ORGANIZATION FOR INTERNATIONAL INVESTMENT
INTERNATIONAL BUSINESS INVESTING IN AMERICA

April 15, 2013

The Honorable Devin Nunes
Chair
International Working Group
1013 Longworth House Office Building
Washington, DC 20515

The Honorable Earl Blumenauer
Vice Chair
International Working Group
1111 Longworth House Office Building
Washington, DC 20515

Re: Tax Treatment of Business Debt and Impact on Global Investment in the United States

Dear Congressman Nunes and Congressman Blumenauer:

The Organization for International Investment (OFII) appreciates the opportunity to submit comments to the *International* Tax Reform Working Group.

OFII is a business association of U.S. subsidiaries of global companies, a business community which plays a major role in U.S. job creation and economic growth. OFII works to ensure fair and non-discriminatory treatment for its member companies and advocates for policies which increase U.S. competitiveness in attracting foreign direct investment (FDI). FDI has long been vital to the American economy, providing millions of high-wage jobs, supporting the economies of local communities in all 50 states, and helping to fuel U.S. manufacturing, innovation, and exports.

Tax reform is a unique opportunity to make the United States significantly more competitive as a location for business investment in a challenging global environment. OFII strongly supports Chairman Camp's goals of a significant reduction in the U.S. corporate income tax rate, elimination of unnecessary complexity and administrative burden, and the establishment of a more transparent tax code that will provide the stability and certainty critical to long-term business planning. In pursuing these goals, OFII believes it is essential that any changes to the tax code be carried out in a non-discriminatory manner that encourages global investment in the U.S. economy.

This comment letter will focus on the tax treatment of business debt and the role of debt finance in facilitating important investment and economic activities in the United States.

Foreign Direct Investment is Vital to the U.S. Economy

U.S. subsidiaries of global companies generate precisely the types of high-value jobs and economic activities that should be encouraged through fundamental tax reform. According to the most recent U.S. government statistics, U.S. subsidiaries employ 5.3 million Americans, or 4.7 percent of the private sector workforce, generate 5.8 percent of U.S. private sector GDP, and undertake 14.4 percent of all U.S. non-residential capital investment. With a combined annual payroll of $408 billion and average employee salary at $77,409, these companies provide well-paying U.S. jobs at salary levels substantially higher than the economy-wide average. Additionally, this business community comprises a significant portion of the U.S. corporate tax base; according to the most recently published IRS data, foreign-owned companies pay approximately 14 percent of total U.S. corporate income taxes.

FDI plays a particularly important role in key areas of the U.S. economy, such as manufacturing, innovation, and trade:

- Manufacturing: More FDI flows into the manufacturing sector than any other area of the U.S. economy. In total, 34 percent of FDI in the United States is concentrated in manufacturing – with an even higher concentration in recent years as U.S. manufacturing continues its resurgence. U.S. subsidiaries provide jobs to roughly two million manufacturing workers, accounting for over 17 percent of the total American manufacturing workforce. These jobs pay an average annual salary of $85,211, compared to the national average of $74,534 for all manufacturing workers. Not only are these jobs well-paying, they have a positive ripple effect throughout the U.S. economy. An economic study commissioned by OFII last year found that each manufacturing job at a U.S. subsidiary supports five additional jobs in the broader economy.

- Research & Development: FDI is a tremendous catalyst for American innovation, employing tens of thousands of scientists and engineers throughout the country. U.S. subsidiaries underwrite 14 percent of all research and development (R&D) activity in the United States, spending over $40 billion annually on U.S. R&D.

