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Thomas J. Gibson
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The Honorable John Thune
U.S. Senate
511 Dirksen SOB
Washington, DC 20510

The Honorable Benjamin Cardin
U.S. Senate
509 Hart SOB
Washington, DC 20510

Dear Senators Thune and Cardin:

I am writing on behalf of the American Iron and Steel Institute (AISI) to provide you and the Senate Finance Committee Business Income Tax Working Group with stakeholder input as the working group continues its evaluation of ways to reform the nation's tax code within its jurisdiction. Steel and other manufacturing industries are the backbone of the U.S. economy. A strong manufacturing sector creates significant benefits for society, including jobs with family supporting wages, investment in research and development, essential materials for our national defense, and high-value exports. As a result, a robust American manufacturing sector, including a strong and vibrant steel industry, is critical to ensuring a healthy domestic economy and tax policy should incentivize investment in domestic manufacturing facilities and equipment.

While we appreciate reviewing proposals like that of former House Way and Means Committee Chairman Dave Camp (R-MI) or former Senate Finance Committee Chairman Max Baucus (D-MT) to revamp the tax code, we are very concerned that the cumulative effect of many of the proposals put forth will ultimately raise the effective tax rate on U.S. manufacturers by repealing longstanding tax provisions utilized by capital intensive industries, and will increase the overall cost of capital. In fact, the Joint Committee on Taxation's (JCT) macroeconomic analysis of the Camp proposal highlighted this very point in its statement that, "Overall, the proposal is expected to increase the cost of capital for domestic firms, thus reducing the incentive for investment in domestic capital stock."[1] This is very troubling and seems to run counter to what a pro-growth tax code should do. We understand that the Finance Committee Working Groups are expected to report to the full committee recommendations for tax reform based upon the research and input they have received from stakeholders. As such we wanted to take this opportunity to provide you with comments on several key tax provisions currently in the tax code that have the most significant impact on the steel industry.

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[1] The Joint Committee on Taxation's analysis of the macroeconomic effects of Chairman Camp's "Tax Reform Act of 2014," February 21, 2014 letter to Chairman Camp, Page 13.

Accelerated Depreciation (the Modified Accelerated Cost Recovery System, MACRS)
Enhanced capital-cost recovery systems, like MACRS or "bonus" depreciation, have always been viewed as effective ways to spur real business investment and to make U.S. manufacturing more competitive. However, some proposals that reduce the statutory tax rate do so by proposing a repeal of MACRS and replacing it with a system similar to the alternative depreciation system (ADS) which requires longer recovery times and the use of a straight-line depreciation method.

For capital intensive industries like steel, accelerated depreciation is not a timing issue, it is a cash flow issue which is extremely important in making capital investment decisions. By providing a faster return on capital investment, accelerated deprecation provides strong incentives, and in many cases actually makes it possible to undertake new investments which require significant cash expenditures and take a number of years to yield a return. Proposals which would repeal this cost recovery system and replace it with ADS, which provides depreciation lives for production equipment that can be more than two times as long as under MACRS, will directly penalize those who invest the most in capital expenditures and ultimately impact whether or not many manufacturing companies make certain discretionary capital investments. While we recognize that this change may not affect a company's earnings statements, it will negatively impact a company's investment decisions and will have the effect of raising the cost of new capital investments while providing tax savings to investments already made.

Likewise, using slower depreciation is a questionable revenue offset because while in the short-term, it will increase the amount of revenue coming into the federal government, in the longer-term, those same cuts will lead to revenue losses, having the effect of increasing the budget deficit.

As such we have real concerns about the impact of slowing depreciation on the overall economy as well as on our member companies and their ability to make new investments. In fact, some analyses assert that if the Camp tax reform plan was implemented with accelerated depreciation, more GDP would be generated than under Camp's plan with the repeal of MACRS.

The Domestic Production Activities Deduction (Section 199)
The domestic production activities deduction, or Section 199, was enacted as part of the American Jobs Creation Act of 2004 and provides a valuable benefit to those manufacturing products in the United States.

The Section 199 provision came about as a result of the World Trade Organization's ruling that the United States' extraterritorial income exclusion violated WTO rules concerning export subsidies. As such, Congress repealed the extra territorial income provision and enacted Section 199 in its place in order to better level the playing field for U.S. manufacturers who are at a competitive disadvantage with countries that have a VAT and utilize VAT export rebates. In addition to this international inequity which still exists, a number of nations have an income tax rate much lower than the United States, lower even than the targeted 25 percent rate. In light of this, we believe that Section 199, or a comparable provision, remains critical for domestic manufacturers to compete globally. We also believe that the provision should also be allowed in years in which a company reports losses so that the benefit from manufacturing in the United States is reflected when those losses are used.

The Interest Expense Deduction

Again, as a capital intensive industry, the interest expense deduction is very important given the extremely large investments our companies must make. As such, we caution against proposals which would place arbitrary limits on the deductibility of corporate interest expenditures. An Ernst and Young study titled "Business Tax Reform and the Tax Treatment of Debt," from May 2012 found that a revenue neutral rate reduction financed by an across-the-board interest deduction limit would deter domestic investment. The report concludes that "such limitations raise the cost of new investment by significantly more than an equal cost reduction in the corporate income tax rate lowers the cost of new investment."

Interest on debt incurred in business is an ordinary and necessary cost of doing business and should remain fully deductible. Limiting a corporation's ability to deduct its interest will increase the overall cost of capital, disproportionally hurting those capital intensive industries that need to borrow to grow because of the considerable costs associated with those investments. In particular, it will negatively impact small and medium size businesses that do not have access to other sources of capital. Like other provisions in the tax code, the ability to deduct a company's interest expense is very important and contributes significantly to decisions to invest in major manufacturing facilities.

