Comments of

The National Association of Manufacturers

Submitted to the Senate Finance Committee

International Tax Working Group

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I. Introduction

The National Association of Manufacturers (NAM) welcomes the opportunity to submit comments to the Senate Finance Committee International Tax Working Group.

The NAM is the largest manufacturing association in the United States, representing manufacturers of all sizes in every industrial sector and in all 50 states. Manufacturing employs nearly 12 million men and women, contributes more than $1.8 trillion to the U.S. economy annually, has the largest economic impact of any major sector and accounts for three-quarters of private-sector research and development.

NAM members know firsthand that our current tax system is fundamentally flawed and discourages economic growth and U.S. competitiveness. As outlined in the NAM's A Growth Agenda: Four Goals for a Manufacturing Resurgence in America, a key objective for the association is to create a national tax climate that promotes manufacturing in America and enhances the global competitiveness of manufacturers in the United States. A pro-manufacturing tax policy must acknowledge that a high tax burden makes manufacturers in the United States less competitive.

To achieve these goals, we need a comprehensive tax reform plan that both reduces the corporate tax rate to 25 percent or lower and includes lower rates for the nearly two-thirds of manufacturers organized as flow-through entities. We also believe that comprehensive tax reform must include a shift from the current worldwide system of taxation to a modern and competitive international tax system, a permanent and strengthened research and experimentation (R&E) incentive and a strong capital cost-recovery system.

The NAM very much appreciates the current focus on improving our nation's tax system. Enactment of a pro-growth, pro-manufacturing tax reform plan will go a long way to strengthen our economy and ensure vibrant economic growth in the future. ***A Missed Opportunity: the Economic Cost of Delaying Pro-Business Tax Reform***, a study released by the NAM in January 2015, takes a close look at the economic impact of enacting a five-prong pro-business tax package similar to NAM's priorities and concludes that lack of action on pro-business tax reform is costing the U.S. economy in terms of slower growth in Gross Domestic Product (GDP), investment and employment. In contrast, the report finds that over a ten-year period, a pro-business tax plan would increase GDP over $12 trillion relative to CBO projections, increase investment by over $3.3 trillion and add over 6.5 million jobs to the U.S. economy.

The following comments, which focus on international tax policy, reflect NAM Board-approved policy on tax reform and are based on the premise that any changes would be part of a comprehensive tax reform plan.[1]

II. Promoting International Competitiveness and Foreign Direct Investment

Manufacturers have a strong interest in our nation's international tax regime. Almost half of American worldwide companies are manufacturers, and 57 percent of all manufacturing employees in the United States are employed by U.S. companies with operations overseas. Global investment by American companies plays an important role in the growth and vitality of the U.S. economy. Despite the economic benefits of having American companies expand beyond our shores, U.S. tax laws make it difficult to compete globally. The U.S. tax system, including high corporate tax rates and highly taxed exports, increases the cost of doing business for U.S. companies with global operations.

In addition, the U.S. system taxes income even when it is earned outside of the United States. As a result, American businesses with customers around the world generally have a higher tax burden than their competitors. This higher cost of capital is a significant disadvantage for companies competing for customers in a global economy.

If American companies cannot compete abroad, where 95 percent of the world's consumers are located, the U.S. economy suffers from the loss of both foreign markets and domestic jobs that support foreign operations. To make U.S. multinationals more competitive, the NAM supports moving from the United States' current worldwide tax system to a territorial tax system similar to those in most industrialized countries, structured to enhance U.S. competitiveness, not raise additional revenue.

Territorial systems are now the international norm. The vast majority of our trading partners have territorial systems that tax income earned within their borders but do not tax the foreign profits repatriated to their own economies. In recent years, Japan and the United Kingdom—two of the largest economies—abandoned worldwide taxation systems in favor of a territorial approach. Adopting a tax system that is comparable to tax systems in other industrial countries is critical to the ability of manufacturers in the United States to compete in the global marketplace. A competitive tax system will impact jobs at U.S. headquarters, increase exports from manufacturers in the United States and improve the efficiency of their supply chains.

