



STATEMENT FOR THE RECORD

OF

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FOR THE HEARING ON

“TAX REFORM AND FOREIGN INVESTMENT IN THE UNITED STATES”

BEFORE

**THE U.S. HOUSE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURES**

JUNE 23, 2011

Chairman Tiberi, Ranking Member Neal, and members of the House Ways and Means Select Revenue Measures Subcommittee, thank you for the opportunity to submit this statement for the record on behalf of the Overseas Shipping Group, Inc. (“OSG”). We applaud the Committee and Subcommittee for their work on the critical issue of tax reform.

The issue of incentivizing foreign direct investment in the U.S. is an important consideration as tax reform progresses. Our statement focuses on a related topic – a provision in the current U.S. tax code that is effectively encouraging the investment of significant capital of U.S. shipping companies in foreign assets. We applaud Chairman Tiberi for his leadership in introducing H.R. 1031, the “American Shipping Reinvestment Act of 2011” (“ASRA”), which would address this anomaly. Companion legislation, S. 626, has been introduced in the Senate. We strongly urge enactment of this important bipartisan legislation, which would repeal this antiquated law, provide for an immediate investment in our nation’s maritime industry, and stimulate U.S. economic activity and job growth during this fragile time in the country’s economic recovery.

THE U.S. MARITIME INDUSTRY

The U.S. maritime industry plays a crucial role in the U.S. economy, serving as the backbone of modern transportation and making possible the transport of raw materials, petroleum products, affordable food, and manufactured goods. The maritime industry is an important contributor to the U.S. economy, sustaining thousands of American jobs in the shipbuilding, seagoing, and related trades. A recent PriceWaterhouseCoopers analysis estimated that, in 2009, U.S. flag ships that carry goods between U.S. ports – which must be U.S.-owned, built, and crewed – accounted for approximately 74,000 jobs in the U.S. economy, resulting in \$36.4 billion in U.S. economic output and \$6.5 billion in U.S. labor compensation. Another approximately 426,000 jobs arose from indirect and induced effects, accounting for \$35.5 billion in U.S. economic output and \$22.6 billion in U.S. labor compensation.

The U.S. maritime industry is also an essential component of our national security. The U.S. flag fleet supports a shipbuilding defense industrial base and pool of qualified seafarers and shipping assets needed for military sealift in times of war or national emergency. For example, U.S. flag commercial vessels and their American crews transported the majority of cargoes – more than 25 million measurement tons – in support of Operations Enduring Freedom and Iraqi Freedom during the period of 2002-2008.

Additionally, American-owned companies’ international ships are part of what is called the Effective U.S. Controlled Fleet (“EUSC fleet”), or the fleet of merchant vessels, registered in certain foreign nations, that are available for requisition, use, or charter by the U.S. government in the event of war or national emergency. However, a 2002 study commissioned by the Department of Defense (“DOD”) and performed by professors at the Massachusetts Institute of Technology found that the EUSC fleet dropped by 38 percent in terms of numbers of ships and nearly 55 percent in terms of deadweight tonnage between 1986 and 2000.

This finding is reflective of the decline in American-owned international shipping. American-owned shipping companies used to be a major transportation sector on the world’s

oceans. However, progress has been made in recent years to address international tax inequities affecting the shipping industry and to help rebuild the U.S.-flag shipping industry. Through the enactment of a tonnage tax regime and restoration of deferral in 2004, significant progress has been made, but more needs to be done.

THE OVERSEAS SHIPHOLDING GROUP, INC.

OSG is a market leader in global energy transportation services. OSG owns and operates an International Flag and U.S. flag fleet of 118 vessels made up of 109 operating vessels and nine under construction aggregating 12.1 million deadweight tons. The fleet transports crude oil, petroleum products and gas in the U.S. and throughout the world.

Founded in 1948, OSG has been successful through multiple shipping cycles. This success is the result of OSG's vision, breadth and experience, emphasis on quality and the safety of the environment, the size and diversity of its fleet, and the skills and commitment of its professional staff and crews.

OSG is based in New York and has offices in Athens, Houston, London, Manila, Montreal, Newark, Newcastle, Singapore and Tampa. It has 3,500 employees, of which 3,050 are seafarers.

THE AMERICAN SHIPPING REINVESTMENT ACT

ASRA addresses the unintended consequence of an antiquated tax provision enacted in 1975. Under the 1970s tax provision, U.S. shipping companies must maintain investments in qualified foreign shipping assets made between 1975 and 1986.

More specifically, between 1975 and 1986, "foreign base company shipping income" was included as a category of subpart F income. Under this provision, subpart F income generally did not include foreign base company shipping income to the extent it was reinvested during the taxable year in certain qualified shipping investments. If, however, in a subsequent year a net decrease in qualified shipping investments occurred, the amount of previously excluded subpart F income equal to such decrease was treated as subpart F income. In other words, any net decrease in these investments resulted in an immediate tax penalty.

