Comments of

The National Association of Manufacturers

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International Tax Reform Working Group

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Overview

The National Association of Manufacturers (NAM)—the largest manufacturing association in the United States representing manufacturers in every industrial sector and in all 50 states—has long held that our current tax system is antiquated, fundamentally flawed and discourages economic growth and U.S. competitiveness. NAM members very much appreciate the current focus in the White House and on Capitol Hill on improving our nation's tax system. Because of the critical importance of manufacturing to our nation's economy, any effort to rewrite the tax laws should result in a fiscally responsible plan that allows manufacturers in the United States to prosper, grow and create jobs.

In particular, manufacturers have a strong interest in our nation's international tax regime. Almost half of American worldwide companies are manufacturers, and 53 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 around the world.

Promoting International Competitiveness and Foreign Direct Investment

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 a territorial system that taxes income earned within their own borders but does not tax the foreign profits that are repatriated to their own economies. In fact, Japan and the United Kingdom—two of the largest economies—recently 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.

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 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.

The NAM supports the 95 percent dividends-received deduction (DRD) proposed by Chairman Camp in the discussion draft he released in October 2011.[1] The 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 trading partners, including the United Kingdom, Spain, Denmark, Finland, Austria and Netherlands, that provide a 100 percent participation exemption, we acknowledge that the taxation of 5 percent of controlled foreign corporation (CFC) dividends obviates the allocation of 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.

In addition, the enactment of a territorial system would simplify U.S. tax law by eliminating several complex tax rules. For example, Chairman Camp’s discussion draft would 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. For example, 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 are minimized.

Transitioning to New Rules

[1] For more extensive comments from the NAM on Chairman Camp’s proposal, please see NAM's comments originally submitted to the House Ways and Means Committee on April 11, 2012.

Transition rules will be important for all areas of tax reform, particularly the international area. 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, Chairman Camp's proposal to impose a 5.25 percent 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 the bricks and mortar of their foreign business. These companies, which have invested in "hard assets" outside the United States to address the needs of a global marketplace, could face a significant tax liability without sufficient cash to pay the tax. Even though companies would have eight years to pay this tax liability, the mandatory transition tax would impose an additional cost burden on U.S 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.

The transition tax also would pose a sizable compliance burden on taxpayers and a challenging administrative burden on the IRS because the tax would apply to all accumulated deferred earnings and profits, regardless of how long ago they were earned. In particular, it will be difficult to determine precisely the accumulated earnings and profits for companies with longstanding foreign subsidiaries.

Implementing a New System

Concerns About "Base Erosion"

The NAM recognizes that most policymakers are concerned 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.

In contrast, NAM members believe that the three "base erosion" options in Chairman Camp's draft need further refinement, and the NAM appreciates Chairman Camp's invitation for constructive input. A well-designed territorial regime should both protect the American tax base while it exempts active foreign business income. Indeed, the technical explanation of the discussion draft indicates that the DRD would apply to distributions of foreign active business income. However, the discussion draft also proposes to continue to currently tax active foreign business income within the scope of the existing subpart F income rules and subject even more active business income to immediate U.S. tax by expanding the scope of subpart F.

In addition, the options for expanding subpart F income would impose an additional tax charge for many U.S.-based companies selling goods and providing services in foreign markets, creating an additional and significant hurdle to competing with non-U.S.-based companies in these same markets. 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.

While Chairman Camp's discussion draft labels the three options "prevention of base erosion," each option lacks a meaningful active business exception and would impact a wide range of legitimate transactions. Manufacturers in the United States 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]

CFC Look-Through

Although Chairman Camp's draft is silent on the continuation of the CFC "look-through rule" that excludes from subpart F income certain payments of dividends, interest, rents and royalties between related CFCs, the NAM strongly encourages a new territorial system to retain these rules. 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 should be viewed as allowing for the efficient use of capital among CFCs.

Treatment of Interest Expense

While the NAM understands that some limitation on interest expense may be appropriate under a territorial system, manufacturers encourage the committee to study carefully any such limitation on the deductibility of interest payments.

Chairman Camp's proposal would expand the present-law limitation on the current deductibility of interest expense in a manner similar to rules applied to foreign companies investing in the United States through U.S. subsidiaries. Specifically, current deductions for net interest expense would be subject to the greater of two limits: (1) net interest expense attributed to "non-excess" domestic indebtedness (computed by comparing the U.S. debt-to-asset ratio to the worldwide debt-to-asset ratio); or (2) a specified percentage of "adjusted taxable income" as that term is defined in section 163(j).

The proposed restrictions on interest deductions could negatively impact borrowing and capital investment. In addition, the effect of the provision would depend on a particular industry's borrowing needs and would have a more damaging impact on some industries than others. Given these concerns and the arbitrary nature of the percentage of adjusted taxable income chosen, the NAM encourages the Committee to consider using a higher percentage of adjusted taxable income to minimize unintended consequences.

Conclusion

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[2] According to the Bureau of Economic Analysis, in 2010 (latest figure available), U.S.-based multinational companies were responsible for some $615 billion in U.S. exports—almost 50 percent of total exports.

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 enhances the global competitiveness of manufacturers in the United States and avoids policy changes that would increase the tax burden on the manufacturing sector. Clearly, restructuring our international tax rules to reflect the realities of operating in a 21st century global marketplace is a key part of this effort.

Manufacturers very much appreciate the efforts of Chairman Camp and the members of the House Ways and Means Committee for their diligent work to reform the U.S. tax system, particularly their support for developing a corporate income tax structure that attempts to put U.S. business on a level playing field with its competitors organized in other countries and to make the United States a more competitive place to do business. Manufacturers thank you for the opportunity to share our thoughts and concerns with you, and we look forward to further discussing these issues and working with the International Tax Reform Working Group and the rest of the Committee to achieve a pro-growth, pro-competitiveness and pro-manufacturing tax system.