Businesses headquartered outside the United States that invest in our nation also play an important role in the growth and vitality of the U.S. economy. Like their domestic counterparts, they provide high-paying jobs for millions of Americans and are an important source of U.S. exports. Because of the importance of foreign direct investment to the U.S. economy, it is critical that policymakers avoid imposing discriminatory taxes on foreign-owned companies. Congress should focus on tax policies that attract and maintain more capital investment, rather than discourage it.

III. A U.S. Territorial Tax System

NAM members believe that a territorial system should allow for the free flow of capital back to the United States from foreign operations for reinvestment in the domestic economy. The

[1] See also NAM Comments on Camp Discussion Draft, August 2014

current high corporate tax rate of 35 percent, even though it is partially offset by foreign tax credits at lower tax rates imposed outside the United States, often results in a high U.S. tax charge on earnings repatriated from foreign subsidiaries. This additional charge causes what is often referred to as a "lockout" of earnings, preventing them from being brought back to the United States.

As part of tax reform, the NAM supports a 95 percent dividends-received deduction (DRD), which has been proposed by former House Ways and Means Committee Chairman Dave Camp (R-MI) and others. A DRD would reduce the disincentive to repatriate foreign earnings, freeing up resources for investment in the United States. While the NAM would prefer the approach taken by many of our progressive trading partners, including the United Kingdom, Spain, Denmark, Finland, Austria and Netherlands, which provide a 100 percent participation exemption, we acknowledge that the taxation of five percent of controlled foreign corporation (CFC) dividends reduces the need to allocate costs, such as administrative expenses and research and development that support U.S. multinationals' global operations. These expenses cover activities that generate high-paying U.S. headquartered jobs that might not otherwise be located in the United States.

Enactment of a well-crafted territorial system also would simplify U.S. tax law by eliminating several complex tax rules. For example, a territorial system could significantly reduce the importance of the foreign tax credit. Eliminating the use of the foreign tax credit system as the primary means of preventing international double taxation will reduce the possibility of double taxation currently experienced by U.S. multinationals. In addition, the rules for allocating and apportioning interest expense have long been criticized for over-allocating interest expense to foreign source income, resulting in double taxation of foreign source income. By limiting the importance of the foreign tax credit rules, this and other inequities in the rules would be minimized.

While NAM members are advocates for moving to a territorial tax system, until policymakers agree on a final reform plan, it is important to keep our current tax system in place. Thus, the NAM is opposed to piece-meal changes to long-standing rules, like a stand-alone deemed repatriation provision currently under discussion, which would divert resources to unrelated initiatives and make comprehensive tax reform more difficult to achieve. Moreover, a stand-alone deemed repatriation provision would impose an additional cost burden on U.S companies at a time when they already face significant challenges in the global marketplace, including competing with companies that have much lower corporate tax rates. Indeed, changing rules retroactively injects more uncertainty into business planning, making U.S companies even less competitive and threatening economic growth and U.S. jobs.

IV. Transitioning to New Rules

Transition rules will be important for all areas of tax reform, particularly in the international arena. As noted above, the additional tax faced by companies with worldwide operations makes it difficult for companies to repatriate these earnings back to the United States. Manufacturers believe that an ideal territorial tax proposal would allow taxpayers to repatriate pre-effective date earnings tax-free, regardless of when they are remitted.

In contrast, transition rules that include a mandatory tax on foreign earnings accumulated before a territorial system becomes effective is a major concern for many NAM members that have reinvested a significant portion of those earnings in "hard assets" outside the United States to address the needs of a global marketplace. A mandatory transition tax could impose a significant tax burden on these companies at a time when they are otherwise facing significant

challenges in the global marketplace. Their competitors would not have a comparable burden during the same period. Furthermore, the financial statement impact of this tax cost may be significant and could negatively affect share prices, slowing business growth and potentially having a dampening effect on our still-recovering economy.

