

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

The American Chemistry Council (ACC) is pleased to offer these comments to the Working Group on Manufacturing of the Ways and Means Committee. In particular, we appreciate the invitation we received from the Chairman and Co-Chair of the working group to comment. Answers to specific questions mentioned in that invitation appear in Attachment 1, with some references to relevant discussion below. We look forward to providing any additional information or answering questions.

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

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

¹ A concise and non-technical outline showing the basic operation of the corporate income tax appears as Attachment 3 to this comment.

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

tax. Although very few Code provisions affect manufacturers exclusively, much of the structure of the corporate income tax acknowledges the dynamics and necessities of manufacturing businesses.

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

³ The principles appear as Attachment 2.

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.

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.

Accelerated Cost Recovery

Manufacturers regard accelerated cost recovery of capital assets (“ACR”) as the most fundamental tax provision. As a practical matter, ACR makes capital investment possible because of the leveraging effect on investment return and cash flow. Moreover, ACR is central to determination of the “hurdle rate”⁴ for acceptable return on investment that makes for the binary decision to invest or not to invest.

Historically, “depreciation” meant capital cost recovery, but the term was largely made obsolete by tax law changes in the early 1980’s that de-linked cost recovery from assumed “useful lives” of given assets. ACR describes the current system that features simplified formulas for recovery of costs over a stated period of years. An additional advantage is that ACR avoids contentious determination of useful lives that burdened the tax law for decades.

ACR allows recovery of the cost of capital investment more quickly for tax purposes than under financial accounting rules for the benefit of shareholders and creditors that amortize asset value over asset lives assumed by such rules.

Example: Investment of \$1000 in production machinery with a deemed useful life of ten years. Financial accounting rules specify depreciation on a “straight-line” basis over the ten-year period, reducing book income and balance sheet value by \$100 annually. The same \$1000 is recovered under ACR, but deductions are front-loaded in a yearly sequence such as \$150, \$300, \$250, \$150, \$100, \$50. Cost is recovered over six years rather than ten, under an accelerated method, meaning that the discounted value of deductions under ACR is substantially greater than under a straight-line method, with greater return as a consequence. Note the obvious fact that taxpayers get no greater total deductions under ACR, but that write-off is accelerated.⁵

ACR represents Congressional policy responsive to issues of up-front capital costs, deferred investment return, and business cycles, noted above as common to all manufacturers. In this regard, accelerated cost-recovery compensates for the risk of investing massive capital in relatively lower-profit enterprises, typically with longer start-up for bringing new assets on line and longer pay-out times in order to achieve return commensurate with the investment. The

⁴ Achieving an after-tax return on capital invested in a project is the essential element in the determination of whether the return on the capital is sufficient to justify the risk of making the investment. Calculation of the hurdle rate is by reference to projected annual cash outflows and inflows over the project life, including tax effects and other factors. Failure to achieve an adequate rate of return, often spoken of as the hurdle rate, will generally mean that particular investment will not be made.

⁵ ACR is distinguishable from “bonus depreciation”, the stimulus vehicle enacted temporarily in recent years. For a variety of reasons, including, most importantly, its *ad hoc* implementation, bonus depreciation has been of little consequence to the chemical industry and other large manufacturers in promoting new investment. However, the economic effect of encouraging capital investment is common to bonus depreciation and ACR – and permanent enactment of bonus depreciation would be much more meaningful.

concept that ACR incentivizes new capital investment is recognized in the Joint Committee of Taxation's report published on July 17th, 2012, in anticipation of a hearing, which states:

“A formulaic system of depreciation can serve to provide a tax incentive for capital investment to the extent the depreciation deductions are faster than the economic or financial statement depreciation of the property. For example, temporary rules providing for additional first-year depreciation (also known as bonus depreciation) were enacted several times in recent legislation with the purpose of providing economic stimulus during times of economic downturn.”⁶

Longer cost recovery periods harm economic growth. To this effect, a 2007 Treasury Department study found that:

“. . . repealing these provisions reduces the incentive to undertake new investments. This reduced incentive to invest can hurt labor productivity, which is central to higher living standards for workers in the long run. Thus, in evaluating the base broadening (through repeal of ACR among others special tax benefits) it is important to recognize that the repeal of several provisions would discourage investment and have a detrimental effect on economic growth. Indeed, the Treasury Department estimates that the combined policy of base broadening and lower(ed) . . . business tax rate to 28 percent might well have little or no effect on the level or real output in the long run because the economic gain from the lower corporate rate may well be largely offset by the cost of eliminating accelerated depreciation. . . If accelerated depreciation provisions were retained (to allow) the federal tax rate to be lowered to only 31 percent . . . the Treasury Department estimates that this approach would contribute somewhat more substantially to the growth of the economy.”⁷

Because ACR is unusually significant to manufacturing and other capital-intensive businesses, repeal would have a disproportionate adverse effect on the industry. As noted above, ACR *leverages* the value of capital investment in productive assets separate and apart from the tax rate. In this regard, even a lower statutory rate under a reformed business tax system may not fully compensate for loss of ACR.