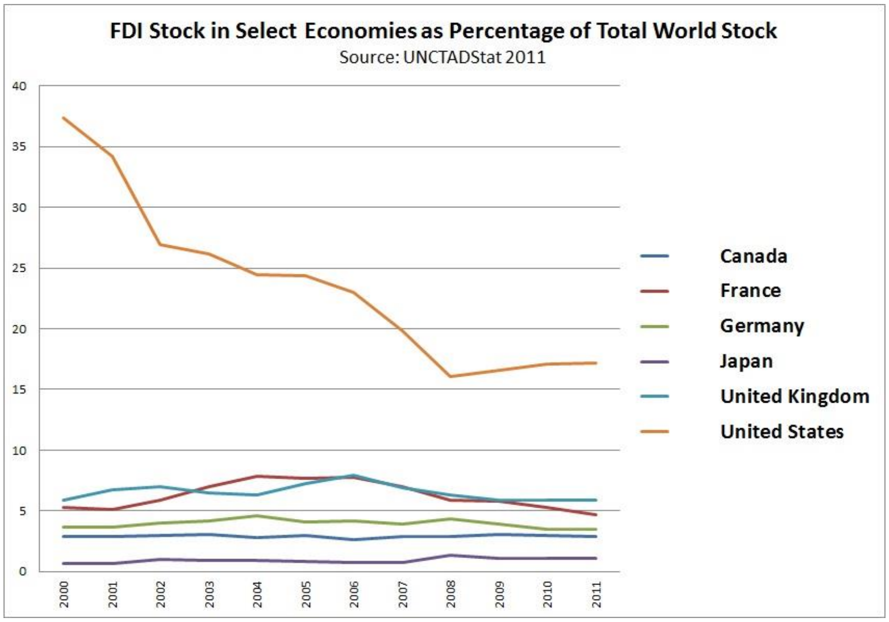
- Trade: Inbound investment is closely linked to outbound trade. Instead of simply investing in the U.S. to access the domestic market, many foreign-based firms use their U.S. operations to reach new markets around the world. In fact, nearly 18 percent of all U.S. exports are produced by foreign-owned companies, which provide $229.3 billion in American goods and services annually to customers around the world.

- Supply Chain, Reinvestment, and Expansion: The effects of FDI are felt "downstream" as well. U.S. subsidiaries support a vibrant network of U.S. suppliers, purchasing hundreds of billions of dollars in goods and services every year from small businesses and local companies to sustain and grow their U.S. operations. Additionally, U.S. subsidiaries reinvest $87.4 billion of their annual earnings back into their U.S. operations and spend an additional $149 billion annually on new property, plant construction, and equipment to help upgrade and expand their businesses. These investments demonstrate substantial commitment to the long-term success and vitality of their U.S. operations.

A tax code that encourages manufacturing, R&D, and exports will attract global leaders in those fields and ensure the United States remains the premier location for high-value cross-border investment.

Increased Global Competition for FDI

Today's global economy provides an unprecedented array of options for companies looking to expand their businesses around the world. While the United States remains the largest recipient of worldwide cross-border investment, its share of global FDI has dropped dramatically in recent years from roughly 37 percent in 2000 to just over 17 percent in 2011, as shown in the chart below. Importantly, this drop is far steeper than in other leading developed economies – many of whom have managed to maintain their relative share over the same period. The decline in U.S. share of FDI has also far outpaced the drop in the U.S. share of another key economic indicator, global GDP.



This changing landscape is the result of a number of factors, but is in part due to the development of emerging economies as attractive investment locations and the aggressive efforts of other countries to attract high-quality, job-creating investment from abroad – including through reforms to their corporate tax codes.

Key Considerations for Tax Reform

Tax reform is an important opportunity to encourage greater foreign direct investment in the United States. OFII believes the Committee should carefully consider three overriding factors in assessing how tax reform may impact the ability of the United States to compete for global investment in the 21st century.

First, OFII is united with the broader business community in its support for a substantial reduction in the U.S. federal corporate income tax rate. The U.S. statutory rate – the highest in the developed world – is out of step with international norms, creates an artificial barrier to inward investment, and harms overall U.S. competitiveness. Other nations, including a number of fellow members of the Organisation for Economic Cooperation and Development (OECD) have recently moved to lower their corporate tax rates to encourage greater levels of domestic investment. When surveying the Chief Financial Officers of its member companies regarding factors impacting the U.S. investment decisions of global firms, OFII consistently finds that reducing the corporate tax rate will significantly increase investment in the United States and lead to further job growth associated with high-value FDI.

Second, in pursuing tax reform, OFII believes efforts to improve the certainty, transparency, and reliability of the U.S. tax system must be carried out in a manner that does not discriminate against the U.S. subsidiaries of foreign businesses. The U.S. tax code should encourage job-creating investment from all sources – including home-grown companies and those whose parent companies are headquartered abroad. Such an approach will similarly help to maximize the benefits of fundamental tax reform and ensure the U.S. maintains its position as a leading force for open investment policy around the world.