In addition, a transition tax on all accumulated deferred earnings and profits would impose a sizable compliance burden on taxpayers. In particular, it will be difficult to determine precisely the accumulated earnings and profits for companies with longstanding foreign subsidiaries.

If a transition tax is adopted, the NAM encourages the Committee to allow taxpayers to net CFCs with deficits in earnings and profits and those with positive earnings and profits. It makes no sense for a U.S.-based multinational without any net foreign earnings to pay a toll charge for the benefits of a territorial system. The ability to use deficits to offset positive earnings and minimize the transition tax should not be limited by the structural limitations of a company's organization chart given the magnitude of this tax and the importance of providing some relief.

In addition, any transition tax should be imposed at a lower rate on earnings that have been invested into plants and equipment. Furthermore, taxpayers should be able to use foreign tax credit carryovers against the transition tax, and loss carryovers against the income on which it is imposed.

V. Implementing a New System

a. Concerns About "Base Erosion"

The NAM understands that there are some concerns about the possible erosion of the U.S. tax base under a territorial tax system. While NAM members do not think that moving to a territorial system necessarily poses an increased threat of eroding the U.S. tax base, the NAM agrees that the current subpart F income rules need to be reconsidered because they were developed in an era when business models and the United States' role in the global economy were quite different. In particular, policymakers need to focus on the impact of the subpart F income rules on U.S. multinationals operating abroad and their ability to compete with their foreign counterparts that often have a lighter tax burden on their foreign operations.

A well-designed territorial regime should both protect the American tax base and exempt active foreign business income. From a competitiveness perspective, it is critical that policymakers avoid broadening the scope of foreign income subject to immediate U.S. tax in a way that essentially makes it a full inclusion system for a significant portion of a U.S. multinational's active foreign earnings. In addition, any anti-base erosion rules must not be overly broad and unfairly penalize suppliers solely on the fact that their component is in a final product that would trigger an anti-base erosion rule.

U.S. manufacturers operate in foreign countries to be near their customers, and foreign operations help American companies market products effectively to foreign consumers, cut transportation costs, avoid tariff barriers, meet local content requirements and provide services locally. These foreign operations do not shrink the U.S. tax base or U.S. operations. Rather, they generate additional jobs both at U.S. headquarters, in the U.S. supply chain and at U.S. facilities that manufacture for the export market.[2]

[2] According to the Bureau of Economic Analysis, in 2012 (latest figure available), U.S.-based multinational companies were responsible for some $738 billion in U.S. exports—53.5 percent of total exports.

b. CFC Look-Through

Manufacturers believe that a new territorial system should include a permanent CFC "look-through rule" that excludes from subpart F income certain payments of dividends, interest, rents and royalties between related CFCs. The CFC look-through rule properly treats the redeployment of earnings between and among CFCs as active income.

These payments represent an important source of funding for CFC operations. The rules, which have bipartisan support in Congress, put U.S.-based companies on a level playing field with foreign-based companies when redeploying foreign earnings in foreign businesses. These payments allow for the efficient use of capital among CFCs.

c. Active Financing

The NAM also supports including permanent active financing rules that exclude from Subpart F income the active financial services income earned in global markets in a territorial system. The active financial services rules—in effect through 2014—provide that U.S. financial services companies will be taxed by the United States on active business income earned by their CFCs only when that income is repatriated to the United States. Thus, these rules provide the same treatment for financial services income as is provided for other active business income earned by CFCs. Under a territorial system, active financing income should be treated the same as other active business income and should not be treated as Subpart F income.

d. Minimum Taxes

The NAM strongly opposes the imposition of a U.S. minimum tax on foreign earnings. A minimum tax on foreign earnings is equivalent to repealing deferral at a lower rate. Imposition of a minimum tax, especially on a country-by-country or CFC-by-CFC basis, would undercut the competitive gains achieved by moving to a dividend exemption system.

e. Treatment of Interest Expense

While the NAM understands that some limitation on interest expense may be considered, manufacturers encourage the Committee to study carefully any such limitation on the deductibility of interest payments.