This is not to deprecate a lower statutory corporate tax rate. On the contrary, reduced rates are among the primary goals of tax reform and are prominent among Principles for Tax Reform adopted by the ACC Board.⁸ However, to the extent that tax reform seeks greater

⁶ JCT Report, July 17, 2012, pp. 13-14.

⁷ *Approaches to Improve the Competitiveness of the U.S. Tax System for the 21st Century*, p. 69, published by the Treasury Department in 2007.

⁸ See, Attachment 2.

economic growth through greater capital investment, ACR, in fact, provides the “greater bang for the buck” identified as such by the Treasury study.⁹

We respectfully question whether “reform” and the progress the term implies, actually would occur if changes in the tax law meant a significant disadvantage from new capital investment, with less growth, and erosion of the national economic base that the manufacturing sector represents.

Rate Reduction

ACC supports a substantial tax rate reduction to make the U.S. the most competitive place to do business, and to achieve greater investment, economic growth and job creation. Ideally, tax reform would make a substantially lower rate effective immediately, but the rate might be phased in over a number of years in order to satisfy revenue constraints.

Incentives for Research and Development (R&D)

Other countries offer increasingly generous tax and other financial benefits for research activities because of universal recognition that R&D creates advantage in the global marketplace and constitutes a job-creating engine for scientific professionals and support staff. The U.S. has fallen out of the top ten globally when measuring government incentives for private sector R&D, now measuring 27th, and risks losing these key jobs to other more competitive jurisdictions.

Growth of the U.S. economy depends in large part on continued research and development, providing manufactured products that are innovative, of enhanced quality, of greater variety, and that are produced more efficiently. R&D carried out by the chemical industry supports other manufacturing industries, virtually all the products of which have chemical components that enhance value and make U.S. goods more competitive in world markets.

The chemical industry is among the largest creators and users of technology. The U.S. chemical industry spends approximately \$16 billion annually (separate from pharmaceuticals), with a significant majority of expenditures supporting research conducted in the U.S. R&D incentives have encouraged the chemical industry to conduct research domestically, thereby maintaining high-paying jobs and technological leadership. This is among key factors in retaining a domestic chemical industry that can compete globally. The tax reform debate should

⁹ See, Study cited above, at pages 31-32.

consider the continuing role of incentives for creation of U.S. technology, while addressing the mobile nature of capital and intellectual property. The Committee should examine the current R&D credit in the context of global incentives for research and development, and whether the credit or other devices would prove most valuable to U.S.-based manufacturers.

Tax reform should reestablish U.S. global competitiveness for R&D incentives. Incentives for conduct of domestic R&D are less competitive vis-à-vis the tax regimes of our trading partners, and the U.S. risks forfeiting R&D to countries with greater incentives. When the R&D Credit was first created in 1981, the U.S. provided the most generous tax treatment for research among all Organisation for Economic Development and Cooperation (OECD) nations. Today, Canada, China, India, Japan and other global competitors offer better R&D incentives, to include innovations such as "patent boxes" that reward both the conduct of R&D and retention of Intellectual Property (IP) domestically.

Tax provisions that promote research across all sectors of the economy are industry and taxpayer neutral, and thus consistent with sound tax policy principles, and would be an appropriate response to competitive challenges from other jurisdictions. Elimination of incentives for domestic R&D – which is to say, increasing R&D cost – would impair global competitiveness of U.S. businesses and technology. Retaining domestic R&D will provide an effective means of enhancing economic growth and global competitiveness, as the history of R&D incentives bears out.

Continued deduction of R&D expenses currently, an updated tax credit for R&D expenditures reflecting global markets and economics, and patent boxes are but three among a variety of provisions for promotion of domestic R&D. Favorable tax treatment for IP income, separate from or in addition to deductions and credits are among ideas for consideration in addressing declining U.S. incentives for domestic research.

LIFO

Short for “last-in-first-out”, LIFO is typically adopted by taxpayers that anticipate inflation in the costs of merchandise and other types of inventory items. For these taxpayers, LIFO measures taxable income most accurately. Taxpayers not choosing LIFO typically adopt the FIFO inventory method (“first-in-first-out). As a general matter, FIFO taxpayers anticipate level or declining inventory costs, and for such taxpayers FIFO measures taxable income most accurately.

