Statement of Business Roundtable for the Record
House Ways and Means Committee
Subcommittee on Select Revenue Measures
Hearing on Expiring Tax Provisions
April 26, 2012

The Honorable John M. Engler
President, Business Roundtable

Recommendation

Business Roundtable welcomes this hearing providing an examination of the extension of expired and expiring tax provisions. Business Roundtable believes that the tax system plays an important role in determining job creation, economic growth, and the competitiveness of U.S. businesses. For this reason, Business Roundtable strongly supports the immediate and seamless extension of the expired business tax provisions from last year, including the research credit and important international provisions discussed below, as well as the temporary continuation of the 100 percent bonus depreciation rules that expired at the end of 2011.

Given the uncertainty created by not knowing what the state of the law may be and given the competitive pressures of the global market, an immediate and seamless extension of these provisions will provide immediate benefits to the U.S. economy. Business Roundtable further urges that Congress move forward as soon as possible on a process to enact corporate tax reform providing a modernized, competitive and permanent tax system that eliminates confusion and uncertainty for America's job creators. Tax reform is absolutely essential to economic growth and job creation to be competitive in world markets today. A competitive corporate tax rate comparable to the OECD average and a competitive territorial tax system similar to the rest of the world are two essential components of corporate tax reform.

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Introduction

Business Roundtable (BRT), the association of chief executive officers of leading U.S. companies, represents member companies with over $6 trillion in annual revenues and more than 14 million employees. BRT member companies comprise nearly a third of the total value of the U.S. stock market and invest more than $150 billion annually in research and development -- nearly half of all private U.S. R&D spending. Our companies pay $163 billion in dividends to shareholders and generate an estimated $420 billion in sales for small and medium-sized businesses annually. Business Roundtable commends Chairman Tiberi and Ranking Member Neal for their bipartisan support for tax reform. The current tax system has not been thoroughly examined in over 25 years. Over this time period the rest of the world has modernized their tax systems and today we find the U.S. tax system a significant obstacle to the competitiveness of U.S. companies and their American workers.

Business Roundtable CEOs are firmly dedicated to business tax reform that results in a permanent, modernized and simplified tax code to increase the competitiveness of the United States as a location for investment and employment by both U.S.-based and foreign-based companies. Our policies should strive not only to make us competitive with other world economies, but to make the United States the best place in the world to launch a career, headquarter a business, hire employees and conduct business operations.

Major structural features of our tax code have harmed U.S. competitiveness. While extension of expiring provisions is no substitute for the urgent need for competitive tax reform, failure to extend these provisions before Congress can complete work on tax reform will only further diminish America's competitive position and result in significant deleterious effects on business expansion and job growth. Congress should immediately and seamlessly extend the expired business tax provisions from last year, including the research credit and important international provisions -- specifically, active financing income and "look through" rules -- and provide an extension of temporary 100 percent bonus depreciation to promote the economic recovery and increase private sector employment.

Tax Extenders

Much longstanding business tax policy exists in the tax code today in the form of temporary provisions. The Joint Committee on Taxation identifies 101 tax provisions as either having expired in 2011 (60 provisions) or expiring in 2012 (41 provisions). By comparison, in 1999 the comparable count was just 12 provisions. The enactment of provisions on a temporary basis rather than permanent results in diminished incentive effects and contributes to unnecessary business uncertainty. Any business that treated its customers in the way the government runs the tax code -- not telling its customers the prices charged to them until after they had made their purchases -- would find its customers leaving to a more reliable competitor.

While the best solution to fixing our corporate tax system is permanent reform, we cannot afford to let important existing business provisions expire before a permanent tax code is in place. Extension of these provisions should not be controversial. The Administration has also called for the extension of the expiring business provisions in its FY2013 Budget.

