

AMERICAN CHEMISTRY COUNCIL

**WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

HEARING ON “TAX REFORM AND THE U.S. MANUFACTURING SECTOR”

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The American Chemistry Council (ACC) thanks the Committee for continuing to examine comprehensive tax reform, and specifically for the recent examination of tax reform and the U.S. manufacturing sector. Because of the importance to the U.S. economy of the manufacturing industry and the effect of tax rules on manufacturers, the subject is particularly significant to the Committee’s consideration of a reformed business tax system.

Ultimately, our comments address whether the manufacturing sector grows or retrenches, the corresponding economic effects, and whether jobs will be created or lost.

ACC and its place in U.S. manufacturing:

ACC 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 \$720 billion enterprise and a key element of the nation's economy. Nearly 27% 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 5.5 American jobs in other manufacturing industries, meaning that over 5 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 \$171 billion in exports in 2010, or more than ten cents out of every export dollar. The US chemical industry is a leader in the amount of R&D performed, innovation delivered, and exports shipped, contributing enormously to the nation’s economy. Further, given the recent surge in the development and availability of domestic natural gas, which is an important feedstock for the production of chemical products, the US chemical industry has reacted by announcing plans for billions of dollars of

new US based investment. These investments will spur the US economy, increase employment and increase the US standard of living.

As a major US advanced manufacturing industry, we are keenly interested in how tax reform can, and will, affect our industry and manufacturers generally. To ensure the US regains its competitive edge, our tax code should be reformed to drive US investment, innovation and productivity to create US jobs. The focus of your July 19, 2012 hearing on manufacturing was timely, and the decisions you make can be critical to the health of the manufacturing sector in general, and to the American chemical industry in particular. In considering the outlook for tax reform, last November, the ACC Board adopted the following “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 Organization 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.*

Our comments below reflect these principles.

Proposals for business tax reform:

As our principles state, the ACC believes 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 also support the adoption of a more internationally competitive and modernized system of taxing earnings outside the US.

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 a lower tax rate—requiring repeal of a broad range of so-called “tax expenditures.” We respectfully suggest that the Committee take into account the impact on revenues that would result from a reformed system, more supportive of economic growth, in assessing whether such reforms would be revenue neutral. We fear that embarking on a complex and difficult tax reform process that simply achieves revenue neutrality on a “static basis” would be less effective in promoting economic growth since, by definition, it would create winners and losers in a zero sum game

We are also concerned that a base broadening effort to repeal a number of so-called tax expenditures could disproportionately and adversely affect US manufacturing. For example, accelerated depreciation is highly significant in encouraging and supporting investments and job creation by the manufacturing sector. Without careful balancing of the impact of changes in current law on the manufacturing sector, solid, middle class jobs could be impacted.

A poorly designed system could reduce the chemical industry’s ability to compete in U.S. and global markets, could cause the industry to experience reduced growth or contraction, resulting in a corresponding reduction of the manufacturing workforce. Likewise, spill-over consequences would adversely affect suppliers and service-providers that depend upon manufacturing customers.

Our concerns arise from recent economic analyses of certain tax expenditures and the consequent effect of repeal of such provisions on economic growth.¹ Specifically, unless the statutory tax rate under a reformed business tax system is low enough to compensate industry for the loss of tax provisions for investment, reductions in capital investment and economic growth are likely to result.

Similarly, tax reform must also provide fair rules for the taxation of earnings outside the US. Finally, any comprehensive changes to the tax code must include transition rules in order to ensure that taxpayers have time to adjust to a new tax regime without economic contraction and consequent reduction in employment.

Rate reduction –

The US has the highest marginal corporate tax rate of any major industrial nation in the world. This high tax rate acts as an impediment to US investment and expansions for both US and foreign owned firms. The US needs to enact comprehensive tax reform that *significantly* reduces the tax rate. Doing so can provide powerful incentives for US investment, particularly when not neutralized by other changes that directionally increase the cost of capital. ACC realizes that coupled with the tax rate, a wide number of tax expenditures may be eliminated or reduced to fund the lower tax rate. But if the rate reduction is not sufficiently large and if the loss of tax expenditures disproportionately affects the manufacturing sector, the result may be less, not more, growth.

¹ See, e.g., Joint Committee on Taxation Report , “Background and Present Law Relating to Manufacturing Activities Within the United States”, July 2012, p. 87.

Accelerated Cost Recovery --

The accelerated depreciation of capital assets, known as “accelerated cost recovery” or “ACR”, has been allowable under the tax code for decades. ACR is a central element in the business plans of most chemical manufacturers. It allows recovery of the cost of capital investment more quickly for tax purposes than under financial accounting rules that amortize asset value over asset life, but slower than under expensing or recent “bonus depreciation” rules.