The Last-In, First-Out (LIFO) Accounting Methodology

The LIFO accounting methodology is a long standing, widely accepted accounting measure that allows companies that are subject to rising inventory costs to be properly taxed on their real income. The LIFO system allows a company to assume for accounting purposes that it sells first the inventory most recently acquired, allowing a company to match the most recent inventory costs with the most recent sales resulting

in a reduction of taxable income in times of rising prices. LIFO has been used by some steel companies since the 1940s and is particularly important to businesses which have small profit margins and/or have particular sensitivity to rising materials costs, like the steel industry and many of our customers. If LIFO is repealed, as has been proposed, a company would generate increased taxable income as if it had sold part of its inventory even though no real profit was made. While the Camp proposal, in particular, allows companies to pay the increased tax on these phantom profits over four years beginning in 2019, this minimal relief still decreases cash flow and is fundamentally unfair as it penalizes companies by raising taxes on them for using an accepted accounting practice. This tax hike will be devastating for some taxpayers, including a number of steel companies and our customers who are cyclical in nature and must maintain sizeable inventories. Instituting such a tax increase is counterproductive to spurring economic growth and investment and leveling the international playing field for domestic manufacturers.

Research and Development (R&D) Tax Credit

Virtually all manufacturers are involved in research and development in order to improve and innovate their product lines and production methods to be more competitive globally and the steel industry is no different. The steel industry, collaboratively through AISI, and separately as individual companies, make significant investments in research and development, incentivized by the R&D tax credit. R&D is critical to spurring innovation and increased productivity which are fundamental to a strong economy. Additionally, when companies invest in research and development in the United States, good-paying jobs are created often not only at the company making the investment, but also at small and medium-size manufacturers and at higher education institutions that contribute to the research efforts. Because of the uncertainty of whether or not the R&D tax credit will be extended every year, more and more R&D investment dollars are going from the U.S. to other countries that offer more generous research investment incentives. If we want to continue to be the nation that out innovates and out produces the rest of the world, it is critical that the U.S. once again make itself the most attractive place for research investment and we support permanent enactment of the R&D credit.

Percentage Depletion

A number of AISI member companies own and operate mining facilities in addition to their steelmaking facilities and utilize the percentage depletion deduction which allows them to deduct a certain percentage of their gross or net income derived from the extraction of natural resources from the earth. Mining requires significant financial commitments to long-term projects to deliver a competitive product at a low margin. Congress created percentage depletion because it recognized that the limitations of cost

depletion resulted in premature loss of important mineral reserves, including those American resources critical to the production of iron and steel. With percentage depletion, Congress intended to ensure that these essential national assets would be fully developed and utilized.

For example, enormous amounts of capital must be expended at the front end of mining projects to realize future returns. Yet the quality and quantity of reserves for any particular property may be uncertain and as such the revenue stream unknown. With such sizable capital costs, in addition to production and revenue uncertainty, cost recovery through percentage depletion was enacted to account for the uncertainty and provide needed cash flow for the necessary continued investment in mining operations. The availability of percentage depletion was taken into account when investment decisions were made for mines now in operation, and it would be unfair to now take percentage depletion deductions away. Percentage depletion is an essential component to the global competitiveness of domestic mining operations.

The long-term viability of the domestic steel industry and other manufacturers is heavily reliant on a stable supply of domestically produced raw materials that are needed for production, and as such, we are concerned with any proposed repeal of percentage depletion.

Qualified extraction expenses

The production of steel is inherently energy intensive, and the industry consumes substantial amounts of electricity, natural gas, and coal and coke to make our products. Energy is typically 20% or more of the cost of making steel and the availability and reliability of supplies of these energy sources is essential to our industry's international competitiveness. Steel manufacturers are also major suppliers to the energy industry.

The intangible drilling costs (IDCs) deduction has been allowed since 1913. This vital incentive helps ensure that energy intensive manufacturers, like steel, have access to affordable energy by allowing operators or working interest owners to fully deduct intangible drilling costs relating to oil and gas investments in the first year. The deduction for IDCs has the ability to drive new manufacturing investments in the United States by decreasing the cost of energy production and thus the cost of energy used in manufacturing.

Any proposals that would disallow immediate deduction of IDCs, and requires all such costs to be capitalized and amortized over a period of time, would lead to lower levels of investment and production, negatively impacting energy costs. At a time when production of shale-based oil and natural gas is leading to a manufacturing renaissance

in the U.S. through significant investments, plant expansions, and job creation, we caution against tax changes that remove incentives for energy production.

Corporate Alternative Minimum Tax (AMT) Repeal/Transition Rules

AISI fully supports the repeal of the corporate AMT, and we believe it is critical that U.S. companies be given a fair transition to a new system, by being allowed to carry net operating losses (NOLs) and other tax assets they have accumulated under the current system into any new system. Other tax assets of particular concern include minimum tax credits (MTCs) and other general business credit carryforwards that should be retained and either be refunded or allowed as a credit against income tax following tax reform. We did find beneficial the provision in the Camp tax overhaul that would have allowed a taxpayer with AMT credit carryforwards to claim a refund of 50 percent of the remaining credits beginning in 2016, 2017, and 2018 and a refund of all the credits in 2019.

In closing, I want to commend the Finance Committee members and staff for continuing to push forward on tax reform, which is no easy task. I would also note that we in no way want to imply that we oppose making any changes to some of the tax provisions in the tax code that benefit manufacturers, but we can say affirmatively that the cumulative effect of the repeal of all the provisions identified above would be very damaging to capital intensive manufacturers. We appreciate the opportunity to provide input into this process and we look forward to working with you and the Finance Committee as efforts to reform the tax code move forward in the weeks ahead.

Sincerely,

Thomas J. Gibson
President and CEO
American Iron and Steel Institute