COMMENT
TO THE WAYS AND MEANS COMMITTEE
TAX REFORM WORKING GROUP ON INTERNATIONAL
BY
THE AMERICAN CHEMISTRY COUNCIL
April 15, 2013

The American Chemistry Council is pleased to offer these comments to the Working Group on International of the Ways and Means Committee. We believe the Committee is to be commended for undertaking a review of the eleven topics identified in this survey. We agree with what we understand to be the overriding goal of the Committee, which is to arrive at a framework for tax reform that increases U.S. economic growth and strengthens the competitiveness of U.S. business taxpayers in the global economy.

The American Chemistry Council

The American Chemistry Council represents the leading companies engaged in the business of chemistry. ACC member companies apply the science of chemistry to create and manufacture innovative products that make people's lives better, healthier and safer.

The business of chemistry is a $769 billion enterprise and a key element of the nation's economy. Nearly 23% of U.S. GDP is generated from industries that rely on chemistry, ranging from agriculture to oil and gas production, from semiconductors and electronics to textiles and vehicles, and from pharmaceuticals to residential and commercial energy efficiency products.

Our industry directly employs over 780,000 Americans in high-paying, quality jobs and each of those jobs supports an additional 7.6 American jobs in other manufacturing industries, meaning that nearly 6 million Americans are working in the industries that rely on chemistry to drive economic growth, innovation, and American competitiveness. Importantly, our industry is one of the nation's largest exporting sectors, with over $188 billion in exports in 2012, or more than 12 cents out of every export dollar.

This Comment

We understand that the goals of the working groups on tax reform are in large part to make each of the eleven subject areas more fully comprehensible to Members of the Committee as well as to all Members of the Congress and all concerned with U.S. tax and economic policy. On that basis, we will describe concisely the provisions of the Code with greatest effect on operation and management of manufacturers, on capital investment, capital retention, and the growth of manufacturing businesses.[1]

[1] A concise and non-technical outline showing the basic operation of the corporate income tax appears as Attachment 2 to this comment.

This comment is a product of the ACC Tax Policy Committee, existing under the governing instruments of the association and for decades providing the ACC Board and Executive Committee with recommendations concerning tax policy issues. Most members of the Tax Policy Committee are chief tax officers or senior counsel for ACC member companies.[2]

Manufacturing and the U.S. Economy

Manufacturing is the cornerstone industry in the U.S. economy. Manufacturing output supports other industries both directly and indirectly; manufacturing businesses are long-lived, supplying good-paying jobs and weathering business cycles; and manufacturers are among the largest employers in the U.S. economy, supplying the ballast that allows economic security and growth.

Aspects of manufacturing that make it the basic element in the U.S. industrial sector come with economic realities of creating, maintaining, and growing a manufacturing business, matters common to all manufacturers of whatever size:

- The industry is capital intensive, but at the same time, and increasingly, requires skilled employees; start-up and expansion is both expensive and slow to achieve full capacity, with deferred return on investment as a consequence;

- In order to weather business cycles, manufacturers require financial tools to deal with inflation and market variations;

- In order to compete in a global economy, manufactures must create new technology and new products and operate with ever greater efficiency.

These and more are requirements for success and business continuation.

The importance of manufacturing to the economy, along with the economic reality that manufacturers face has strongly influenced tax policy since enactment of the corporate income tax. Although very few tax Code provisions affect manufacturers exclusively, much of the structure of the corporate income tax acknowledges the dynamics and necessities of manufacturing businesses.

[2] In addition to these comments, the ACC has filed comments with the Working Group on Manufacturing, and the Working Group on Debt, Equity and Capital.

Products of the business of chemistry are part of over 96% of all manufactured goods produced in the U.S. From this standpoint as a leading segment within the manufacturing sector, ACC is aware of larger tax policy issues affecting manufacturers. Our policy concerns are not only with the chemical industry, but with virtually all other manufacturing companies that are our customers and that supply products, innovation, and jobs to drive the U.S. economy.

