management in the name of shareholder profit. As dividends are usually rewarded at "normal profit" levels, most of these gains ended up in the pockets of the members of the Executive Suite through higher profits, stock options and outsized bonuses. CEO dominance of compensation committees and the rise of the celebrity CEO did the rest, voiding the social contract with labor that saw the rise of the American middle class in the 20th century.

Today's witnesses made valid points about how to make American companies more profitable on the world stage, through reducing specific tax benefits and lowering rates. Some economists even cite Laffer Curve information and assert that any rate cut, even absent base broadening, would produce more revenue. The question then arises, who would benefit from these policy changes?

While they would almost assuredly fatten government coffers, and may even provide some benefit to shareholders, by and large the chief beneficiaries of such cuts would be members of the "C Suite," both those at the top and their immediate staffs in upper management. These benefits would accrue to the largest companies only. Smaller firms without a large international presence would benefit little, since many such firms do not even use a corporate form of ownership.

Any reform to corporate tax rates must be accompanied by general tax reform which includes measures to make work pay for families, such as an increase in the minimum wage, an expansion of programs for displaced workers, increases to the refundable child tax credit so that it more approach living wage levels and, above all, an end to special tax rules for dividends and capital gains so that the incentive to concentrate the benefits of productivity at the top of the income latter are reduced.

The Center for Fiscal Equity has a four-part proposal to replace the current system, including replacement of the corporate income tax with a more generally collected net business receipts tax. The key elements are

- Value Added Taxes (VAT) to fund domestic military and civil spending;
- VAT-like Net Business Receipts Taxes (NBRT) to fund non-Old Age and Survivors(OASI) entitlement spending and to provide a vehicle for both tax benefits, such as a consolidated Child Tax Credit and the continuation of the health care exclusion, as well as any state-level efforts to shift entitlement funding to tax benefit funding (ex. public and private charter schools);
- OASI taxes to allow an income-sensitive benefit based on the employee tax, but with the employer tax credited as an average to move redistribution to the collection end and an increase to the income cap to improve solvency and benefits, possibly in exchange for limited personal accounts invested in insured employee-ownership (rather than in Wall Street assets where they have little control or influence); and
- Income surtaxes, to include distributions from inheritance, to assure period based system progressivity and to fund overseas, naval sea and strategic military spending, net interest on the debt, repayment of the OASI trust fund and any transition costs to personal retirement accounts.

Adequate attention has been paid to the VAT of late, while no debate on fundamental reforms to OASI will likely occur under the current regime. We will, therefore, confine the remainder of our comments to the Net Business Receipts Tax and the need to increase income tax revenue.

The Net Business Receipts Tax (NBRT)

The NBRT base is similar to a Value Added Tax (VAT), but not identical. Unlike a VAT, and NBRT would not be visible on receipts and should not be zero rated at the border – nor should it be applied to imports. While both collect from consumers, the unit of analysis for the NBRT should be the business rather than the transaction. As such, its application should be universal – covering both public companies who currently file business income taxes and private companies who currently file their business expenses on individual returns.

The NBRT would replace payroll taxes for Hospital Insurance, Disability Insurance, Survivors Insurance for spouses under 60, Unemployment Insurance, the Business Income Taxes, on corporations, business income taxes now collected under the personal income tax system, as well as most of the revenue collected under the personal income and inheritance taxes, less the amount collected under a VAT. The health insurance exclusion now included in the Business Income Tax and other subsidies under the Affordable Care Act. Most importantly, it would fund an expanded and refundable Child Tax Credit.

The expansion of the Child Tax Credit is what makes tax reform worthwhile. Adding it to the employer levy rather than retaining it under personal income taxes saves families the cost of going to a tax preparer to fully take advantage of the credit and allows the credit to be distributed throughout the year with payroll. The only tax reconciliation required would be for the employer to send each beneficiary a statement of how much tax was paid, which would be shared with the government. The government would then transmit this information to each recipient family with the instruction to notify the IRS if their employer short-changes them. This also helps prevent payments to non-existent payees.

The expansion of the child tax credit to \$520 per child per month is paid for by ending the tax exemption for children, the home mortgage interest deduction and the property tax deduction. This is more attractive to the housing industry than the alternative proposal, which is to end or limit the credit and use the proceeds to help bring the budget into primary balance. Shifting the benefit in this way holds the housing industry harmless, since studies show that the most expensive cost of adding a child is the need for additional housing.

Assistance at this level, especially if matched by state governments may very well trigger another baby boom, especially since adding children will add the additional income now added by buying a bigger house. Such a baby boom is the only real long term solution to the demographic problems facing Social Security, Medicare and Medicaid, which are more demographic than fiscal. Fixing that problem in the right way definitely adds value to tax reform.