This being the case, any discussion of LIFO should recognize that as a practical matter and as anticipated by the Code:

LIFO and FIFO methods are alike in providing taxpayers under each method a calculation of taxable income based on deducting higher costs of inventory acquired during the year.

Accordingly, elimination of LIFO would surely create “losers” and “winners” under tax reform, benefitting those businesses best served by adopting FIFO.¹⁰

Loss of LIFO inventory accounting would mean that some manufacturers operating under the LIFO method for many years would experience a major retroactive tax increase through “LIFO recapture” discussed below. The result could prove crippling, and in fact could cause business termination. The retroactive tax is in addition to higher annual tax cost going forward.

Prime among benefits to manufacturers is that LIFO allows greater reinvestment of earnings in the business, thereby providing greater capacity to weather business cycles, and to expand, particularly when inflation is an issue. A substantial portion of manufacturers chose LIFO, along with a majority of taxpayers, both large and small, from wholesale and retail industries for which inventory costs have a particularly close correlation with net earnings.

Since 1939, Congress, the Internal Revenue Service (IRS), and the Securities and Exchange Commission (SEC) have recognized LIFO as the most accurate manner of calculating business income, for tax as well as financial accounting, by certain categories of businesses. To this effect, inventory accounting methods allowed under the Code and IRS regulations exist so as to measure taxable income by preventing mismatching of income and deductions. LIFO is one of the two most common inventory accounting conventions, not a device or “loophole” for avoiding tax, but an essential element in the structure of a business income tax. Historically, tax economists have not regarded LIFO as a tax expenditure, but rather, an alternative and appropriate means of keeping business books and calculating tax liability, not unlike cash as opposed to accrual accounting.

It should be noted that the Treasury does not regard LIFO as a tax expenditure. However, the Joint Tax Committee added LIFO to its list of tax expenditures in 2008. The changed position by the Joint Committee was without comment or explanation, notwithstanding its

¹⁰ The triggering event and reserve recapture are not evidence of any preference in GAAP accounting or under the Code for FIFO, nor do they imply that FIFO is somehow the “correct” inventory method. LIFO is designed to help finance increased investment in inventory caused by inflation and the resulting higher cost of inventory replacement. LIFO defers tax on this artificial inventory gain, and is essentially a loan by the company to itself that must be repaid when the business ultimately is sold, or when the company goes off the LIFO method. The LIFO reserve represents this loan on the books of the company, with reserve recapture an accounting “true up”. FIFO taxpayers are less concerned with the problem of renewing inventory at inflated cost, choose not to make a “loan”, and accordingly have no such reserve on the books. FIFO is not an accounting method preferred by financial and tax accounting; rather, it is a different method for a different category of businesses and under accounting principles requires no reserve.)

longstanding position to the contrary, which was consistent with the Treasury position. However, re-characterization corresponded with an initiative for early repeal of LIFO in light of an assumption that the method would become obsolete, along with U.S. Generally Accepted Accounting Principles (GAAP) financial accounting rules in general. In this regard, the U.S. appeared certain to “converge” the GAAP rules with the International Financial Reporting Standards (IFRS) system promulgated by European nations. IFRS does not recognize LIFO, so it was assumed that convergence would eliminate LIFO for the U.S. If repeal preceded IFRS, the revenue score would represent a very significant windfall for the government. However, the assumption of incipient IFRS adoption proved unfounded.

In the first instance, the SEC carefully considered the convergence issue over a number of years, and in mid-2012 reported that adoption of IFRS is on indefinite hold, citing LIFO among the reasons. Moreover, the report noted that even if the U.S. ultimately were to adopt some form of IFRS, LIFO is among provisions likely to be an exception from convergence requirements, in the same category as certain accounting rules allowed to continue at the discretion of certain nations that adopted IFRS.

Repeal of LIFO would create a dual detriment to LIFO taxpayers, while providing a dual benefit to the federal fisc. First, repeal would mean higher annual tax liability, by limiting deduction of more expensive inventory (while deduction of higher inventory costs would continue for FIFO taxpayers). Second, and as noted above, repeal of LIFO triggers “recapture” of LIFO reserves – the difference between inventory costs accrued under LIFO and the lesser amount taxpayers would have accrued if accounting for inventories under FIFO.