Proposals for Business Tax Reform

In 2011, the Tax Policy Committee drafted "Fundamental Principles for Tax Reform", subsequently approved and endorsed by the ACC Board.[3] Consistent with the principles, we suggest that business tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America. The measure of each decision and trade off made in the process of tax reform should be whether it advances these goals.

We note that business tax reform is generally proposed within a framework of revenue neutrality, under which the reformed system of business income taxes would produce the same amount of tax revenue as the current system, but at the lower tax rate—requiring repeal of a broad range of so-called "tax expenditures."

We respectfully suggest that the Committee consider satisfying this objective by taking into account the increased revenue that would result from modifying the Code to be much more supportive of economic growth. In contrast, we caution embarking on a complex and difficult tax reform process that achieves revenue neutrality on a "static basis" since that, by definition, simply creates winners and losers in a zero sum game.

A number of the so-called tax expenditures suggested for repeal, like accelerated depreciation, are critical to the manufacturing sector. Thus, manufacturing is likely to be disproportionately and adversely affected by such an approach to tax reform. Given the recognized importance of the manufacturing sector in providing solid, middle class jobs, we caution against this approach. The industry would find it even more difficult to compete in U.S. and global markets, and would experience reduced growth or contraction, with a corresponding reduction of the manufacturing workforce. Likewise, spill-over consequences would adversely affect suppliers and service-providers that depend upon manufacturing customers. We seriously question whether there is pro-growth tax "reform" if the existing business tax burden is simply rearranged among business sectors and with the capital intensive sector being disproportionately hurt.

Our concerns arise from economic analysis of tax expenditures, the effect of certain benefits for the manufacturing industry, and the consequent effect on employment of capital.

[3] The principles appear as Attachment 1.

Manufacturing Renaissance

The chemical industry has announced tentative budgeting of $71 billion for plants to use ethane from shale gas as the feedstock that provides basic materials used in manufacturing 96% of all U.S. manufactured products. This new source of lower-cost feedstock can mean a significant cost advantage for U.S. manufacturers and a manufacturing renaissance. However, construction of the new chemical plants depends upon continuation of tax provisions critical to manufacturers.

Only a few years ago, customers of ACC member companies asked how long a domestic chemical industry in the U.S. could survive. Customer concern reflected the run-up in costs of natural gas, the primary feedstock with which chemical manufacturers produce the basic materials the customers use in their own production processes. A historical price advantage enjoyed by U.S. manufacturers because of relatively inexpensive natural gas had disappeared, as U.S. natural gas supply declined. Availability of a domestic source of basic and specialty chemicals is obviously important to U.S. manufacturing, given volatility of global markets, transportation issues, and uncertainties of world output and availability.

However, declining prospects for the domestic chemical industry and, by extension, its manufacturing customers dramatically changed with recent technology that allows access to massive shale-gas underlying much of the Northeast, Midwest, and Southwest. If these resources are developed to potential, U.S. manufacturers will achieve a world price advantage for chemical-product inputs. New job growth, exports, and inbound foreign-capital are among the more obvious factors that will contribute to a renaissance in U.S. manufacturing, led by inexpensive chemical feedstocks and low cost energy.

But exploitation of the shale gas resource requires capital investment commensurate with the enormous growth potential for the U.S. economy. A significant concern for those considering investment in these new plants is continuation of tax provisions that underpin multi-billion dollar investments and the related risks.

A Competitive Territorial Tax System is Essential for Future U.S. Prosperity

The modern economic realities of business operations and government tax policy in a global economy require a fresh approach to international taxation in the U.S. With 95% of the world's population outside the U.S., the U.S. tax system must enable, not impede, the competitiveness of U.S. companies. The best approach to international tax reform is to review carefully the international tax policy developments in the rest of the industrialized world with a view to emulating the best practices of other nations.

The clear trend over the last 20 years is that almost all Organisation for Economic Development and Cooperation (OECD) countries, even those that traditionally had worldwide tax systems, have determined the preferred—and hence now the competitive-- system for taxing income earned outside their home country borders is a territorial system, i.e., a tax system that essentially exempts active foreign business income from "home" country taxation. The lone significant outlier is the U.S. We would also note that such countries have significantly reduced their corporate income tax rates as well.

