100 Years Standing Up for American Enterprise

U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: Hearing on Tax Reform and the U.S. Manufacturing Sector

TO: House Committee on Ways and Means

DATE: July 19, 2012

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

The Chamber thanks Chairman Camp and Ranking Member Levin for the opportunity to comment on how comprehensive tax reform could improve the ability of U.S. manufacturers to contribute to job creation and economic growth.

The Chamber commends this Committee for its continuing work on fundamental tax reform and strongly supports these efforts. However, we believe that true fundamental tax reform will not take place before year end. The Chamber therefore urges the Committee and Congress to act immediately to extend all expiring 2001 and 2003 tax rates (including current marginal rates, dividend and capital gains rates, and estate tax relief), to extend vital expired and expiring business tax provisions, and to provide alternative minimum tax (AMT) relief. Extending all these provisions now will help to prevent the negative impact on jobs and the fragile economy that is likely to result from inaction. Simultaneously, the Chamber urges this Committee and Congress to continue to work toward comprehensive tax reform.

THE NEED FOR IMMEDIATE ACTION

Unless Congress and the President act, the 2001 and 2003 tax rates will expire on January 1, 2013. In addition, many traditional business "extenders" expired at the end of 2011, and others will expire at the end of 2012.

Failure to act on these rates and these expired and expiring provisions could be particularly hard for domestic manufacturers. Recent estimates suggest that between 70 percent and 81 percent of domestic manufacturers are organized as pass-through entities, meaning they pay their taxes under the individual tax code and will be subject to the higher marginal rates. Further, the traditional business extenders, such as the research and development (R&D) tax credit, help manufacturers innovate and compete in the global marketplace and contribute to economic growth and job creation in the United States.

The ramifications of failing to extend current tax rates and expired and expiring provisions are further compounded by the draconian, ill-designed, across-the-board discretionary spending cuts that are scheduled to begin on January 1. The Congressional Budget Office ("CBO") estimates that failure to address the expired and expiring provisions, combined with these looming spending cuts, will result in an estimated $600 billion fiscal policy reduction in 2013.[1]

The impact of inaction on the weak economy could be devastating. CBO estimates that growth is expected to slow from 2.2 percent in 2012 to only 0.5 percent in 2013 and to remain below its potential rate until the first half of 2018. CBO further projects that unemployment will increase by 2.0 million, raising the unemployment rate by about 1.0 percentage points.[2] According to CBO, "given the pattern of past recessions as identified by the National Bureau of

[1] See CBO | Economic Effects of Reducing the Fiscal Restraint That Is Scheduled to Occur in 2013.
[2] See id.

Economic Research, such a contraction in output in the first half of 2013 would probably be judged a recession."[3]

Similarly, Mark Zandi, from Moody's Analytics, estimates that without changes to fiscal policy, the fiscal drag will subtract more than 3.0 percentage points from GDP in 2013 while former Federal Reserve Vice Chairman Alan Blinder believes the "resulting fiscal contraction – consisting of both tax increases and spending cuts – would be about 3.5 percent of gross domestic product" and would be a "disaster for the United States."

Congress and the President need to act immediately to prevent the negative impact on jobs and the fragile economy that is likely to result from failure to extend the expired and expiring tax provisions. The best way to get the economy growing fast enough to create jobs and drive the unemployment rate down is to ensure that taxes do not increase for consumers and businesses.

The Chamber appreciates that all tax policies must be carefully examined in the context of fundamental tax reform. However, as we work towards that fundamental, comprehensive tax reform, we must not delay extending the 2001 and 2003 tax rates and expired and expiring provisions.

COMPREHENSIVE TAX REFORM AND THE MANUFACTURING SECTOR

Global Competitiveness

For American worldwide companies to compete in global markets, they need a level playing field. The United States currently has the highest corporate tax rate in the world. Moreover, the United States is the only major industrialized Organisation for Economic Cooperation and Development "OECD") country that continues to employ a worldwide system of taxation. This high tax rate and possibility of double taxation, while mitigated by provisions such as deferral and the foreign tax credit, harms the ability of American worldwide companies to compete against foreign companies who face little or no home country tax on their foreign earnings.

As noted, the U.S. tax code is lagging sadly behind its worldwide competitors. First, the U.S. marginal corporate tax rate, at 35 percent, is completely out of step with other major industrialized OECD nations. As noted by the Tax Foundation,[4] a nonpartisan organization, "2012 marks the 21st year in which the U.S. corporate tax rate has been above the simple average of OECD nations. Even if we account for country sizes, the weighted average of OECD nations fell below the U.S. rate in 1998 and has been getting lower ever since."

Further, we not only shackle our businesses with high rates, but we have taken no action to lower our rate as other countries have acted. As the Tax Foundation notes, "there have been

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[3] See id.
[4] See Hodge, "The Countdown is Over. We're #1," Tax Foundation, *available at* http://taxfoundation.org/article/countdown-over-were-1.

133 major corporate tax cuts globally since 2006. Indeed, between 2006 and 2010 alone, more than 75 countries cut their corporate tax rates - some more than once." Our major trading partners– Canada and Great Britain – have already taken steps to make themselves more competitive by dropping their corporate tax rates, while the United States has done nothing to reduce rates.[5]

In addition to our high rates, we remain the last major industrialized OECD country with a worldwide system of taxation. As countries like Great Britain not only lower rates but shift to quasi-territorial systems of taxation, the United States continues to overburden American businesses. Other countries are shifting to more efficient and globally conducive systems of taxation, while we are standing by and doing little to help American companies compete, let alone win.