In this regard, note that such an arbitrary levy on income earned in prior years must be paid currently, but from cash not produced by current sales – the retroactive element. The earlier earnings were reinvested in the business (for growth or to guard against business cycles). The business must find the cash somewhere else. Even if the financial posture of a taxpayer forced off LIFO were sufficient to survive the retroactive tax, the business has reduced assets, requires additional borrowing, or foregoes capital expenditures.

These consequences are inconsistent with tax reform goals of stability, economic and job growth and increased investment.

Deduction of Interest Expense

Repealing or limiting the corporate debt interest deduction as part of comprehensive tax reform would have a direct and negative impact on the capital formation process, and reduce investment in large-scale manufacturing projects.

Interest paid on debt is recognized as a cost of doing business and virtually every business relies on debt at some level to finance its operations. Investing activity targeted for growth is based upon achieving certain rates of return over and above their cost of capital. Reducing or eliminating the interest deduction would immediately increase the cost of capital, thereby increasing hurdle rates companies use to evaluate investment opportunities.¹¹ This will lead to reduced investment and capital spending activity with the potential for companies to reevaluate capital decisions that have already been made or are under consideration.

Companies need flexibility in raising capital for their operations, whether through debt or equity. They use a range of factors in striking the right balance: cash flow, capital costs, types of projects to be financed, risk profile, and desired financial profitability. We appreciate the concern with companies that are too heavily in debt and are over-leveraged, but the market is a very efficient mechanism for sorting this out. Companies with too much debt will see their cost of capital increase in the market, which would probably move them toward a more balanced mix of debt and equity that will keep their capital costs more in line with their competition. There is no need to legislate what the market already manages efficiently and effectively.

Moreover, imposing a limit or reducing interest expense deductibility would have an immediate and sustained impact on capital costs. The resulting decrease in corporate investment activities would threaten the already low economic growth experienced in the U.S. over the last several years.

¹¹ For a description of “hurdle rates” and the effect on investment decisions, *see* n. 4, above.

Attachment 1

ACC RESPONSES TO QUESTIONS FROM REP. GERLACH AND REP. SANCHEZ

Manufacturing Tax Incentives

Q: From the perspective of your industry, which provisions in the Tax Code do you consider the most important to manufacturers?

A: The provisions most important to the chemical industry include:

- Accelerated recovery of capital costs,¹²
- Deduction of interest expense,¹³
- Incentives for R&D,¹⁴
- The LIFO method of inventory accounting.¹⁵

Q: 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 rate?

A: This depends on a number of factors. Under the current tax system, the tax provisions listed above are important to most ACC member companies. This is why a small rate adjustment combined with the disproportionate modification of those provisions would harm many of our companies. Accordingly, the rate reduction must be large enough to prevent the elimination or modification of these tax provisions from harming the U.S. economy and capital intensive companies in particular that must compete domestically and internationally. ACC would need to see the entire tax reform package in order to provide a meaningful answer.

¹² See, “Accelerated Cost Recovery” above.

¹³ ACC has filed a comment with the Ways and Means Committee Debt, Equity, and Capital Working Group to address in part the importance of deduction of interest expense, as a fundamental element in the operation of a tax on net income, and the potential tax on phantom income if the deduction were limited.

¹⁴ See, “Incentives for Research and Development” above.

¹⁵ See, “LIFO”, above. We include LIFO in this answer, even though as is apparent from our comments, we agree with the Treasury Department and the historical position of the Joint Tax Committee that LIFO is not a tax expenditure, but rather, an accounting convention that best measures taxable income of given taxpayers, and as such is more akin to cash versus accrual accounting methods than to “incentive” provisions enacted by Congress in order to achieve a policy outcome.

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

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

A: Tax incentives for U.S. manufacturing are similar to, but generally less favorable than those of international competitors. In recent years, changes to the tax regimes of foreign jurisdictions have become more explicitly an extension of national economic policy, recognizing fundamental changes in the global economy and seeking to provide competitive advantage to home-country taxpayers. In the U.S., “tax policy” as a means to secure economic benefits has virtually disappeared as a factor in tax legislative initiatives, supplanted by ever more aggressive goals of revenue enhancement. There is in addition an inaccurate perception of unfair advantage by business taxpayers through ostensible “loopholes” that in the most significant instances represent either well-considered Congressional policy or conventional tax accounting. It is hoped that attention by the Committee to tax reform will restore at least a competitive balance between the U.S. and its major trading partners.

Q: In general, what impediments are there in the U.S. Tax Code that make it difficult for American manufacturing to compete in the global marketplace?

A: U.S. retention of a worldwide tax regime, as opposed to the territorial systems of our competitors.¹⁶

Q: 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?