The U.S. International Tax Code is Non-Competitive

Under current law, worldwide American companies' earnings from foreign operations are effectively "locked out" of the U.S. American companies competing with foreign-based companies in foreign markets pay income tax rates in foreign jurisdictions that are lower than the U.S. rate of 35%, which is the highest in the industrialized world. The American company must pay the difference between the low foreign rate and the high U.S. rate when bringing foreign earnings home. The foreign competitor with a home in a "territorial" tax regime pays no such additional tax on its foreign earnings when distributed to the home country of the parent company—even in the frequent circumstance that the foreign taxes in any year are less than the parent company's home country tax. Thus, the U.S.-based company is at a distinct disadvantage in competitive foreign markets for two reasons—first, an additional layer of home country (U.S.) tax is imposed, unlike our trading partners, and second, that additional layer is based on an uncompetitive tax rate of 35%. U.S. enactment of a competitive territorial system of taxation would put American companies on a level playing field with foreign-based competition, particularly if coupled with a lower tax rate and/or features that provide exemption or reduced rates for activities directly associated with earning active foreign business income.

The present U.S. system, imposing an additional home country tax when lower-taxed foreign earnings are repatriated, encourages U.S. companies to keep cash abroad. Removing this "lock-out effect" would encourage movement to the U.S. of very significant amounts of cash presently sitting in foreign bank accounts of foreign subsidiaries of U.S. multinationals. Movement of this cash to U.S. parent companies could cause an increase in investment in U.S. capital equipment, creation of new jobs in the U.S. and payout of dividends to U.S. shareholders, who in turn invest in other American businesses.

It is clear that the high U.S. tax rate combined with an outdated international system of taxation puts U.S. companies at a competitive disadvantage to foreign-owned companies competing in the global marketplace. The additional layer of U.S. tax on foreign earnings limits expansion opportunities, employment and investment, both at home and abroad. As U.S. companies expand globally, they increase U.S. employment -- in engineering, R&D and administration and supervisory support roles. Moreover, a territorial system eliminating disadvantages of the current system to U.S. companies engaged in global markets also would enhance the growth of virtually all the domestic companies that support global reach through the U.S. supply chain of goods and services.

Furthermore, recent studies have found that within global production networks, when some tasks are relocated to foreign affiliates in different parts of the world, the coordination to make the finished product tends to create new jobs in the U.S. parent company as well. And growth of global supply chain networks of U.S. multinational corporations (MNCs) also results in growth of other intermediate suppliers of goods and services, many of which are small and medium-sized American companies.

U.K. and Japan Adoption of a Territorial Tax System

Recently, two countries with long-standing “worldwide” tax systems, the United Kingdom and Japan, have independently determined that it is better to move to a territorial system that exempts foreign income. Like the current international tax regime in the U.S., these “worldwide” systems of U.K. and Japanese tax laws had imposed a home country tax when lower-taxed foreign earnings were repatriated to the parent company as dividends. U.K. and Japan determined that worldwide taxation was stifling their resident multinational companies in the highly competitive global economy and limiting domestic employment and investment while failing to add any significant amount of revenue to government coffers. The U.S. is under similar competitive pressures, and without comprehensive tax reform, faces a future with fewer job opportunities.

Anti-Base Erosion Provisions of a Territorial System

The Ways and Means Committee discussion draft on international taxation released October 26, 2011 (the “Discussion Draft”) contained several options to prevent base erosion. While our comments do not endorse any of those options or any alternatives, we offer the following considerations in developing approaches to prevent inappropriate erosion of the U.S. tax base:

- Focus on erosion of the U.S. tax base, not the erosion of tax bases in foreign countries. It should not be the role of the U.S. tax law to punish U.S. companies that operate successfully in jurisdictions that impose a substantially lower income tax burden than the U.S. does. Increasingly, countries are determining that income taxes, and particularly corporate income taxes, are among the most harmful ways to generate tax revenues. As more countries develop alternatives to high income taxes, U.S. companies should not be disadvantaged based on the type of revenue raising choices a particular foreign country makes. It would be ironic for a foreign nation to choose a less harmful revenue raising approach, only to have its choice undercut by the United States, with the result that U.S. based companies are prevented from participating in that country’s development.