This tax should fund services to families, including education at all levels, mental health care, disability benefits, Temporary Aid to Needy Families, Supplemental Nutrition Assistance, Medicare and Medicaid. If society acts compassionately to prisoners and shifts from punishment to treatment for mentally ill and addicted offenders, funding for these services would be from the NBRT rather than the VAT.

This tax could also be used to shift governmental spending from public agencies to private providers without any involvement by the government – especially if the several states adopted an identical tax structure. Either employers as donors or workers as recipients could designate that revenues that would otherwise be collected for public schools would instead fund the public or private school of their choice. Private mental health providers could be preferred on the same basis over public mental health institutions. This is a feature that is impossible with the FairTax or a VAT alone.

If cost savings under and NBRT, allow companies to offer services privately to both employees and retirees in exchange for a substantial tax benefit. Employers who fund catastrophic care would get an even higher benefit, with the proviso that any care so provided be superior to the care available through Medicaid. Making employers responsible for most costs and for all cost savings allows them to use some market power to get lower rates, but not so much that the free market is destroyed.

Enacting the NBRT is probably the most promising way to decrease health care costs from their current upward spiral – as employers who would be financially responsible for this care through taxes would have a real incentive to limit spending in a way that individual taxpayers simply do not have the means or incentive to exercise. While not all employers would participate, those who do would dramatically alter the market. In addition, a kind of beneficiary exchange could be established so that participating employers might trade credits for the funding of former employees who retired elsewhere, so that no one must pay unduly for the medical costs of workers who spent the majority of their careers in the service of other employers.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit.

The Center calculates an NBRT rate of 27% before offsets for the Child Tax Credit and Health Insurance Exclusion, or 33% after the exclusions are included. This is a “balanced budget” rate. It could be set lower if the spending categories funded receive a supplement from income taxes. **As importantly, the combination of this tax with a Value Added Tax, retention of a separate OASI payroll tax and retention of progressive income surtaxes allows for a low enough tax rate, after offsets, to provide a competitive advantage to American corporations while distributing these gains beyond the CEO Suite.**

Income and Inheritance Surtax

Retaining an income surtax could have few rates or many rates, although we suspect as rates go up, taxpayers of more modest means would prefer a more graduated rate structure. The need for some form of surtax at all is necessary both to preserve the progressivity of the system overall, especially if permanent tax law enacted before 2001 is considered the baseline (which it should be) and to take into account the fact that at the higher levels, income is less likely to be spent so that higher tax rates are necessary to ensure progressivity.

This tax would fund net interest on the debt, repayment of the Social Security Trust fund, any other debt reduction and overseas civilian, military, naval and marine activities, most especially international conflicts, which would otherwise require borrowing to fund. It would also fund transfers to discretionary and entitlement spending funds when tax revenue loss is due to economic recession or depression, as is currently the case. Unlike the other parts of the system, this fund would allow the running of deficits.

Explicitly identifying this tax with net interest payments highlights the need to raise these taxes as a means of dealing with our long term indebtedness, especially in regard to debt held by other nations. While consumers have benefited from the outsourcing of American jobs, it is ultimately high income investors which have reaped the lion's share of rewards.

The loss of American jobs has led to the need for foreign borrowing to offset our trade deficit. Without the tax cuts for the wealthiest Americans, such outsourcing would not have been possible. Indeed, there would have been any incentive to break unions and bargain down wages if income taxes were still at pre-1981 or pre-1961 levels. The middle class would have shared more fully in the gains from technical productivity and the artificial productivity of exploiting foreign labor would not have occurred at all. Increasing taxes will ultimately provide less of an incentive to outsource American jobs and will lead to lower interest costs overall. Additionally, as foreign labor markets mature, foreign workers will demand more of their own productive product as consumers, so depending on globalization for funding the deficit is not wise in the long term.

Identifying deficit reduction with this tax recognizes that attempting to reduce the debt through either higher taxes on or lower benefits to lower income individuals will have a contracting effect on consumer spending, but no such effect when progressive income taxes are used. Indeed, if progressive income taxes lead to debt reduction and lower interest costs, economic growth will occur as a consequence.

Using an income tax to fund deficit reduction explicitly shows which economic strata owe the national debt. Only income taxes have the ability to back the national debt with any efficiency. Payroll taxes are designed to create obligation rather than being useful for discharging them. Other taxes are transaction based or obligations to fictitious individuals. Only the personal income tax burden is potentially allocable and only taxes on dividends, capital gains and inheritance are unavoidable in the long run because the income is unavoidable, unlike income from wages.