Business Roundtable strongly supports the seamless extension of business tax provisions that expired at the end of 2011 and especially notes the importance of extending the research credit, the active financing provisions, and "look through" rules as structural provisions of the tax code. The policy goals of these three provisions should also be supported in a permanent, reformed tax system in order to drive innovation and international competitiveness. In addition, the temporary 100 percent expensing (100 percent "bonus depreciation") provision enacted in 2010 to speed economic recovery should be extended to solidify the recovery and job growth in 2012.

Research Credit. The research credit is an example of a structural tax provision enacted on a temporary basis. The research credit was implemented in order to increase research activity by American businesses. It has been extended on 14 separate occasions since its initial enactment in 1981. The credit has frequently been extended retroactively, most recently in December 2010 as part of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, which extended the credit retroactively to the beginning of 2010 and prospectively through the end of 2011. In the 31 years since its original enactment, it has been in place for all but one year when the credit expired and was not retroactively extended (July 1, 1995-June 30, 1996).

As noted by the Treasury Department, the research credit provides a strong incentive for businesses to expand their research efforts. Because scientific advancements through research are a form of a "public good," the benefits of which are not fully received by the company undertaking the research, businesses under invest in R&D activities relative to the economy-wide benefits of this spending.

The research credit directly supports employment. Approximately 70 percent of research costs that qualify for the credit are labor costs. Companies receiving the credit employ one million domestic researchers. The research credit supports innovation in manufacturing, with nearly 70 percent of research credits claimed by manufacturing companies.

Active Financing Income. A basic principle of the U.S. tax system is that active foreign business earnings of subsidiaries of U.S. companies are not taxed in the United States until such earnings are remitted back to the U.S. parent. This basic principle of deferral has also been the law for active financial services income for nearly the entire history of the tax code, until changed in 1986. Since 1997, the principle of deferral for active financial services income has been a temporary provision of the tax code, and has been extended numerous times. The current temporary provision expired at the end of 2011.

U.S. financial service companies -- including banking, securities, and insurance companies -- compete in foreign markets around the world with other financial institutions to provide financial services locally to foreign customers. Commercial clients of these financial service companies look to a financial institution that can meet their needs worldwide -- not just in the United States. The ability of U.S. financial service companies to be competitive in foreign markets increases the jobs they provide in the United States. In addition, U.S. financial service companies providing their services to foreign customers can help boost exports of U.S. goods by assisting in the financing of these goods to foreign customers.

In the absence of the active financing temporary provision U.S. financial service companies would face a significant tax disadvantage relative to their foreign-headquartered competitors. Failure to extend this provision would harm the competitiveness of U.S. companies and reduce U.S. jobs.

"Look-through" rule. A temporary provision of the tax code allows U.S. companies to redeploy income between a foreign subsidiary earning active business income and a related foreign subsidiary in another country through the payment of dividends, interest, rents, or royalties without being subject to current U.S. taxation on the payment. The look through rule "looks through" to the underlying source of income to determine whether such income is active foreign business income eligible for deferral or passive income that would be subject to current U.S. taxation.

The look through rule was first effective in 2006 and has been extended twice since its original enactment. The look through rule expired at the end of 2011.

The look through rule permits income to be redeployed among related foreign subsidiaries in an efficient manner. Because the cost of financing through internal funds is generally lower than use of external funds, a firm will generally first wish to utilize internal funds before tapping external sources of finance. The look through rule allows a multinational company to redeploy internal funds between foreign subsidiaries without creating a tax barrier to such transfers.

The look through rule helps maintain the competitiveness of U.S. companies operating in foreign markets. In the absence of the look through rule, foreign operations might require greater use of external funds or greater reliance on funds drawn directly from the U.S. parent. Most of our foreign competitors operate under territorial tax systems that facilitate the redeployment of foreign earnings. Strong and internationally competitive U.S. companies increase U.S. employment and the strength and vitality of the U.S. economy.

100 Percent Expensing (100 percent "bonus depreciation"). Temporary partial expensing at a 30 percent rate for equipment and machinery was first enacted to boost economic recovery in 2002 and 2003 for investments made on or after September 11, 2001 and before January 1, 2005. The provision was later enhanced to provide 50 percent partial expensing and expired at the end of 2004. In 2008, partial expensing was enacted at a 50 percent rate as part of the Economic Stimulus Act of 2008 and was later extended through 2010.