A: The higher U.S. statutory rate is undoubtedly a disadvantage, but statutory rate reduction, achieved in certain ways may not be a sufficient means of restoring competitive balance.¹⁷ For example, base broadening measures that would disproportionately and negatively impact U.S. manufacturing could negate the benefit of rate reduction and prove counterproductive. The structure of the entire tax reform package must be considered in determining whether the changes will improve competitiveness in the global marketplace and promote economic and job growth in America.

¹⁶ The ACC has filed a comment with the Ways and Means Committee International Working Group, providing details of our support for a territorial system.

¹⁷ See, e.g., discussion under “Manufacturing and the U.S. Economy”, above, in particular, with respect to requirements for success and business continuation; also, “Accelerated Cost Recovery”, with respect to “leveraging effect” and other aspects of ACR as fundamental to capital investment decisions.

Q: Would eliminating the tax provisions listed in the first question above, and replacing such items with a meaningful reduction in the statutory tax rate help manufacturers to better compete domestically and/or internationally?¹⁸

A: This depends on the definition of “meaningful” rate reduction. As noted, under the current tax system, the tax provisions listed above are important to most ACC companies. An insufficient rate adjustment combined with the disproportionate modification or elimination of those provisions would harm many of our companies. ACC would need to see the entire tax reform package in order to provide a meaningful answer.

Improving the Tax Code for Manufacturers: Reforming Manufacturing Tax Incentives

Q: 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?

A: The ACC Tax Committee has not specifically considered tax simplification as adjunct to tax reform. As a general matter, requirements of tax accounting under the current corporate tax regime place a significant burden upon but do not strain the resources of member companies of the ACC, which for the most part are very large C corporations. The current Code is complex because the U.S. economy is increasingly complex, albeit increasingly efficient. We remain dubious of tax reform solutions that are simplistic or propose a “one size fits all” logic.

Q: How does your industry rely on or take advantage of cost recovery provisions such as accelerated depreciation? Do those recovery methods help manufacturers manage cash flows? Are there rules governing depreciation that should be evaluated or modified in tax reform?

A: Please see our substantial attention to cost recovery in our comments above that make the case that accelerated cost recovery is virtually essential to the manufacturing industry, more so than perhaps other industries, because of huge capital commitments, long start-up, and deferred return on investment from manufacturing operations. ACC is not, however, seeking a cost recovery method providing greater acceleration than that currently in effect.

¹⁸ Although some ACC member companies are in the category of “small and medium-sized”, and some, in fact, elect pass-through treatment, the issues facing C corporations alone are daunting, and the ACC Tax Committee has thus far not considered treatment of pass-throughs as part of tax reform. We note, however, that virtually all issues of concern to C corporations, and discussed in our comments to the Working Groups are common to manufacturers operating as pass-through entities.

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

A: Enhancement of incentives to R&D certainly would count toward innovation and product development. But, as noted in other contexts above, most important is recognition that integrated tax provisions of larger industrial policy are necessary to continuation and growth of manufacturing industries. There is no singular solution.

Q: Many of our global competitors utilize patent boxes or “innovation boxes” which essentially provide tax benefits for the commercialization of successful R&D. Would U.S. implementation of such structure in the U.S. help manufacturers compete globally?

A: Please see our discussion of incentives for R&D in comments above.

Attachment 2

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 3

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.¹⁹ Virtually all large corporations and the great majority of publicly-traded entities are C corporations.²⁰

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.²¹

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, gains²², rents, royalties, refund of earlier taxes paid, refunds from customers, release of liability, found money – any economic increase enjoyed by the taxpayer.²³
- (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 materials²⁴, costs of utilities, simple maintenance of property, plant

¹⁹ Not dealt with below are “S” corporations, entities with corporate form under state law but that are not subject to income tax, with shareholders taxed directly upon earnings of the business. *See*, n. 7.

²⁰ 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.

²¹ A convenient consequence is that the taxpayer has the money with which to pay the tax.

²² Treatment of capital gains and losses is of limited concern to corporate taxpayers.

²³ 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.

²⁴ 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.

and equipment, etc.²⁵; 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 most significant of which is recovery of costs of property, plant, and equipment put into service.²⁶

- (4) The result is “taxable income”, which is the net of gross income minus deductions, equaling economic increase subject to income tax.²⁷
- (5) To taxable income, apply a “statutory tax rate” – the percentage tax rate specified under the Code for corporations -- typically 35%²⁸, 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.²⁹

²⁵ 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.

²⁶ 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.

²⁷ 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.

²⁸ 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.

²⁹ Under the U.S. system of “worldwide” taxation, the same item of income may be subject both to 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.