Even without progressive rate structures, using an income tax to pay the national debt firmly shows that attempts to cut income taxes on the wealthiest taxpayers do not burden the next generation at large. Instead, they burden only those children who will have the ability to pay high income taxes. In an increasingly stratified society, this means that those who demand tax cuts for the wealthy are burdening the children of the top 20% of earners, as well as their children, with the obligation to repay these cuts. That realization should have a healthy impact on the debate on raising income taxes.

The last question is whether the income and inheritance surtax can be incorporated into the NBRT, as proposed by Lawrence B. Lindsey in testimony to this committee earlier this year. While it is feasible, we reject it because it will either lead some to be overtaxed while others are under-taxed or will require a personal financial reporting system that many employees and investors would regard as intrusive if it came at the hands of employers or investments. While there is resistance to letting the government know all of one's financial details, we are quite certain letting your employer into all your business would be considered worse. What bartender wants to work for a lower wage (if he or she could even find a job) if part of being hired was the requirement to disclose family trust fund income to management, who would have to pay taxes on behalf of that employee at a higher rate? Better to leave the personal income tax in place so that only the government knows who is really rich.

Thank you for this opportunity to provide comments to the Committee.

STATEMENT OF THE R&D CREDIT COALITION
ON
RESEARCH AND DEVELOPMENT INCENTIVES IN THE U.S. AND ABROAD
SUBMITTED FOR THE RECORD OF THE HEARING
ON
“CEO PERSPECTIVES ON HOW THE TAX CODE AFFECTS HIRING,
BUSINESS, AND ECONOMIC GROWTH”
BEFORE
THE UNITED STATES SENATE COMMITTEE ON FINANCE
ON
JULY 27, 2011

Introduction

The R&D Credit Coalition welcomes the opportunity to provide comments for the record of the July 27, 2011 Senate Committee on Finance (“Committee”) hearing to examine “how the tax code affects hiring, businesses and economic growth.

The R&D Credit Coalition would like to thank Chairman Baucus and Ranking Member Hatch for their leadership in sponsoring legislation in the previous Congress that would provide for a strengthened and permanent R&D tax credit. We look forward to working with them this year to advance a similar proposal to ensure that U.S. businesses have the certainty and incentives they need to maintain and increase their R&D jobs here in the U.S.

The R&D Credit Coalition is a group of more than 100 trade and professional associations along with hundreds of small, medium and large companies that collectively represent millions of American workers engaged in U.S.-based research throughout major sectors of the U.S. economy, including aerospace, agriculture, biotechnology, chemicals, electronics, energy, information technology, manufacturing, medical technology, pharmaceuticals, software and telecommunications.

Although the make-up of the R&D Credit Coalition is diverse, the member companies share a major characteristic—they collectively spend billions of dollars annually on research and development (“R&D”), which provides for high-wage and highly-skilled, domestic jobs. Companies must decide where they are going to invest their research dollars—here in the U.S. or abroad. The high U.S. corporate tax rate and the temporary nature of the U.S. R&D tax credit, compared to the lower corporate tax rates and more attractive research incentives, often permanent, in most other countries, are key factors that companies consider in determining where they are going to create R&D jobs. Today, a company claiming the U.S. R&D credit on average only realizes an effective credit rate of 6%. In addition, the U.S. requires that the deduction for R&D expenses be reduced by the amount of any R&D credit.

Thus, corporate tax reform proposals limiting or eliminating research and development tax incentives could have a dramatic impact on both the number and location of R&D jobs in the U.S., as well as the ability of our companies to compete effectively in the global marketplace. Given the Committee’s focus on how the tax code can encourage job creation in the United States, the R&D Credit Coalition would like to share our preliminary views regarding the impact of the R&D tax credit on job creation in the U.S., and the implications of regimes found in other countries that were designed to provide more competitive R&D incentives abroad.

Discussion

The R&D tax credit was originally enacted in 1981 and has provided an important incentive to spur private sector investment in innovative research by companies of all sizes and in a variety of industries. The enactment of this incentive helped establish the U.S. as a leader in cutting-edge research. In fact, during the 1980s, the U.S. was the leader among OECD countries in providing the best R&D incentives for companies. However, many of our foreign competitors have since instituted more generous R&D incentives in the decades following, causing the U.S. to drop below the top 10, and today ranks 24th in research incentives among industrialized countries. The temporary nature of U.S. R&D incentives is a strain on U.S. companies, causing uncertainty that negatively influences future company R&D budgets. Providing the certainty of a permanent credit, especially in a tax reform environment, is critical to maintaining U.S. leadership in advanced research and ensuring that U.S. companies will continue to do their R&D here in the U.S.

Many other countries offer *both* lower tax rates and more attractive R&D incentives, proving that the U.S. should not engage in an “either/or” debate with respect to lower marginal rates and boosting U.S. job creation through R&D incentives when looking at options to reform the corporate tax code.