ACR encourages new investment in manufacturing, by providing a cost-recovery rules that compensate companies in part for the risk of investing large amounts of capital in relatively low-profit enterprises. For the chemical industry, this typically means longer start-up periods for bringing new assets on line and longer pay-out times in order to achieve returns commensurate with the investment.

Because ACR is extremely significant to manufacturing, repeal would have an obvious, and disproportionate adverse effect on the industry. ACR *leverages* the value of capital investment in productive assets. Accordingly, greater investment means more growth and more U.S. jobs, all of which could be at risk if tax reform removed the provision.

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

Incentives for research and development –

The chemical industry is among the largest creators and users of technology. Accordingly, the current federal tax incentives for research and development represent a key factors in retaining a domestic chemical industry that can compete with chemical manufacturers globally that typically enjoy more favorable home-country tax regimes. The tax reform debate should consider the continuing and important role of competitive incentives for creation of US technology, including expensing and an effective R&D credit, while addressing the mobile nature of capital and intellectual property. As a goal, the tax system should encourage investment in the US in R&D activities, the ownership of resulting intellectual property (IP) in the US and exploitation of the IP from the US.

A territorial system for taxation of foreign earnings –

ACC endorses adoption of a competitive territorial taxation system in replacement of the obsolete and overburdened world-wide system for taxation of foreign earnings from active business operations. The US is the only major industrial nation with a worldwide tax system. The incremental US tax imposed upon ACC member companies’ foreign operations causes such companies to be less competitive than

their foreign competitors. This is not just a matter of abstract theory since 95% of the world's population is outside the US. To serve this large and growing market, we encourage the Committee to continue to search for ways to promote exports of property manufactured in the US to meet these global needs. But in addition to serving such markets by exports, as explained below, ACC member companies must also expand overseas to grow and prosper. It is important to note that as these companies expand throughout the world, new high value jobs in the US in R&D, engineering and administration are created in the US.

Manufacture of chemical products is a global industry and highly competitive. Freight is a significant cost for ACC member companies: to compete effectively they cannot produce all products in the US, ship them across an ocean and truck them to a customer in the interior of a continent. We must be local to compete effectively and the current US tax code acts as an impediment to our competitiveness.

Finally, movement to a territorial taxation system would eliminate the current "lock out" effect of existing tax law and allow substantial amounts of cash to be repatriated to the US. This result, when coupled with pro-growth domestic tax changes, would drive additional capital investment and employment in the US.

LIFO

Congress enacted the LIFO tax accounting method in 1939, concluding that for some taxpayers, LIFO is a more accurate means of calculating taxable income. A business cannot thrive and maintain operations, unless it generates enough after-tax cash flow to produce and purchase replacement goods at current—not historical prices. By matching current revenues against current inventory costs, LIFO can provide a better measure of the true economic performance of a business.

Without LIFO, a business could not deduct current prices from taxable income and its ability to produce or purchase new, replacement inventory and to maintain and grow investment would be impaired. Purely inflationary gains would be masked and taxed as "profit."

Like ACR, inventory accounting methods have been designed to appropriately reflect taxable income and to serve as prime instruments for encouraging reinvestment of earnings. Far from a "loophole", LIFO is an essential element in the structure of a tax on business net income. Elimination of LIFO represents a tax increase to manufacturers, a significant cash cost, and would hinder growth.

Summary: "Level playing fields"

As reflected in the attached Guiding Principles for Corporate Tax Reform and as an overall principle to guide policymakers, ACC believes that US tax reform must provide for a "level playing field" where US companies investing abroad can compete equally with foreign investors, and where US subsidiaries of foreign investors which invest in the US and US parented companies are treated equally. Further, we believe that tax reform should not create winners and losers among industries or among types of businesses, but should attract investment and enhance job creation throughout U.S. business enterprises and foreign enterprises investing in the United States. In summary:

- The US should adopt US tax rules that will enable, rather than impede, US companies to compete on a level playing field with regard to their foreign business operations. ACC supports the adoption of a territorial system (which is comparable to those of our major trading partners) for the taxation of foreign business income, that would permit competitive treatment for US companies.
- US companies operating in the US—whether US owned or foreign owned-- should be subject to comparable rules, and thus taxed on a level playing field with regard to US business operations. ACC supports US tax rules which would provide parity between US-owned companies and foreign-owned companies.
- Changes that would place the burden of US tax reform on one or more particular industries would not result in a level playing field. For example, when looking at potential base broadeners, the manufacturing industry (including the chemical industry) should not be disproportionately impacted, unfairly so, vis-à-vis other industries. Otherwise, this would have a significant negative impact on US manufacturing, economic growth, new investment and jobs.