American Iron and Steel Institute

25 Massachusetts Avenue, NW
Suite 800
Washington, DC 20001
Phone 202.452.7146
Fax 202.452.1039
E-mail tgibson@steel.org

www.steel.org

Thomas J. Gibson
President and Chief Executive Officer

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Representative Jim Gerlach
Chair
House Ways and Means Committee
Manufacturing Tax Working Group
2442 Rayburn House Office Building
Washington, DC 20515

Representative Linda Sanchez
Vice Chair
House Ways and Means Committee
Manufacturing Tax Working Group
2423 Rayburn House Office Building
Washington, DC 20515

Representative Peter Roskam
Member
House Ways and Means Committee
Manufacturing Tax Working Group
227 Cannon House Office Building
Washington, DC 20515

Dear Representatives Gerlach, Roskam, and Sanchez:

The American Iron and Steel Institute (AISI), on behalf of its U.S. producer member companies, is pleased to provide stakeholder input to your recent inquiry about how to improve the tax code and tax incentives for U.S. manufacturers. AISI is comprised of 24 producer member companies, including integrated and electric furnace steelmakers, and 124 associate and affiliate members who are suppliers to or customers of the steel industry. AISI's member companies represent over three-quarters of both U.S. and North American steel capacity.

Steel and other manufacturing industries are the backbone of the U.S. economy. A strong manufacturing sector creates significant benefits for society, including good-paying jobs, investment in research and development, essential materials for our national defense, and high-value exports. A robust American steel industry is critical to ensuring a healthy domestic economy.

Last year, AISI commissioned a report by Professor Timothy J. Considine of the University of Wyoming on the industry's impact on the U.S. economy. Professor Considine found that the steel industry's purchases of materials, energy, and supplies for the production of steel stimulate economic output and employment in a range of sectors across the economy. Steel's economic contributions are multiplied many times over, with Professor Considine finding that every $1 increase in sales by our sector increases total output in the U.S. economy by $2.66. In aggregate, the steel industry accounts for over $101 billion in economic activity directly employing over 153,000 people in the United States and directly or indirectly supporting more than one million U.S. jobs.

Like the rest of our economy, the steel industry is recovering from the depths of the recession but is far from fully recovered. In 2012, steel imports surged into the U.S. market, impeding the domestic industry's full recovery from the economic recession. This surge is not driven by U.S. demand as the capacity utilization rate in the U.S. steel industry remains low at around 75%. Rather, the surge of steel imports into the U.S. is a result of overcapacity of steel throughout the world due in large part to foreign government market-distorting policies and weakened demand in Asia and Europe. China, for example, continues to provide massive subsidies to its steel industry and promotes exports in a number of ways including by manipulating its value added tax (VAT) system to provide domestic producers with inexpensive primary and intermediate products. Reports indicate that China intends to continue encouraging exports of steel products through VAT rebates.

AISI is very concerned about this trend and is sensitive to policy changes that could make production here more expensive and less internationally competitive. With that in mind, below are the industry's responses to some of the specific questions made in your recent inquiry:

1. **Manufacturing Tax Incentives: A Tax Code to Increase U.S. Manufacturing**
From the perspective of your industry/company which provisions in the current Tax Code do you consider the most important to manufacturers?

Of these tax provisions, in the context of comprehensive tax reform, which of these would you be willing to give up in return for a lower tax rate?

In today's global economy the steel industry is similar to many other manufacturing sectors in that individual steel companies have different financial structures and as such do not necessarily prioritize certain tax deductions/credits in the same way. The industry does, however, agree on the importance of several tax deductions and credits that are utilized by the steel industry as well as by the manufacturing sector more broadly. Examples of such deductions and credits and their importance to the industry and manufacturing are explained below:

<u>Accelerated Depreciation</u>
As a capital intensive industry, cost recovery provisions such as accelerated depreciation, or bonus depreciation, are very important to us in addition to our customers in downstream manufacturing industries. U.S. steelmakers must continuously invest in new plants and equipment, in good times and bad, in order to modernize, remain competitive and comply with environmental laws and regulations. Investments in steel plants and equipment are multi-million dollar investments and can be viewed as quite risky in an industry facing strong competition globally that does not always follow the rules. Likewise, such large investments take a number of years to yield their return. In the steel industry and many downstream manufacturing industries, the evaluation of current and future cash flow is one of the most important criterion for determining if a discretionary capital investment should be made. Because depreciation expense lowers reported income, it brings a tax savings that is real cash flow which is critical in many cases for a major discretionary project to go forward. In other words, accelerated depreciation, or bonus depreciation, has a direct impact on new capital investments which create good-paying, manufacturing jobs and tax revenue for local governments that are part of the foundation of strong communities and to rebuilding the nation's economy.