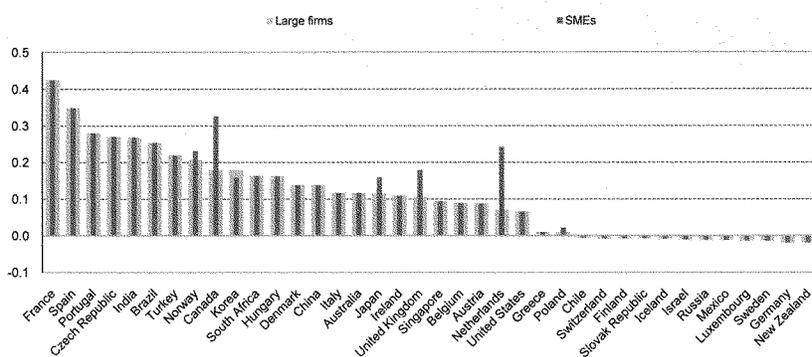
The R&D credit is a *jobs* credit—with seventy percent of credit dollars used for salaries of high skilled R&D workers in the United States. A study by the Information Technology and Innovation Foundation (ITIF), “estimates that expanding the Alternative Simplified Credit (ASC) from 14 percent to 20 percent would spur the creation of 162,000 jobs in the short term and an additional, but unspecified, number of jobs in the longer run.”¹ The U.S. must ensure that our tax system supports high-skilled, high-paying jobs, here in the U.S. We cannot let our tax system put these jobs at risk of moving abroad.

¹ Information and Technology Innovation Foundation, “*Create Jobs by Expanding the R&D Tax Credit*,” by Robert D. Atkinson. January 26, 2010 (page 1)

International R&D Tax Incentives

The number of OECD countries offering some sort of incentive for research has grown dramatically in recent years as countries attempt to become leaders in research. The U.S. share of global R&D fell from 39 percent in 1999 to 33 percent in 2007.² In addition, the following OECD chart shows that in 2009, the United States ranked 24 among 38 industrialized countries offering R&D tax incentives.³

OECD Science, Technology and Industry Scoreboard 2009 - OECD © 2009 - ISBN 9789264063716
Tax subsidy rate for USD 1 of R&D, large firms and SMEs, 2008



Bipartisan Support for a Strengthened, Permanent Research & Development Incentive

Every Administration has supported the R&D tax credit since its enactment. More recently, a March 25, 2011, Treasury Department study stated, “Two years ago, the President set an ambitious goal of achieving a level of research and development that is the highest share of the economy since the space race of the 1960’s—3 percent of GDP—a commitment he re-emphasized in his State of the Union address in 2011. The R&D tax credit is a vital component of achieving this goal and helping us out-innovate our competition. This is why, in addition to making it permanent, the President proposed on September 8, 2010, to expand and simplify the credit, making it easier and more attractive for businesses to claim this

² OECD, Ministerial Report on the OECD Innovation Strategy, May 2010, p. 8.

³ OECD, “Science, Technology and Industry Scorecard,” December 2009, p 79.

credit for their research investments. This proposal was subsequently included in the President's FY 2012 Budget and should be part of the reform of our corporate tax system currently under consideration."⁴

Moreover, Congress has extended the credit 14 times since it was first adopted in 1981. Earlier this year, Ways and Means Committee members Kevin Brady (R-TX), John Larson (D-CT) and many others introduced H.R. 942, The American Research and Competitiveness Act of 2011. This legislation would provide important certainty for U.S.-based research spending by making the R&D tax credit permanent as well as simplifying and strengthening it, thereby increasing its effectiveness. We urge Congress to pass this legislation before the credit expires on December 31, 2011.

Conclusion

It is vitally important that U.S. policy makers support a strengthened and permanent research and development incentive as part of any tax reform measure. A robust and permanent research and development tax credit is critical to competitiveness, innovation and U.S. jobs. Congress must recognize, that in the global economy, many companies have a choice as to where they are going to do their research—and with many other countries offering *both* lower corporate income tax rates and more robust R&D incentives, the U.S. must ensure that R&D incentives are included as part of any tax reform package. The R&D Credit Coalition looks forward to assisting members of the Committee and their staffs to gain a more detailed understanding of the research and development tax credit and its impact on U.S. jobs.

⁴ "Investing in U.S. Competitiveness: The benefits of Enhancing the Research and Experimentation (R&E) Tax Credit," U.S. Department of the Treasury, March 25, 2011, page 1.