Third, the Committee must carefully consider the manner in which possible changes to the tax treatment of business debt will impact the U.S. investment climate. The longstanding ability to deduct interest as an ordinary business expense is directly linked to critical economic activities and provides essential flexibility in a company's capital structure. Debt finance plays an important role in facilitating investments by all types of U.S. companies – including those headquartered abroad. Changes to the tax code which arbitrarily penalize debt would be inconsistent with the goal of promoting domestic investment, job creation, and international economic competitiveness through tax reform.

<u>Interest Deductibility Aids Economic Growth</u>

The ability to deduct interest as an ordinary and necessary business expense is a longstanding principle of U.S. corporate income tax policy. All companies – small, medium, and large – use debt as a basic and necessary tool to finance investment and fundamental business activities. The U.S., like all OECD countries, allows interest to be deducted as normal business expense. The use of debt in conjunction with equity investments optimizes the overall cost of an investment and therefore the return on investment, helping to fuel positive economic activity that grows economies.

The deduction for interest expense reduces the after-tax cost of debt finance and thus lowers the *cost of capital* for all businesses operating in the U.S., making investment here more attractive. As a general matter, the cost of capital sets the *hurdle rate* that the return on an investment opportunity must exceed in order to pay the returns required by bondholders and shareholders. The higher the cost of capital, the higher the hurdle rate and the lower the amount of investment a firm can profitably undertake. Changes in tax law that would increase the cost of capital carry the risk of reducing domestic investment, employment, wages, and economic growth.

One key source of investment financing for a subsidiary company is its global parent company. In addition to equity investment, a parent company can provide a loan to its subsidiary or guarantee a loan from an unrelated third party, such as a bank. In any case, the parent company plays a critical role in ensuring the subsidiary has access to the funding it needs to carry out its business activities – everything from meeting payroll to buying new equipment to building a new factory. Without the flexibility of raising capital through intercompany debt finance, the U.S. would become a far less competitive environment for investment – especially for global businesses with a wide array of choices for where to place their investments.

<u>Current Limitations on Related Party Debt for U.S. Subsidiaries</u>

U.S. subsidiaries of foreign businesses are currently subject to unique interest limitations under section 163(j) of the Internal Revenue Code, which was intended to prevent base erosion through "excess" interest expense. Section 163(j) limits deductions of interest on loans from a foreign related party, such as a non-U.S. parent company, even if the terms of the loan meet the arms-length standard. It also imposes limitations on deductions of interest paid to an *unrelated* lender, such as a U.S. bank, when the loan is guaranteed by a related party (e.g., a parent or affiliate company). This is true in spite of the fact that a loan from a U.S. lender is tax revenue neutral (i.e., the interest deducted by the U.S. borrower is taxable income for the U.S. lender) and presents <u>no opportunity</u> for the kind of base erosion 163(j) was intended to prevent. Such restrictions – which currently apply in practice *only to U.S. subsidiaries* – can increase the cost of capital for investment.

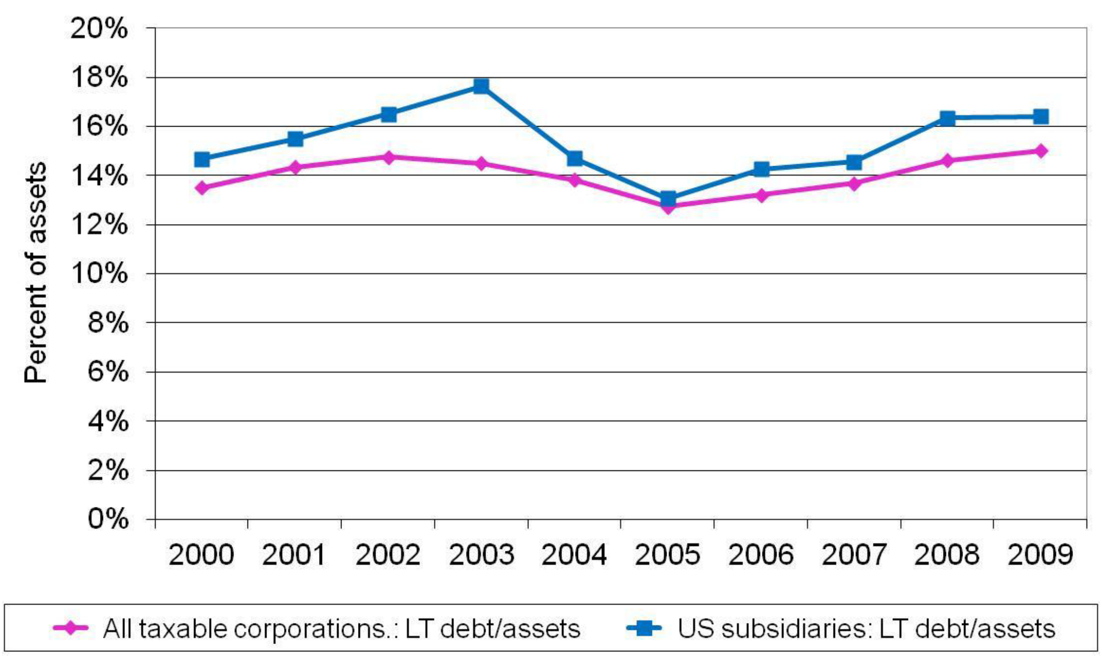
<u>Further Limitation Not Justified by Data</u>