- Debt-financing is an important source of funding for capital investment, and it is appropriate for businesses to be able to deduct interest expense related to borrowing. In the context of a competitive international tax system, any efforts to limit interest expense under the auspices of base erosion must:

  1. Be carefully, and narrowly, drawn so that they do not impede U.S. economic development by limiting the deductibility of interest on debt used to finance U.S. business activities where the borrowing reflects an efficient manner of obtaining financing and is at levels that are in fact commercial and arm’s length;

  2. Not impose a new complex framework of administratively burdensome, inflexible rules;

3. Be market based and avoid arbitrary constraints on debt financing that fail to recognize the cyclical nature of capital intensive industries or the sound business reasons for companies to vary their debt levels based on their particular business model, financial profile and risk diversification strategy.

- Avoid incentives for foreign subsidiaries of U.S. MNCs to pay more foreign tax, and for foreign governments to raise their taxes at the expense of the U.S. fisc.

- Take into account that many U.S. (as well as foreign) MNCs are managed on a regional or global basis, not by maintaining a full-service operation in each individual country. Services must be shared across a number of countries and subsidiaries to be efficient. The "home-country exception" of Option B of the Discussion Draft seemed to assume a free-standing supply chain in each country.

- Avoid distortive "cliff effects," e.g., where one U.S. tax treatment follows if a certain effective foreign tax rate is paid by a subsidiary of a U.S. MNC, but a totally different U.S. tax treatment applies if the foreign tax rate is just slightly higher or lower.

- Consider the anti-base erosion provisions in the territorial tax systems of other developed countries. To impose much more onerous terms on U.S. MNCs operating globally would be inconsistent with the purposes of adopting a territorial tax system.

- Understand that global expansion by U.S. companies is essential for U.S. companies to prosper, grow and capture new markets. Such expansion adds to the U.S. economy and creates jobs in the U.S. To be competitive globally, U.S. companies must consider cost savings from operating closer to foreign customers and raw material suppliers, availability and costs of labor, logistics costs and many other factors.

Transitional Tax on Pre-Enactment Earnings

The Discussion Draft imposes a 5.25% tax on pre-enactment earnings of foreign subsidiaries of U.S. MNCs at the time of transition to a territorial system. We appreciate that the terms of this provision are to some extent driven by the need for revenue-neutrality and therefore would not necessarily resemble features of the transition to a territorial tax system adopted in other countries. Still, we offer the following recommendations:

- In the interests of simplicity and the ability to administer the law, consider the difficulty of accurately computing historical accumulated earnings and profits for subsidiaries of U.S. MNCs that have been in business for many decades.

- Understand that financial statement accumulated earnings do not equate to cash on hand that can be repatriated at the time of transition to a territorial system. In many cases, foreign subsidiaries have reinvested much of their accumulated earnings in capital assets, and therefore do not have cash available to repatriate. Consider whether the transition tax should treat differently the cash or equivalents on hand in foreign subsidiaries versus accumulated earnings represented by plant and equipment.

- Consider whether the transition tax should take into account that some foreign subsidiaries in a group may have positive accumulated earnings, while others have accumulated deficits. Rather than ignoring the deficits and taxing the positive earnings at transition, netting of positive and negative earnings of group members should be allowed.

Dynamics of the Global Economy Require Reform

While the U.S. GDP is large relative to that of many other countries, it does not follow that the U.S. or its resident companies are materially different from their competitors or immune to global competitive forces. Foreign companies pursue the advantages of investing in the U.S. economy on an essentially equal basis without facing uncompetitive international tax rules either in their home jurisdictions or here in the U.S.