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July 28, 2011

The Honorable Max Baucus
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Orrin Hatch
Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Baucus and Ranking Member Hatch:

On behalf of the Retail Industry Leaders Association (RILA), I write to offer retailers' perspectives on tax reform for your committee's hearing on July 27, 2011, titled "CEO Perspectives on How the Tax Code Affects Hiring, Businesses and Economic Growth." RILA supports tax policies that will improve the business climate for retailers, both domestically and internationally, by helping them continue creating jobs, investing in this country, and bring price-competitive value to American consumers.

By way of background, RILA is the trade association of the world's largest and most innovative retail companies. RILA promotes consumer choice and economic freedom through public policy and industry operational excellence. Its members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales, millions of American jobs and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

Growth-Orient Tax Reform: Lower Business Tax Rate

The retail industry is vital to our nation's economy, representing one of the largest industry sectors in the United States with nearly 15 million jobs and \$3.9 trillion in annual sales overall in 2010. The industry pays billions of dollars in federal, state, and local income taxes, and collects and remits billions more in state and local sales taxes. At the federal level, retail taxpayers typically have among the highest effective tax rates, hitting the top statutory rate of 35 percent in many cases. As you consider tax-reform options, one of the most far-reaching options that the Committee could endorse would be a reduction in the federal tax rates on business income.

The last major overhaul of the system occurred with the enactment of the Internal Revenue Code of 1986, which substantially reduced the corporate tax rate along with major restructurings to the corporate and individual tax system. Over the ensuing 25 years, Congress has made thousands of changes to the tax code increasing its complexity and tax rates, resulting in greater burdens for American businesses. Today, the United States has nearly the highest statutory tax rate on corporate income, which has a number of significant ramifications for U.S. retailers.

Overall, high corporate taxes reduce the availability of critically needed capital for business to invest in their workforce. A number of studies confirm that a significant share of corporate taxes is borne by labor. Thus, a reduction in the tax burden will free companies to create new jobs, increase real wages and income, and improve standards of living for U.S. workers. With the unemployment rate hovering around 9 percent nationally, this is a critical opportunity for Congress and the Administration to reverse the job losses that have occurred over the past several years.

Moreover, our current high corporate tax rate hinders retailers' ability to maintain their existing operation and invest for the future. Especially in the current economic environment where the flow of private-sector capital has been constrained, a lower tax rate would free up essential corporate earnings for investments in new equipment, facilities and products. Similarly, it would enable retailers to retain more of their earnings to reinvest for the long-term growth of their companies, which will contribute to nation's economic recovery and ultimately to sustained economic expansion.

Looking beyond the domestic benefits, a lower corporate tax rate also holds significant potential for improving the competitiveness of U.S. businesses. In recent years, a growing number of U.S. retailers have expanded into the global marketplace. Yet, the United States is set to have the highest corporate tax rate in the world once Japan implements its proposed rate reduction, and the United States remains one of the only countries with a system for taxing worldwide income. As a result, the United States has created a difficult environment for its multinational businesses to compete in the global economy. And further exacerbating this situation, other members of the Organisation of Economic Cooperation and Development (OECD) have been pursuing measures to reduce their tax rates. Lowering the U.S. corporate tax rate would help level the playing field for U.S. multinationals and encourage companies to keep jobs and investments in this country. At the same time, it is important to recognize the tremendous growth in the number of businesses operating as pass-through entities (e.g., sole proprietorships, partnerships, limited liability companies, and S corporations), including some RILA members. These business taxpayers are critically important to the U.S. economy and must be taken into consideration in the debate if overall tax reform is to be successful.

For the foregoing reasons, RILA supports efforts to reduce significantly the rate applicable to U.S. corporations and other forms of business. We encourage the Committee to endorse this approach as a step toward improving the business climate for retailers, both domestically and internationally, which will help the retail industry continue creating jobs, investing in new equipment and technologies, and contributing to the nation's long-term economic growth.

Principles for a Simpler, Permanent and Stable Tax System

While we believe a reduction in the business tax rates is fundamental to successful reform of the tax code, we also recognize that myriad other aspects of the tax law must be examined in the overall effort to broaden the tax base and simplify the tax code. To contribute to that goal, RILA

has developed the attached a set of tax reform principles. These principles represent a foundation on which a tax system can be built that will achieve necessary revenues while minimizing the burdens and complexities of our current tax system, which stifle innovation, hinder job creation, and deter overall economic growth.

Fundamental to any successful tax reform is a simple, permanent, and stable tax system. While RILA strongly endorses the objectives underlying tax reform, we urge the Committee to be cognizant of this imperative. Every day, businesses across the country struggle with the increasingly complex tax code. Current law requires a substantial number of employees, advisors, and time for the required tax compliance, including tax accounting and reporting. Moreover, the current system also forces retailer to expend enormous resources to undertake annual audits by the Internal Revenue Service (IRS), which often entail a lengthy and costly process for resolving frequent disputes over the application of the tax laws and regulations.