The Treasury Department has periodically reviewed data on U.S. subsidiaries in relation to 163(j). These studies, including the most recent in 2007, found no evidence of earnings stripping by traditional foreign-based corporations with U.S. subsidiaries. Furthermore, a subsequent 2008 Treasury study found that U.S. subsidiaries and U.S.-headquartered corporations were largely on par in their levels of debt and profitability.

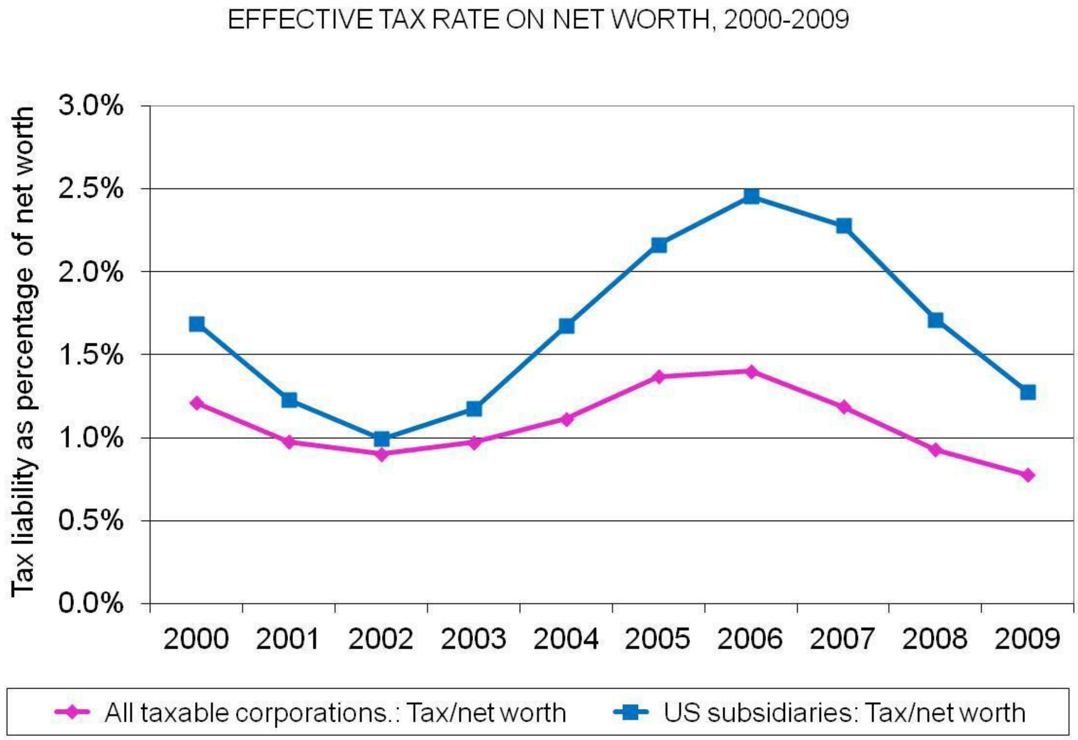
Likewise, IRS data through 2009 (most recent published) show <u>no material difference</u> in relative levels of debt or interest expense between U.S. subsidiaries and all taxable corporations. For example, comparing IRS data for U.S. subsidiaries to those of all taxable corporations demonstrates that:

1) U.S. subsidiaries have very similar levels of debt as a percentage of assets,

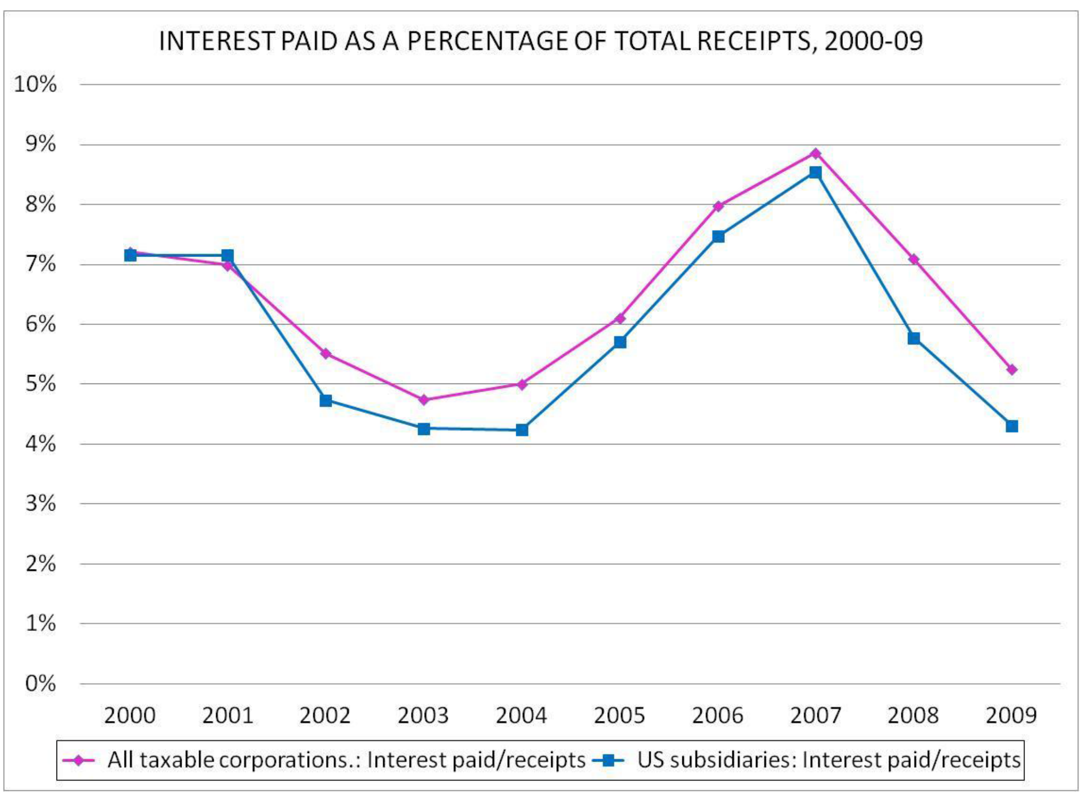
LONG-TERM DEBT AS A PERCENTAGE OF ASSETS, 2000-2009



2) U.S. subsidiaries have slightly higher effective tax rates based on net worth, and,



3) U.S. subsidiaries have slightly smaller interest expense as a portion of total receipts.

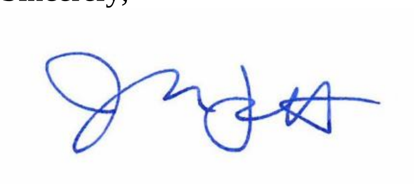


In short, multiple studies and many years of IRS data provide no evidence of a need to further tighten current rules governing interest deductibility for U.S. subsidiaries.

Conclusion

OFII and its member companies deeply appreciate the Committee's efforts to create a pro-growth tax system that will strengthen our economy and make the U.S. the most attractive place in the world for investment. The deductibility of interest is a critical component of a company's ability to grow and invest in the United States. Placing further limitations on interest deductibility for U.S. subsidiaries of global companies would undermine the goal of promoting domestic investment, job creation, and economic competitiveness through tax reform.

Sincerely,



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