In particular, NAM members have significant concerns with proposals that would deny a deduction for an arbitrary percentage of interest expense, deny a deduction based upon a formulaic allocation of interest, or create an unreasonable low threshold of deductible interest expense relative to earnings. Restrictions on interest deductions could negatively impact borrowing and capital investment. In particular, manufacturing is a capital intensive industry, and as such, interest expense deductibility is important to sustain existing operations as well as fund new investment.

In addition, the NAM is concerned about proposals to further limit interest deductions for U.S. subsidiaries of foreign–headquartered corporations and eliminating their ability to carry forward excess interest expense to future tax years. Proposals like these disregard the important role that foreign direct investment plays in the U.S. economy and discriminates against non-U.S.-headquartered companies that play an important role in the U.S. economy and U.S. communities. Indeed, one out of five U.S. manufacturing employees is employed by a U.S. subsidiary. The ability to deduct interest expense is a critical factor in a company's decision to invest and create jobs in the United States.

f. Treatment of Branches

The NAM also supports maintaining the current tax treatment of branches. Some proposals, which would treat certain foreign branches of domestic corporations like CFCs for all purposes of the code, would be unworkable and penalize companies with existing branches.

g. Tax Reform and Puerto Rico

Federal tax policy has traditionally recognized the unique relationship of Puerto Rico to the United States and has helped foster a strong manufacturing sector in the territory. Indeed, manufacturing is currently the leading private sector employer and represents almost one-half of Puerto Rico's economy. In light of the important role that U.S. tax policy has played in the economy of Puerto Rico, we urge the Committee to consider fully the impact of tax reform proposals on the Puerto Rican economy and job base.

h. Innovation Box

The NAM also is open to the idea of a preferential rate for intellectual property (IP) income earned by U.S. companies resulting from R&D developed or owned in the United States. Many jurisdictions, including the United Kingdom, Ireland, Netherlands and France have adopted Innovation Boxes (which provide for a reduced tax rate— generally five to 15 percent— for IP-related income) to keep the research, production and commercialization of IP and the associated jobs in their home countries. The creation and commercialization of R&D in the U.S. is directly tied to highly-skilled jobs with good wages and benefits. An Innovation Box would level the playing field with our foreign counterparts that already have reduced rates and tax incentives, and encourage companies to invest in innovation, manufacturing and retain ownership of the resulting, valuable IP in the United States.

VI. Conclusion

There is no doubt that the U.S. tax code—which includes the developed world's highest corporate tax rate, outdated international tax rules and a host of temporary provisions—is a drag on U.S. economic growth and competitiveness. While the NAM is a strong advocate for comprehensive reform of our current tax code, we also believe it is critically important to keep our current tax system in place until policymakers agree on a final, comprehensive reform plan.

Piecemeal changes or repeal of long-standing rules, like current anti-inversion proposals, will inject more uncertainty into business planning and make companies in the United States less competitive, threatening economic growth and U.S. jobs. Moreover, using "one-off" tax increases to pay for unrelated policy changes will make it even more difficult to achieve pro-growth tax reform.

Manufacturers want the United States to be the best place in the world to manufacture and attract foreign direct investment. The NAM very much appreciates the diligent efforts of Chairman Hatch, Ranking Member Wyden and the other members of the Senate Finance Committee to reform the U.S. tax system, particularly their support for developing a corporate income tax structure that attempts to put U.S. businesses on a level playing field with their competitors organized in other countries and to make the United States a more competitive place to do business. Indeed, comprehensive tax reform should not be a far-off goal but a near-term priority for the Congress and such reform should address the fundamental flaws in our existing system.

Thank you for the opportunity to share our thoughts and concerns with you. We look forward to further discussing these issues and working with the International Tax Working Group and the rest of the Committee to achieve a pro-growth, pro-competitiveness and pro-manufacturing tax system.