Clearly, a simplified tax system would mean significant savings for taxpayers and the IRS by lowering compliance costs, reducing filing burdens, and minimizing disputes between taxpayers and the government, freeing resources to be put to more productive use.

Similarly, business taxpayers would benefit greatly from a tax law that is stable and predictable. Over the past two decades, dozens of provisions have been added to the tax code, many well intended and achieving their particular employment, investment, or other objective. Yet, in too many cases, these provisions were added on a temporary basis, even when the tax policy objective should have been permanent. Examples particularly relevant to the retail industry include 15-year depreciation for improvements to retail and restaurant property, the research and development tax credit, the Work Opportunity Tax Credit (WOTC), and the controlled foreign corporation look-through rules, to name a few. And, compounding the tenuousness of these provisions are recent instances when they have expired and taxpayers have been left with no certainty of even retroactive renewal until nearly the end of the year in which the tax provisions were supposed be effective.

Long-term planning is essential for business success, and with federal and state taxes playing such a significant role in retailers' financial decision making, the continual expiration and uncertainty of renewal of so much of the tax code has had adverse consequences – it has forced increased tax reserves, postponed investments in new facilities and improvements, and held back critically needed new jobs.

Accordingly, RILA urges the Committee to resist including temporary provisions in tax reform legislation. While we appreciate that significant changes to the current tax system will necessitate the need for transition rules, which are inherently temporary, we encourage the Committee to establish such rules that provide adequate time for implementation of a new tax system and that take into account existing agreements, practices, and other requirements without letting them become new expiring provisions that become another source of uncertainty.

This country is in desperate need for an efficient and effective tax system. Once that is achieved, the temptation to make on going changes must be resisted.

Additional Retail Considerations for Tax Reform

For RILA members, the need for lower tax rates and a simple, stable and predictable tax code are top priorities for tax reform. As the Committee examines all the contours of tax reform, we also offer some considerations on select issues that have been of historic importance to the retail industry.

Inventory Accounting Methods

In the context of broadening the base, inventory accounting methods are often referenced as tax expenditures or benefits that could be eliminated. RILA strongly believes that such a view is erroneous and misguided. Any effective tax system must have rules to determine which goods are sold in a given year and which remain in a business' inventory for future sale. Similarly, procedures are necessary to determine the cost of the merchandise sold and the value of the products that remain in ending inventory for a business to clearly reflect its income that is subject to tax.

Without such rules, businesses would be forced to employ a system of specific identification, with each product sold having to be traced back to its original purchase price. In the retail environment such a system would be simply infeasible. A retailer may have hundreds of thousands of products for sale on a given day in hundreds of stores across the country. Moreover, a retailer will continually purchase quantities of a single product (e.g., style and size of a shirt, type of hammer, particular quantity of a brand of aspirin, etc.) in order to maintain a sufficient supply for sale. Since each product is indistinguishable from the other, it would be impossible to assign the actual cost to the particular product at the time it is ultimately sold.

Given that inventory accounting methods are indispensable, RILA submits that they should be treated as fundamental operating rules, not a tax expenditure or other benefit that could be eliminated to offset other tax reforms, such as a reduction in tax rates.

The existing inventory accounting methods, on which retailers have relied for decades, enable retailers to assign costs to the goods sold and reflect their income clearly. For the retail industry, these inventory accounting methods include the first-in/first-out (FIFO) method, the last-in/first-out method (LIFO), and the retail inventory method. For purposes of determining a company's remaining inventory at year end, financial and tax accounting rules also permit businesses in certain cases to write down the book value of an inventory item – under the lower-of-cost-or-market (LCM) method – to take into account a decrease in the economic value of the item offered for sale.

We are concerned by the Administration's proposals in its budget submissions to repeal LIFO and LCM (particularly under the retail inventory method), both of which are widely used within the retail industry. For many retail businesses, LIFO is a much more accurate method for measuring financial performance and calculating the associated income tax. LIFO takes into account the greater costs of replacing inventory as costs rise, thereby giving a more conservative measure of both the financial condition of the business and the economic income subject to tax. Absent LIFO, phantom profits would be taxed, which would be inconsistent with the fundamental principle of U.S. tax law that unrealized appreciation in the value of assets is ordinarily not taxed.