Congress should look at the historic trend line for the U.S. economy and the likely direction of that line in the future. In recent years, the U.S. GDP as a percentage of worldwide GDP has been shrinking. Similarly, the number of U.S. companies that are among the largest 100 companies in the world has been declining steadily. These trends are likely to continue, even with robust economic growth at home and abroad. This is not necessarily bad news. New markets have developed over the past twenty years in countries that before 1990 had closed economies. This trend implies that we should recognize the importance of being connected and competitive with the rest of the world.

Benefits of Adoption of a Competitive International Tax System

The U.S. should adopt a territorial system of international taxation that will enable the U.S. to tax business income earned in America, without stifling the opportunity for American companies to participate in the growth of the global economy. International tax reform should include innovative ways to apply traditional guidelines to modern business enterprises that enable income tax laws to raise the necessary revenue in each jurisdiction consistent with the arms-length principle of transfer pricing. This approach, properly crafted, would recognize and rely on the underlying economics of business conducted in global markets. By combining this approach with a competitive territorial structure, American companies will be better able to compete globally. The result would be more quality and quantity of job opportunities in the U.S. and a higher U.S. standard of living.

Attachment 1

American Chemistry Council
Guiding Principles for Corporate Tax Reform

- *Tax reform should produce a fair, simpler, and internationally competitive tax system that promotes economic growth and job creation in America.*
- *Tax reform should recognize and reflect the important role of American manufacturing and the jobs it creates.*
  - *Manufacturing is a capital intensive activity, and therefore, tax treatment of capital cost recovery is of key importance.*
  - *Advanced manufacturing techniques and products rely on research, and therefore, incentives for research and development expenses also should be supported.*
- *ACC supports adoption of a competitive territorial system for the taxation of income earned outside the United States.*
- *ACC supports a substantial income tax rate reduction to reflect rates comparable to Organisation for Economic Development and Cooperation (OECD) averages.*
- *Tax reform must produce a "level playing field concept" such that American companies investing abroad can compete equally with foreign investors, and American and foreign companies investing in the United States are treated equally.*
- *Tax reform should be enacted comprehensively, not piecemeal, and should include transitional rules that allow taxpayers to adjust to a new tax regime without financial dislocation, contraction, or reduction in employment.*

Attachment 2

A BRIEF DESCRIPTION OF THE CORPORATE INCOME TAX

The category of corporations subject to the rules discussed below are "C" Corporations, that under the tax Code are taxable entities subject to rules in most ways consistent with those for taxation of individuals.[4] Virtually all large corporations and the great majority of publicly-traded entities are C corporations.[5]

Although complex, the rules for taxing the income of corporations are based on a statutory structure, the most significant elements of which are common to the corporate tax as first enacted in 1913. At most basic, the corporate tax is a levy imposed on business earnings, net of the expenses incurred in order to produce the earnings.[6]

The footnotes are not technical, but are to explain certain aspects of the corporate tax more completely (and to avoid clutter in the seven paragraphs below).

(1) Taxpayers compute tax liability on the basis of a "taxable year", almost always an accounting period of twelve months, although not necessarily a calendar year. The constant of an annual accounting period is fundamental to operation of the tax.

(2) For the taxable year, determine the amount of "gross income", which is the total of sales, receipts, gains[7], rents, royalties, refund of earlier taxes paid, refunds from customers, release of liability, found money – any economic increase enjoyed by the taxpayer.[8]

(3) Then, calculate "deductions" from gross income, which are the "ordinary and necessary" expenses of operating the business, to include employee compensation, interest expense, cost of supplies and materials[9], costs of utilities, simple maintenance of property, plant and equipment, etc.[10]; plus, a portion of certain expenses incurred currently or in an earlier taxable year, but subject to ratable deduction over a stated number of years, the

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[4] Not dealt with below are "S" corporations, entities with corporate form under state law that are not subject to income tax, with shareholders taxed directly upon earnings of the business. *See,* n. 7.

[5] Some partnerships, real estate investment trusts, and limited liability companies are also publicly traded, and subject to rules similar to those for "S" corporations, noted above.

[6] A convenient consequence is that the taxpayer has the money with which to pay the tax.

[7] Treatment of capital gains and losses is of limited concern to corporate taxpayers.