The Domestic Production Activities Deduction (Section 199)

Enacted as part of the American Jobs Creation Act of 2004, the domestic production activities deduction provides a valuable benefit to those manufacturing products in the United States. Currently, the domestic production activities deduction results in approximately a 3 percentage point reduction on the tax rate on eligible activities conducted in the U.S. Of particular importance is that the Section 199 provision came about as a result of the World Trade Organization's ruling that the United States' extraterritorial income exclusion violated its WTO agreement 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 utilize VAT export rebates. This international inequity still exists which makes Section 199, or a comparable provision, critical for domestic manufacturers to compete globally. We do suggest, however, that Section 199 can be improved by increasing the Section 199 deduction and tightening the definition of activities that qualify so that only true manufacturing and value-added industrial processes are covered. If domestic manufacturing is truly critical to the U.S. economy, then Section 199 should be preserved, because a redistribution of wealth from manufacturers to other sectors of the economy will not result in the pro-growth, job-creation, tax reform Members are seeking.

The Interest Expense Deduction

Limiting the deduction for interest expense would hit steel companies especially hard by causing an automatic tax increase and may discourage investment in U.S. manufacturing. As a result of the steel crisis in the late 1990's and early 2000's, a number of steel companies went bankrupt and foreign steel producers purchased U.S. steelmaking assets, keeping a number of domestic facilities open and running. Steelmakers across the country also made and continue to make major investments to upgrade and open new state-of-the art facilities which cost millions of dollars. In both cases and because of how capital intensive the industry is, these investments often require a company to incur a sizeable amount of debt. As such, the ability to deduct a company's interest expense is also very important to the steel industry and contributes significantly to decisions made regarding investments in major plant and equipment investments. There are a number of policymakers who have stated their support for repealing or limiting this deduction because it favors debt over equity which they believe should be reversed. We would caution those who have taken this position that the end result will likely discourage further investment in U.S. manufacturing. As such, we recommend a thorough analysis of the impact of the interest expense deduction on the investment of capital intensive industries, especially as we have not fully recovered from the recession.

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

LIFO is a long standing accounting measure that allows companies that are subject to rising inventory costs to be properly taxed on their real income. It does so by assuming for accounting purposes that a company 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 were repealed, a company would generate increased taxable income as if it had sold part of its inventory even though no real profit was made. The repeal of the LIFO method would be devastating to many of our customers in addition to some steel

companies which would be counterproductive to leveling the international playing field for domestic manufacturers.

Percentage Depletion

A number of AISI member companies own and operate mining facilities in addition to their steelmaking facilities and as such utilize the percentage depletion deduction. In addition to improving the leveling of the playing field, the percentage depletion deduction, set at a fixed percentage of the income from mining property, recognizes the unique nature of mining investments. Mining requires significant financial commitments to long-term projects to deliver a competitive product at a low margin. Enormous amounts of capital must be expended at the front end of mining projects to realize future returns. With such sizable capital costs, cost recovery through percentage depletion is critical to the global competitiveness of domestic operations, as well as the long-term viability of the domestic steel industry and manufacturers that rely on a stable supply of domestically produced raw materials needed for production.

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.

In summary, manufacturers, like steel producers, are capital-intensive and face intense competition in global markets and tax treatments like those listed were included in the code to help level the international playing field and make U.S. manufacturers more competitive globally. In addition to leveling the playing field, the other direct effect of these tax incentives is to lower the effective tax rate for manufacturers. According to a Tax Foundation report (Tax Foundation Special Report No. 194), the average effective tax rate for the manufacturing sector between 2003 and 2008 was 19.7%. How tax reform impacts the effective rate of manufacturers is critical to whether or not reform promotes growth and resurgence in the manufacturing sector. This means that to the extent that a reduction in the statutory corporate tax rate is combined with the elimination of certain deductions and credits, those measures critical to manufacturing competitiveness must be preserved, or the rate reduction must be sufficient to offset the increase in tax liability resulting from the loss of these deductions and credits. A net tax increase on manufacturing as a result of tax reform would only further retard the stagnated recovery we face and could quite possibly cause the economy to slip back into recession.

2. The U.S. Corporate Rate, Manufacturing Tax Incentives and the Global Landscape

Are the tax incentives available to U.S. manufacturers similar to the tax incentives available to your international competitors? If not, please provide examples.

In general, what impediments are there in the U.S. Tax Code that makes it difficult for American manufactures to compete in a global marketplace?

Are companies at a competitive disadvantage due to the fact that the U.S. currently has the highest statutory corporate tax rate of all OECD countries?

Would eliminating the tax expenditures listed in #1 and replacing such expenditures with a meaningful reduction in the statutory corporate tax rate help manufacturers to better compete domestically and/or internationally? What about for pass-through entities and smaller manufacturers if the individual marginal rate is reduced?

In order to increase our global competitiveness, the federal government must lower the overall taxes that U.S. businesses pay. Other nations have been lowering their corporate tax rates in order to encourage economic growth while the United States' combined (federal plus state) tax rate is the highest in the world, at almost 40 percent. Having the highest corporate tax rate in the world is certainly a disadvantage faced by U.S. businesses internationally. Another major tax obstacle faced by U.S. businesses is the utilization by a number of our trading partners of some form of the value-added tax. The normal rebate of the VAT on exports works like an export subsidy for foreign exporters and the imposition of the VAT on imports acts as an import tariff at the same time, which places the U.S. in an even greater uncompetitive situation due to the fact that we do not utilize the VAT.