LIFO repeal would have two adverse effects on countless retail businesses. First, businesses would have to recapture their LIFO reserves, which would result in substantial additional cash required to pay the resulting income tax, even if spread over several years, especially for businesses that have relied on LIFO for many years or even decades. This would amount to an enormous retroactive tax increase by repealing fully authorized deductions from income with respect to products sold, in many cases years or decades in the past. Moreover, since companies would have no economic income from such an accounting adjustment, they would effectively be taxed on non-existent cash flow. Second, LIFO repeal would create future tax increases for businesses if inflation accelerates as some expect due to the fiscal imbalances facing the United States. Since inflation increases prices, a business that can no longer utilize LIFO would have to calculate its taxable income based on older inventory costs that do not reflect the inflationary growth in prices, resulting in a higher future tax bills with less earnings available for growth, capital investment, and job creation.

Similarly, the LCM method allows retailers to write down the book value of their ending inventory that has declined in economic value, which frequently occurs with products like clothing at the end of a season or when particular styles change. The loss in value is a real economic loss, and these methods allow businesses to recognize the loss in the year it occurs rather than having to wait until it is able to dispose of the inventory. Moreover, any recovery in the value of the inventory in a subsequent year is not lost since the business would then recognize a larger amount of taxable income in the year the inventory is sold.

Repeal of the LCM method would mean higher taxes on a retailer that would no longer be able to account for a current economic loss in inventory value when it occurs. In addition, during economic downturns, the value of the LCM write-down will also grow, especially under the retail inventory method as retailers are forced to mark down retail prices. Thus, the repeal of the LCM method would have an even greater adverse effect on businesses' tax liabilities in a down economy, at a time when businesses can least afford additional tax liabilities.

Overall, inventory accounting methods are essential to any tax system. And, to achieve the goal of simplicity, stability and predictability, such accounting methods should be simple to apply in order to ensure proper compliance and predictably enforced by the IRS to minimize disputes.

Investment in Workforce

Fundamental to every retail business is its workforce of sales associates, managers, and company executives, and for retail businesses to grow, whether by brick-and-mortar stores or online, requires a dedicated workforce to make the retail sales that ultimately contribute significantly to the overall economy. From that perspective, reducing the tax burden on American businesses holds significant potential for job creation by allowing retailers to invest tax savings in their workforce along with retail facilities.

Depending on the degree to which the tax rates are reduced, RILA urges the Committee to evaluate the continued benefits of providing employment incentives, such as the WOTC, which are intended to increase employment of individuals from specific targeted groups. Historically, the WOTC has helped offset the added costs of hiring and training individuals who rely on public assistance programs or are qualified veterans, disabled persons, low-income seniors, high-risk youth, or residents of designated areas. And, through these credits, businesses have helped disadvantaged individuals find meaningful employment in retail and other settings.

If the WOTC is retained as part of overall tax reform, which RILA would support, it should be made permanent, rather than perpetuating its current temporary status with periodic, and often retroactive, extension. Moreover, consideration should be given to simplifying the program to reduce the associated compliance costs. A permanent and simplified program would remove uncertainty in business planning, expand employer participation, and improve program administration.

Investments in Capital Assets

Along with its workforce, retailers must maintain an inviting, modern shopping environment to attract and maintain customer loyalty. Investment in new stores and facilities is an enormous financial undertaking that can be influenced greatly by the tax treatment of that investment along with the treatment of repair and remodeling costs, which typically occur every five to seven years. Whether a large format retail operation or a smaller store, retailers spend significant resources on "build out" and other improvements to reflect changes in their customer base and to compete with newer stores.

As the cost recovery rules are considered, RILA urges the Committee to ensure that they reflect the true economic life of the property. It is well established that the current 39-year depreciation period for buildings often bears little relationship to the economic life of such structures and even less to building improvements and upgrades required in successful retail businesses. The current 15-year recovery period for retail and restaurant remodeling costs is a step toward such an economically reflective cost recovery, although the period still exceeds the true life of the improvements in many cases. In order to achieve an accurate reflection of the income derived in large measure through such property, RILA believes that retailers, whether they own or lease

their stores, should depreciate such improvements over their economic useful lives, rather than based on an arbitrary and substantially longer recovery period set out in the tax code.

Similarly, RILA urges the Committee to examine rules governing the capitalization of expense relating to capital assets versus those permitting the deduction of expenses for maintenance and repairs. The complexity and ambiguities surrounding such rules lead to ongoing disputes with the IRS, with substantial amounts of time and money spent to resolve issues, in some cases year after year. Clear rules would free up resources, facilitate investment in new facilities as well as improvements to existing ones, and ultimately support overall business growth and job creation.

International Tax Reform

RILA applauds the Committee's efforts to examine the international implications of tax reform on the competitiveness of U.S. businesses operating in the global economy. A growing number of U.S. retailers have expanded into the global marketplace in recent years through the establishment of both retail operations in other countries as well as subsidiaries that strengthen the supply-chain of goods and services they provide to their customers. With the United States being one of the last countries to tax worldwide business income and soon to have the highest corporate tax rate, U.S. retailers operating and looking to expand abroad face significant competitive barriers. These obstacles not only constrain a retailer's ability to grow internationally, but also cost the United States the well-paying jobs that a company typically must add to oversee such global operations.