[8] Under the rules of the Code, this is an amount "realized" -- received – or a current economic benefit quantifiable in dollars. Tax law defines gross income as broadly as possible, and deductions as narrowly as possible.

[9] Manufacturers and some other categories of taxpayers are required to calculate the costs of supplies and materials by maintaining inventories. The inventory rules were designed by the Congress to prevent mismatching of income and expense and so as to best reflect taxable income. The most common inventory methods are FIFO and LIFO.

[10] Dividends (paid on earnings) are not deductible by the corporate taxpayer, resulting in double-taxation of earnings: first at the corporate level and then by the shareholder recipient. The Congress enacted the rules for S Corporations so as to eliminate double taxation in the case of closely-held businesses operating in corporate form.

most significant of which is recovery of costs of property, plant, and equipment put into service.[11]

(4) The result is "taxable income", which is the net of gross income minus deductions, equaling economic increase subject to income tax. [12]

(5) To taxable income, apply a "statutory tax rate" – the percentage tax rate specified under the Code for corporations -- typically 35%[13], resulting in tax liability before credits against tax, if any.

(6) From tax liability, subtract "credits against tax". Credits are a portion (or in some cases, all) of a particular category of expense incurred by the corporation during the taxable year. The Code has two kinds of tax credits. The first is for expenditures that the Congress wishes to encourage, because of economic policy or larger objectives, *e.g.*, the credit for increasing research and development. The second is a credit to prevent double taxation, in this regard, the "foreign tax credit" that reduces U.S. tax liability by the amount of tax paid *on the same items of taxable income* to a foreign jurisdiction. Although simple in concept, few aspects of U.S. corporate tax law are as contentious and misunderstood as the foreign tax credit.[14]

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[11] Cost recovery is sometimes referred to generally as "depreciation". However, "depreciation" is a term actually made obsolete by changes to the rules for cost recovery enacted in the early 1980's that de-linked deductions for recovery of costs of depreciable assets from schedules that sought to equate actual useful life of assets to depreciation allowances under the Code.

[12] A tax on gross income would simply apply the tax rate without deducting expenses. Although having the virtue of simplicity, a gross income tax is obviously unfair because different taxpayers have different levels of expense in the ordinary course of operating their particular businesses. And, as a practical matter, the taxpayer might not have the money with which to pay the tax.

[13] If deductions exceed gross income, the taxpayer, obviously, has a loss for the taxable year and no income to which tax can apply. Losses in a given year, to a limited extent, can become "net operating loss" constituting deductions allowable in another taxable year, a prime example of a tax provision designed to help taxpayers weather economic volatility.

[14] Under the U.S. system of "worldwide" taxation, the same item of income may be subject to both U.S. tax as well as the tax of a foreign country. This, of course, is for income of a U.S. taxpayer, subject to the worldwide rule of inclusion, but also subject to the tax of the foreign jurisdiction in which the income item is earned. Thus, the foreign tax credit is designed to reduce U.S. tax by the amount of the foreign tax paid. A common misunderstanding is that the foreign tax credit can offset U.S. tax on income earned in the U.S. However, the foreign tax credit operates so as to eliminate this possibility. Also not fully understood is that the amount of the credit cannot exceed the amount of U.S. tax paid on the same item of income, *i.e.*, foreign tax paid on income at a 40% rate can offset U.S. tax only to the extent of the 35% U.S. rate on the same item of income. The foreign tax credit rules are among the most complex in U.S. tax law, and as a practical matter, the amount of foreign tax credit allowed to a taxpayer is frequently less than the foreign tax paid (separate and apart from the limitation of the credit to operation of the 35% rate).

(7) The amount of tax payable is after adjustment for such credits. Corporations file estimated returns throughout the year, with a true-up when the full-year return is filed. All large corporations are subject to a continuing auditing process by the Internal Revenue Service. Typically, three or more taxable years are combined in a single “audit cycle”. In recent years, the IRS has instituted programs designed to ease the manpower burden on itself as well as taxpayers with respect to tax audits.