The 100 percent expensing provision was enacted in December 2010 to provide full expensing for investments made after September 8, 2010, and on or before December 31, 2011. The December 2010 law provided that after the expiration of 100 percent expensing, 50 percent expensing continues through December 31, 2012.

Studies reviewed by the Treasury Department support expensing as an effective investment stimulus. In view of the significant ongoing worldwide economic uncertainty, Business Roundtable supports continuation of 100 percent expensing for 2012.

Tax Reform

Reform of the U.S. corporate tax system and its treatment of international income are of significant importance to the growth of the U.S. economy. U.S.-headquartered companies with operations both in the United States and abroad directly employ 23 million American workers and they create over 40 million additional American jobs through their supply chain and the spending by their suppliers and employees. The ability of American companies to be competitive in both domestic and foreign markets is essential to improving economic growth in the United States, reducing high rates of U.S. unemployment, and providing for rising American living standards.

The U.S. corporate income tax system today is an outlier relative to the tax systems of our trading partners at a time when capital is more mobile and the world's economies are more interconnected than at any time in history.

The combined U.S. federal and state statutory corporate tax rate is now the highest in the OECD, 14 percentage points above the average of other OECD countries. A competitive corporate tax rate is an essential element of meaningful corporate tax reform.

The United States is also the only G-8 country that taxes the worldwide income of its corporations. Within the OECD, 26 of the 34 countries use territorial systems for the taxation of foreign earnings, whereby little or no additional home country tax is imposed on active trade or business profits earned abroad when those earnings are remitted home. Japan and the United Kingdom adopted territorial tax systems in 2009 to promote the competitiveness of their locally headquartered multinationals and boost their economies. The U.S. worldwide system of taxation significantly magnifies the damage done by the high U.S. corporate tax, and significantly impairs American businesses competing in world markets.

Since the time of the last major reform of the U.S. corporate tax system in 1986, the world's economies have become increasingly integrated. The importance of cross-border trade and investment has grown significantly, with worldwide cross-border investment rising six-times faster than world output since the 1980s.

Today, the U.S. corporate tax system hinders the ability of U.S. companies to grow and compete in the world economy with the consequence of less investment in the United States and a more slowly growing economy with fewer job opportunities for American workers. The ability of American companies to compete and invest abroad is vital for opening foreign markets to U.S.-produced goods and expanding the scope of investments in R&D and other activities in the United States.

As Congress undertakes tax reform, critical decisions will be made that will affect the ability of the U.S. economy to grow, create jobs, and allow American workers and the companies that employ them to be competitive in the world economy. A thorough evaluation of the tax code will be necessary to determine which policies should be changed and which temporary policies should be made permanent. In making these determinations, it is critical that Congress focus on the importance of economic growth and the significant gains that can be achieved through a more efficient and competitive tax system.

Business Roundtable fully supports your vigorous pursuit of corporate tax reform.

Conclusion

Business Roundtable appreciates the ongoing work of the Ways and Means Committee and this Subcommittee in its focus on tax reform to improve the competitiveness of the U.S. economy and increase jobs and wages of American workers. While permanent tax reform is essential for this purpose, before this important work can be completed it is necessary to provide the seamless extension of the business tax provisions that expired at the end of 2011, including the research credit and the important international provisions, as well as 100 percent bonus depreciation for 2012. As shown in this testimony, important structural features of our tax code are currently carried out through these temporary provisions. Their expiration before a new permanent tax code is in place would diminish the competitiveness of American businesses and place at risk millions of U.S. jobs that depend on the ability of U.S. companies to compete in markets around the world.

On behalf of Business Roundtable, I look forward to working closely with this Committee and Congress on the immediate extension of these tax provisions and toward the overriding objective of tax reform.

Supplemental Sheet

Statement on behalf of Business Roundtable

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