As the tax reform debate progresses, we urge the Committee to continue examining the international tax regime and consider moving the United States to some form of a territorial tax system. With the United Kingdom and Japan most recently embracing such a construct for the taxation of foreign subsidiaries of their domestic companies, the United States should not be left behind while putting U.S. multinationals at a further disadvantage to their global competitors. We appreciate that shifting to a territorial tax system raises a number of challenges such as the treatment of intangible property, transfer pricing rules, and business expense allocation rules. Nevertheless, we believe that the benefits that such a system could bring in terms of simplification, improved competitiveness, and reduction in economic distortions would far exceed any challenges.

Retailers compete every day for consumers' loyalty and spending. The nation's tax rules, domestic and international, should foster their success – not erect competitive barriers – especially as retailers continue to expand into the global marketplace.

Individual Tax Reform

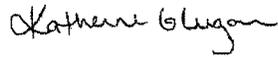
While not directly affecting the business income tax system, the individual tax rules have a significant indirect impact on the retail industry. Individual tax rates and taxable income have a direct effect on consumer spending as well as on their ability to save and invest, which is an

important source of capital for retail businesses. Accordingly, RILA applauds the Committee's recognition that tax reform should not be undertaken piecemeal, but rather comprehensively. And, RILA urges the Committee to give careful consideration to the effect that tax rates, as well as other components of the individual tax code like the alternative minimum tax, have on consumer spending, which contributes to the overall growth in the economy and businesses ability to increase capital for investment and job creation.

Conclusion

Thank you for this opportunity to present our views on tax reform. RILA and its members look forward to working with the Committee to enact meaningful tax reform that includes provisions that support the retail industry and help it to continue to create jobs and grow.

Sincerely,

A handwritten signature in black ink that reads "Katherine G. Lugar". The signature is written in a cursive, flowing style.

Katherine G. Lugar
Executive Vice President, Public Affairs



PRINCIPLES FOR TAX REFORM

- **Keep tax rates low** – Enabling individuals to keep more of what they earn encourages savings and enables them to make purchases of needed consumer products, which also has the benefit of providing a major stimulus to the economy including sustained, improved retail sales. Similarly, low tax rates help American businesses by increasing capital for investment and job creation.
- **Enact simple, predictable and easy to understand tax rules** – A tax system that individual and business taxpayers can easily understand will improve compliance and reduce the cost of tax administration.
- **Establish tax rules that are consistent with economic reality** – For business taxpayers in particular, tax rules need to result in appropriate timing and accurate reflection of income without arbitrary rules that, for example, delay deductions beyond the period in which the income is earned or set depreciation periods inconsistently with the real economic life of the property.
- **Ensure the tax system fosters business competitiveness and promotes economic growth** – In an increasingly global economy, the tax system should not hinder the ability of U.S. businesses to compete internationally as well as domestically against foreign firms. A tax code that treats business fairly and equitably will minimize burdens on compliance and decision-making, thereby enhancing the productive capacity of U.S. businesses and the U.S. economy.
- **Implement reforms that ensure industry-specific neutrality** – Business decisions should be based on economic benefits of the particular transaction, not driven by special tax benefits targeted to one industry versus another. The economy does not benefit when the tax code chooses winners and losers. Accordingly, tax reform should allow the marketplace, not the tax system, to allocate capital and resources appropriately.
- **Avoid a whole-scale change in the tax base** – Dramatic shifts in tax policy, such as implementing a national retail sales or value-added tax, would be immensely disruptive to the economy and particularly detrimental to lower-income workers and families.
- **Make changes permanent and ensure certainty** – A new tax system must be permanent and stable, not littered with expiring provisions that cause uncertainty for families saving for college and retirement and business striving to expand, create jobs, and remain competitive in the United States and abroad.
- **Provide realistic transitions rules** – Significant changes to the current tax system will create substantial burdens on taxpayers, especially in the business sector, to ensure compliance. Establishing transition rules that provide adequate time for implementation and that take into account existing agreements, practices, and other requirements is essential for the success of any new tax system.
- **Recognize that tax revenues are one part of fiscal discipline** – As with any business, long-term fiscal viability requires careful management of *both* revenues and expenses. The tax-revenue lever can only be pulled so much and so often before it harms the business sector (with resulting effects on tax revenues from businesses, employees, and investments). Equal attention must be given to government spending to strike a reasonable balance with a tax code that fosters economic growth, job creation, and investment.