We must act to address our high corporate tax rates and antiquated system of taxing foreign source income to allow American worldwide companies, including U.S. manufacturers, to compete globally. Tax reform legislation should lower the corporate tax rate to a level that will enable all American worldwide companies, including U.S. manufacturers, to compete successfully in the global economy. Further, the current worldwide tax system should be replaced with a territorial system for the taxation of foreign source income.

Pass-Through Entity Considerations

As mentioned above, between 70% and 81% of domestic manufacturers are organized as pass-through entities. These pass-through businesses are a critical source of job creation and innovation in the United States.

Further, according to a study by Ernst & Young, more than 90 percent of businesses in the United States are organized as pass-through entities. That study also found that individual owners of pass-through entities paid 44 percent of all federal business income taxes between 2004 and 2008 and, moreover, that pass-through businesses employ 54 percent of the private sector work force in the United States.[6] Pass-through businesses are a critical source of job creation and innovation in the United States that cannot be ignored in fundamental tax reform.

Under current law, the same top marginal income tax rate of 35% applies both to corporations and pass-through entities. In addition, business tax expenditures included in the code apply to both corporations and pass-through businesses. If corporate tax reform takes place separate from individual tax reform, pursuant to which the corporate rate is lowered in exchange for the elimination or reduction of business tax expenditures, pass-through entities, including manufacturers, will lose the benefit of business tax expenditures without a corresponding rate reduction. Tax reform therefore should lower both the corporate and individual rates and keep them synchronized.

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[5] See id.

[6] Carroll and Prante, "The Flow-Through Business Sector and Tax Reform," April 2011, *available at* http://www.scorp.org/wp-content/uploads/2011/04/Flow-Through-Report-Final-2011-04-08.pdf.

R&D Incentives

The Chamber has long advocated that R&D expenses, an integral component of manufacturing businesses, should be deductible in the year incurred, and a larger credit for increases in research expenditures should be allowed and made permanent.

The United States was the first country to introduce a tax credit to support business R&D. In the 1980's, the United States had the most generous tax treatment of R&D of all OECD countries. Since then, more and more countries have recognized the importance of research and innovation for economic growth, and they are aggressively pursuing R&D activity.

A recent Information Technology and Innovation Foundation paper[7] notes that many studies by independent academics have found that the R&D incentive has a positive impact on economic growth and that, as a result, other countries are outcompeting the United States for R&D investments, and the accompanying jobs and economic activity. Examining our position globally, the paper concludes:

> By 1996 the United States had fallen to seventh in R&D tax generosity among the 30 OECD nations, behind Spain, Australia, Canada, Denmark, the Netherlands, and France. And the slide continued. By 2004 we had fallen to 17th. Even with the recent expansion of the ASC from 12 to 14 percent the United States was only able to hold position at 17th (and 19th for small businesses R&D incentives), as other nations also expanded their R&D tax incentives. However, it is not just OECD nations that have overtaken the United States. A number of other nations, including China, India, Brazil, and Singapore, provide more generous tax treatment of R&D expenditures.

Because innovation is such a crucial long-term driver of growth and jobs, any reform to the tax code should contain incentives for companies to conduct research and development activities in the United States and locate the resulting intellectual property within U.S. borders.

Certainty

Any changes to the tax code should be permanent to ensure certainty for manufacturers and other business sectors that are striving to expand, create jobs, and remain competitive. U.S. businesses are disadvantaged by the uncertainty that results from the temporary nature of so many crucial business tax provisions.

Simplification

Tax reform also should ensure that the tax code contains simple, predictable and easy to understand tax rules to improve compliance and reduce the cost of tax administration. All businesses must grapple with the tremendous complexity of the current tax code. The National

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[7] See Information Technology and Innovation Foundation, "17 is Not Enough: The Case for a More Robust R&D Tax Credit," *available at* http://www.itif.org/files/2011-17-is-not-enough.pdf.

Taxpayer Advocate's 2010 report to Congress[8] stated that taxpayers spend an estimated 6.1 billion hours a year complying with the tax code and listed complexity of the tax code as the most serious problem facing taxpayers and the IRS.

Cost Recovery

Tax reform should eliminate the bias in the current U.S. tax system against capital investment. Capital investment should be expensed or recovered using a capital cost recovery system that provides the present value equivalent to expensing with due regard to the impact the system may have on cash flow.

Equitable Treatment of Industries

Tax reform should ensure industry-specific neutrality and avoid special tax benefits or penalties targeted to one industry versus another. Tax reform should allow the marketplace, not the tax system, to allocate capital and resources.

Transition Rules

Comprehensive tax reform should include realistic transition rules to provide adequate time for implementation and help minimize economic hardships businesses may encounter in transitioning to the new tax system.

CONCLUSION

The Chamber thanks the Committee for the opportunity to comment on tax reform and the manufacturing sector. We look forward to working with the Committee and Congress as the tax reform debate moves forward.

[8] See National Taxpayer Advocate 2010 Annual Report to Congress (Most Serious Problem #1: The Time for Tax Reform is Now, *available at* http://www.irs.gov/pub/irs-utl/2010arcmsp1_taxreform.pdf