Although the deferral for shipping income provision was completely repealed in 1986, the pre-1987 net investment in qualified shipping assets under section 955 of the tax code was retained. As a result, decreases in investments in qualified shipping operations from pre-1987 level continue to trigger subpart F income. These rules apply even after section 415 of the American Jobs Creation Act of 2004 ("2004 Jobs Act") repealed the subpart F rules applicable to foreign base company shipping income.

This quirk in the tax law has created a perverse system that distorts the investment decisions and increases the transaction costs of U.S. companies, particularly with respect to structuring a financing strategy or deciding whether to acquire or divest qualified shipping assets. For example, because of the method for calculating amounts invested in qualified shipping assets, a company's investment may decrease due to the depreciation of its assets, rather than due

to any affirmative action that it takes to withdraw from shipping. In such circumstances, a company may be forced to invest its resources in a way that is not economically optimal in order to avoid triggering subpart F income, regardless of market conditions or business need. Additionally, Subpart F inclusion may be triggered if a company issues debt to invest in non-shipping operations, thereby deterring a company from financing the expansion and diversification of their enterprises. At end, even though these companies have a strong desire to reinvest their foreign earnings in the U.S. and inject money into the economy, they are effectively unable to do so. Instead, the practical consequence is that these earnings are permanently invested abroad.

The bipartisan ASRA legislation would repeal the outdated 1970s tax provision. Additionally, ASRA would provide U.S. shipping companies with a one-time opportunity to receive foreign source earnings at a reduced tax rate. This is appropriate because such companies generally could not previously avail themselves to a 2004 provision to encourage investment of foreign earnings in the U.S.

ASRA also contains a strong jobs provision. In order to preserve the tax benefits provided under ASRA, companies must maintain their current employment levels. If they fail to do so, they will be subject to a significant tax penalty. Specifically, there would be a \$25,000 additional income inclusion for each employee by which the taxpayer's average employment during the two-year period from and including the calendar month of the first shipping income repatriation is less than the average employment during the two-year period prior to that same month of first repatriation.

ASRA'S IMPACT: INVESTMENT, ECONOMIC ACTIVITY, JOBS, AND SECURITY

As Congress considers legislation to address unemployment and stimulate the American economy, it should consider the merits of ASRA. Enacting ASRA would allow, and incentivize, these companies to bring funds that are currently invested abroad home and reinvest them in the U.S. shipping industry. ASRA would spur job growth in the U.S. by creating a broad and diverse range of well-paying employment opportunities for American workers, both in the short- and long-term. As a result, ASRA is broadly supported by American maritime labor, U.S. shipyards, and U.S. shipping companies.

Enactment of ASRA would stimulate investment in the U.S. shipping industry, leading to the creation of well-paying jobs as construction and repair activity in U.S. shipyards increased. The magnitude of the stimulative economic effect of building ships in the U.S. is significant - a 2002 study performed for the Shipbuilders Council of America found that 3.7 jobs were created elsewhere in the economy for every direct shipyard job. Moreover, as a result of tax provisions in the 2004 Jobs Act, OSG commissioned the construction of 10 new tankers at a U.S. shipyard, the largest commercial shipbuilding project in a U.S. shipyard since World War II. A study performed on this project found that the new shipbuilding activity for these 10 tankers would increase average annual employment in the region where the shipyard was located by 1,217 jobs and nationally by 2,902 jobs during the period of construction. OSG later increased its commitment with orders for 2 additional tankers and 2 additional tank barge vessels, resulting in even more employment growth and economic activity.

Once in operation, these ships will generate American employment throughout the life of the vessel, which is estimated to be at least 25 years. Ships operating in the domestic Jones Act trades must be manned by Americans, built in a U.S. shipyard, and owned by U.S.-citizen companies. As such, by encouraging American companies to expand their Jones Act operations, ASRA would create and sustain thousands of jobs for Americans during the operating life of the new vessels. These include well-paying jobs in the seagoing and shore side trades, as well as in the shipyards that will maintain the vessels during their economic life. In fact, it is estimated that the 10 new tankers constructed because of the 2004 Jobs Act will increase average annual shore side and seagoing employment directly related to the vessel's operations by 1,313 and increase average labor compensation by \$1.2 billion over the period of 2007 to 2020.

Investment in the U.S. shipping industry would have an economic "multiplier" effect, spurring job growth in affiliated businesses. In addition to the direct employment effect of ship construction and operations, studies indicate that investment in the U.S. shipping industry would have the indirect effect of increasing demand placed on suppliers through the supply chain and the induced effect of additional spending on goods and services resulting from increased household incomes.

Additionally, ASRA would enhance U.S. national security interests by supporting shipyards that are vital to our defense industrial base by developing new U.S.-flag tanker capacity to transport our nation's energy products, and by providing the DOD with critical assets – manpower and ships – necessary to help sustain military sealift.

CONCLUSION

OSG greatly appreciates the opportunity to submit this statement. As Congress considers ways to increase investment in the U.S., ASRA presents an opening to create thousands of American seagoing and shore side jobs and stimulate critical investments into American shipping companies that help sustain our economic and national security. We are happy to be a resource to Congress, the Committee, and the Subcommittee and we look forward to our continued work together on these issues.