That said, if tax reform is to produce real economic growth and job creation, it cannot simply be a statutory rate reduction that results in an increase in the effective tax rate on manufacturing and triggers a redistribution of wealth from manufacturers to other sectors of the economy. Rather, the key benchmark for determining the appropriate rate reduction must be an analysis of the rate structure necessary to promote the international competitiveness of U.S. industry. For example, studies by the Tax Foundation indicate that in order to match the corporate tax rate of China and the simple average of the OECD countries, the U.S. federal corporate tax rate would have to be reduced to approximately 20 percent.

As you are well aware, the key proposals for a reduction in the statutory corporate tax rate call for reducing the statutory rate only to 25-28 percent and to pay for this rate reduction by eliminating all or most corporate deductions and credits. This is concerning to the steel industry, and should be to the manufacturing sector as a whole, because analyses of the President's National Commission on Fiscal Responsibility and Reform's plan, which reduces the rate to 28 percent and eliminates all corporate tax treatments, indicate that such a plan would subject the manufacturing sector to a $48 billion tax increase, while granting tax cuts to the retail and financial services sectors. Increasing the tax rates of manufacturers would be counterproductive to the stated goal of creating a more pro-manufacturing, pro-growth Tax Code.

3. Improving the Tax Code for Manufacturers: Reforming Manufacturing Tax Incentives

Should any of the manufacturing tax provisions be modified to ease the administrative burden of compliance such as R&D? If so, how should such provisions be modified?

Can you discuss how your company relies on or takes advance of certain cost recovery provisions in the tax code, such as accelerated depreciation? How do those recovery methods help manufactures manufacture cash flows? Do you think there are areas in the rules governing depreciation that should be evaluated or modified in tax reform?

How can the Tax Code better encourage manufactures to innovate and develop new products here in the U.S.?

Many of our global competitors utilize patent boxes or "innovation boxes" which essentially provide tax benefits for the commercialization of successful R&D. Do you believe implementing such a structure in the U.S. would help manufacturers compete globally?

As stated earlier in these comments, an enhanced capital-cost recovery system has always been viewed as one of the most effective ways to spur real business investment and to make U.S. manufacturing more competitive. It provides capital-intensive manufacturers with the increased cash flow that is the lifeblood of our business. By providing a faster return on capital investment, accelerated deprecation provides strong incentives, and in many cases actually makes it possible, to undertake new investment. From our perspective, both accelerated depreciation and lower statutory corporate tax rates are essential to fostering heavy investment in capital intensive projects which spur economic growth and employment in the United States.

While the Committee did not request comments on a carbon tax, the industry feels it is important to note our concerns with those who are advocating for the creation of a tax on CO_2 emissions. Whether or not the goal of a carbon tax is to provide a new revenue stream for deficit reduction or to address climate change, Congress must recognize that as an energy-intensive, trade-exposed industry, a tax on carbon emissions would have a substantially negative economic impact on steel production in the U.S. All energy, climate and tax legislation should take into account our international competitiveness and how the cost of compliance will alter the competitive balance in the global marketplace. The domestic steel industry believes that a carbon tax will raise the cost of producing steel in the U.S., specifically through higher energy prices on the coal, natural gas, and electricity that it purchases. The enactment of any CO_2 reduction legislation, including a carbon tax, in the United States must apply the same level of stringency to other major steel producing nations, such as China, on a contemporary timeline. If it does not, a carbon tax will drive steel production, and the associated CO_2 emissions and valuable manufacturing jobs, offshore to countries with less stringent climate policies or related taxes, negating any real global CO_2 reductions or increase in revenue.

Finally, the last two areas of importance to the steel industry related to tax reform include our support for the repeal of the corporate alternative minimum tax (AMT) and for the inclusion of necessary and appropriate transition rules. The corporate AMT places an enormous administrative burden on corporations and denies companies legitimate deductions, acting as a disincentive to new investment. It is important to note that many more corporations will fall under the AMT if the corporate income tax rate is lowered and the corporate AMT is left alone. As such, we believe that any pro-growth tax reform proposal geared toward simplifying the code should repeal the AMT. We also encourage Congress to ensure a fair transition to a new system. It is critical that U.S. companies be allowed to carry with them

into any new tax system net operating losses (NOLs) and other tax assets they have accumulated under the current 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.

AISI appreciates the ability to provide input from the domestic steel industry to your inquiry about how Congress can create a more pro-manufacturing Tax Code in order to foster a more vibrant manufacturing sector in America. Corporate tax reform, if properly constructed, can provide the environment American companies need to expand and increase production and exports, create jobs, and aid in our economic recovery, which is an essential component to addressing the current fiscal crisis facing the United States. In order to do this, Congress must put forth a tax reform proposal that improves our competitiveness relative to our major global trading partners and does not result in a net tax increase on manufacturing. We look forward to working with the Ways and Means Committee as the Committee moves forward on tax reform.

Sincerely,

Thomas J. Gibson